European integration, rural areas and the CAP

Europäische Integration, ländliche Gebiete und das CAP

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Zusammenfassung

Dieser Beitrag untersucht die Aussichten und Erfordernisse des langfristigen Integrationsprozesses der neuen Mitgliedsländer nach dem Beitritt aus einer EU15-Perspektive. Nach einer Darstellung der makroökonomischen Gegebenheiten richtet sich das Augenmerk auf die spezifischen Probleme der Landwirtschaft. Die Überblicksarbeit basiert im Wesentlichen auf der rezenten Literatur zu dieser Thematik. Eine Schlussfolgerung besteht darin, dass die makroökonomischen Konsequenzen für die EU15 vernachlässigbar sein dürften. Auch im Agrarbereich wird die Verlagerung von Produktionsaktivitäten durch die Immobilität der Faktoren Boden und Arbeit gehindert, wobei ein effizientes System von Agrar- und Strukturbeihilfen stabilisierend wirkt.
Schlagworte: EU, Erweiterung, Integrationsprozess, Landwirtschaft.

Summary

This paper examines the prospects and requirements of the long-term integration process of the new member states after enlargement, mainly from an EU perspective. After looking at the macroeconomic impacts the main focus is directed towards the specific problems of agriculture. The paper is based on a review of recent literature dealing with these topics. One of the conclusions from this survey is that the macroeconomic impacts of enlargement remain fairly negligible for EU15. Regarding agriculture, the relocation of production activities will be hindered by the immobility of land, and partly also people, with efficient agricultural and structural support measures providing an important ingredient for stability.
Keywords: EU, enlargement, integration process, agriculture.

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1. Introduction

In December 2002 the Heads of State and Government from the EU and ten candidate countries reached a historic agreement: on 1 May 2004 Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, the Slovak Republic and Slovenia will become members of the Union.

Today, with accession being fully determined, it is necessary to think about the prospects and requirements of the long-term integration process of the new members. This not only holds at the macroeconomic level, but also for each sector. Undoubtedly, the basic economic principles and processes of integration will also be relevant for agriculture. In addition, the development of the economy in general will set up important boundaries for the future progress of the CAP.

The focus of this paper is twofold: firstly, the dominating economic trends with respect to the integration process are depicted in order to comprehend the chances and risks of this enlargement round. Secondly, these fundamental effects are confronted with the particular situation and the requirements of the CAP in a long term perspective.

The structure of the paper is as follows: in section 2 a brief summary of the historic development as well as the official as well as informal motivations for enlargement is provided. The basic effects of enlargement at the macroeconomic level are elaborated in section 3. The following part (section 4) provides insights into the agricultural and rural dimensions of the enlargement process and the action and reaction of the CAP. Section 5 summarizes the relevant arguments and tries to point out the main development channels for the far future.

2. History of enlargement

Quite immediately after the end of the Cold War in 1989/90, when the economic systems of the Central and Eastern European Countries (CEECs) began to transform into market economies, the European Union started to establish closer ties to these countries and provided financial support for efforts to reform and rebuild these economies. In this early period, association agreements were subsequently established.

At the 1993 summit in Copenhagen the formal will to finally incorporate these associated countries into the Union was expressed (VERHEUGEN, 2001). However, such a move implies fundamental changes for both parties, among them changes in the structure of the economy, a different situation with respect to the availability of production factors, or inevitable alterations of democratic and institutional structures. Thus, the Council linked the accession of these associated countries with their ability to successfully meet the implied obligations.
Main problem areas in this early discussion were considered to be e.g. the limited capacity of the existing EU policy tools to cope with the enormous economic and social disparities, the emergence of immigration flows, the question of the appropriateness of the political system, the likely burden for the EU budget, and, last but not least, agricultural and structural policy issues. The reason why agriculture was seen as a problem is derived from the fact that (i) this sector is still much bigger in the CEECs than in the EU, and (ii) at the same time farming is the most costly policy segment in the EU. Into the bargain, the commitments out of the Uruguay Round acted also as a constraint.
The 1997 Luxembourg Council initiated negotiations with a first group of potential accession countries (Poland, Hungary, Czech Republic, Estonia, Slovenia, Cyprus). Later in this year, at the Helsinki council, the EU started negotiations with the six remaining countries (Latvia, Lithuania, Slovakia, Romania, Bulgaria, Malta). With the paper "Enlargement and Agriculture – Successfully integrating the new Member States into the CAP", published in January 2002, the Commission for the first time outlined in detail how and to what extent CAP payments should be implemented in CEECs.
In December 2002, the Copenhagen Summit brought about the final decision that ten candidate countries (Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, the Slovak Republic and Slovenia) will be members of the EU by May 2004. Also in this meeting, the Heads of State and Government of the EU and the accession countries reached agreement on the agricultural characteristics of enlargement. The new member states receive a rural development package which is specifically adapted to their requirements and is more generous than existing conditions for the present EU member states (see Table 1 for details).

Table 1: The Copenhagen decisions of December 2002

Rural development
- enhanced rural development strategy, broader in scope and available funds compared to EU15;
- € 5.1 bn for the years 2004-06, measures co-financed at a maximum rate of 80% by the EU;
- additional rural development measures financed out of Structural Funds (EAGGF Guidance sector).

Gradual increase of direct payments
- Starting at a level of 25% of the present EU payment level in 2004 direct payments will be increased in a way which ensures that in 2013 the new Member States arrive at the CAP support level.
- Payments can be topped up with EU rural development payments or national funds for any CAP scheme, but must be authorised by the Commission.

Simplified implementation of direct payments
- During a period of three years new member states are allowed to grant direct payments in the form of decoupled area payments applied to the whole agricultural area.
- The simplified scheme may be extended two times by one year.

Production quotas based on recent reference periods
- Production quotas were fixed on the basis of the most recent historical reference periods covered by reliable data.
- Country specific problems have been taken into account in the majority of cases.

The farmers from the new member states have full and immediate access to Common Agricultural Policy (CAP) market measures, such as export refunds, and cereal, skimmed milk powder or butter intervention, which should contribute to stabilising their prices and incomes. Special provisions have been agreed for Cyprus and Slovenia, to take account of their internal support systems prior to accession.
With the recent reform of the CAP, initiated by the Mid-term Review under the WTO obligations, the financial framework for the years between 2007 and 2013 has been set up. So the political agenda has been fulfilled, as not only the accession countries now have a clear perspective over the medium run, but also the EU 15 member states can rely on a solid set of rules for the years ahead. However, political economic considerations, which will be presented later, suggest a cautious position with respect to this view.

3. Arguments and Motivation

3.1. Official Motivation for Enlargement

Commissioner VERHEUGEN (2001) formulated the main benefits of enlargement, being both political and economic, in the following way:

1. The extension of the zone of peace, stability and prosperity in Europe will enhance the security of all its peoples.
2. The addition of more than 100 million people, in rapidly growing economies, to the EU's market of 370 million will boost economic growth and create jobs in both old and new member states.
3. A better quality of life for citizens throughout Europe is expected as the new members adopt EU policies for protection of the environment and the fight against crime, drugs and illegal immigration.
4. Enlargement will strengthen the Union's role in world affairs – in foreign and security policy, trade policy, and many other fields of global governance.

The benefits, which already have been visible in advance of accession, are derived from

- the emergence of stable democracies in Central and Eastern Europe, which also managed to integrate minorities into society;
- higher economic growth and improving employment as a consequence of economic reforms in these countries.

This process has been encouraged not only by the prospect of EU membership, but also by the financial assistance provided by the Union. At the same time, however, the Union enjoyed a considerable improvement of its trade surplus, which e.g. was € 17 bn in 2000. This effect undoubtedly was a driver for generating employment and growth also in the EU member states. The Commission also maintains that even non-member countries will benefit from enlargement through a set of trade rules and administrative procedures.

3.2. Informal Motivations

A key academic study conducted by the Centre for Economic Policy Research (BALDWIN et al, 1997) estimated that enlarging the EU by the countries of Central and Eastern Europe would bring an economic gain for the EU15 of about € 10 bn, and for the new members of € 23 bn.

A recent study of the Commission (EUROPEAN COMMISSION, 2001) arrived at the result that enlargement would increase the growth of GDP of the acceding countries between 1.3 and 2.1 percentage points annually. For the existing member countries the increase in the level of GDP could still be 0.7 percentage point on a cumulative basis. A questionnaire among influential business people (EUROPEAN ROUND TABLE OF INDUSTRIALISTS, 2001) brought about that they anticipate 'potentially huge economic and business benefits of taking applicant countries into the EU as soon as possible'. In detail, these people expect that, in addition to the gains from trade and investment which already benefit EU member states, accession could boost economic growth by at least € 60-80 bn. At the labour market this would translate into a gain of around 300,000 new jobs. Their belief is mainly based on the historic experience of Ireland, Portugal and Spain. In these previously relatively poor economies accession unleashed an impressive stimulation of dynamic long-term growth.

There are several analyses of the impact of enlargement on the labour market and migratory flows. An extensive study prepared for the Commission (BOERI and BRÜCKER, 2000) suggested that only about 335,000 people p.a. would move to the EU15 countries from Central and Eastern Europe even if there were free movement of workers immediately on accession. In practice, the Union has agreed on a flexible transition period of up to seven years for limiting the inflow of workers from new member states

Overall, the positive mood with respect to eastern enlargement in economic circles mainly rested on four factors:

- improved confidence in the political and economic future of the new Member states,
- a boost in foreign direct investment,
- increased cross-border trade flows,
- increasing international competitiveness in all member states.

In general, the actual development in the various areas determines the success of integrating these ten economies into the EU.

4. Economic Consequences of Enlargement

4.1. Overall Effects of Integration

Integrating ten countries with distinctly different histories as well as structures at the same time into the existing EU reveals a firm belief that this step will have positive consequences for the group as a whole. Economic benefits are considered to be in the first place in this respect.

In general, the magnitude of integration effects primarily depends on the depth of integration. In the case of EU Enlargement this depth is very pronounced, as these countries not only enter a customs union, but are also part of the Single Market and, after some time, will also participate in the EMU. So, in this case the standard effects of regional integration will be complemented by additional features (BREUSS, 2002), being

1. trade effects,
2. factor movements,
3. single market effects, and
4. budgetary implications.

Due to the particular situation of the countries involved, eastern enlargement is a very special form of extending a Regional Trade Agreement (RTA). Firstly, there is a distinct gap in GDP per capita between current and new member states, which amounts to around 40% of the EU average if measured in PPP (purchasing power parity). Roughly the same magnitude holds for labour productivity and wages in the CEECs. Trade with the EU is extremely important for CEECs (70%), while this is not the case for the EU (4%), which will cause highly asymmetric trade effects.

Probably all economic research studies dealing with the effect of enlargement demonstrated macroeconomic benefits (e.g. KEUSCHNIGG and KOHLER, 1999, BALDWIN et al., 1997, BREUSS, 2002, etc.). However, in historic time the success of this process is path dependent and thus susceptible to fortuities.

4.2. Trade related aspects of enlargement

From an economic as well as a legal viewpoint any enlargement round of the EU since its inception was a process of incorporating new members into a customs union (CU). The traditional economic view is that an increase of intra-bloc trade is an indicator of successful economic integration. The economic debate concentrates on the question whether the share of trade increases as a result of trade creation or trade diversion, as this determines the overall welfare effects of such a process. Simply speaking, *trade diversion* is present if the former Regional Trade Agreement (RTA) switches imports from competitive third countries to the new entrants. *Trade creation* is to be observed if after the enlargement of the RTA the net imports from third countries increase, e.g. through a reduction of the external protection rate in the enlarged RTA.

The benefits of membership in a regional trade agreement must exceed those of being outside, because otherwise the RTA would not remain in existence. However, this implies that the enlargement of a customs union must benefit the new entrants, which probably may cause disadvantages for other countries. In being aware of these effects the WTO rules, strictly speaking Art. XXIV:5(a), require that the formation – and enlargement - of a customs union must not bring about a net decrease in the economic well-being of non-members. This basically implies that the average bound tariff of the CU after enlargement has to be more or less the same as before, as otherwise the competitive position of non-members would deteriorate.

In actually comparing the protection levels of the new entrants with those of the EU it seems likely that in particular cases increases in tariff levels may occur. This would put other WTO member countries in a position to demand compensation. Also previous EU enlargement rounds had a noticeable effect on the geographical pattern of trade in the form of a strong re-orientation of trade of current members towards new members. This not only holds for manufacturing and services, but also for agriculture.

Welfare gains from liberalizing trade through a customs union may also be triggered by intra-industry reorganisation. Market integration is expected to remove monopoly power at the national or sub-national level by stimulating growth of firm sizes through more competitive markets. Before the completion of the single market these effects remained relatively small, as borders between members of the Community still functioned as a substantial obstacle for intra-community trade. With 1992, the creation of the "Single Market", these hurdles was expected to vanish (VENABLES and WINTERS, 2003). While ex ante analyses predicted gains of several percent of the EU GDP, so far the empirical evidence regarding the actual effects is mixed: on the one hand, we observe an increase in labour productivity, on the other an expansion in the volume of economic activities is evident mainly in sectors with the strongest liberalisation impacts through the Single Market.

The magnitude of the pro-competitive effect of increased trade depends on country characteristics, particularly the intensity of competition before the establishment of the RTA. In addition, empirical evidence points out those sizeable economic benefits require "deep integration", which stands for eliminating the plenitude of "minor" trade obstacles within a customs union; among them trade formalities, different product standards, etc. These findings not only apply to horizontal trade flows, but also to trade patterns related to vertical specialization, which are an increasingly important form of intra-industry trade.

With respect to Eastern enlargement, many of these effects have been anticipated by the association agreements of the previous years. These were set up as preferential trade regimes, which provided significant and mostly asymmetric tariff reductions for CEEC exports. As these agreements were largely based on historical trade flows, the main beneficiaries – in absolute terms - were Hungary, the Czech Republic and Poland. However, due to the particular procedure to allocate the import quotas, also EU importers were able to capture substantial shares of the economic rents created (BUCKWELL and TANGERMANN, 1999). Nevertheless, with respect to EU market access these agreements put the CEECs in a much better position than other third party countries. Starting with the year 2000 - under the so-called "Europe Agreements" - full liberalization of trade for more than 400 agricultural products gradually took place via mutual tariff concessions. Only for some products - yet often politically highly sensitive - tariff protection remained substantial.

Empirical studies showed that European integration has brought about a good deal of trade creation, both internally and externally. However, gauging the exact amount of this effect is rather difficult, as this requires knowing the development of trade without integration, which normally is not identical with the assumption of unchanged trade shares (VENABLES and WINTERS, 2003).

On a macroeconomic scale, trade effects have been recently estimated by BREUSS (2002). In utilizing the Oxford World Economic Model he estimated that with a cumulative gain of 0.05% of the GDP until 2008/2010 for the EU the trade implications will remain marginal. As expected, trade gains for the CEECs are substantially larger, with a cumulated gain e.g. of 2.5% for Poland or 4.2% for Hungary.

Due to the strong regime of protection for domestic producers in the EU it is quite likely that the share of trade diversion is higher in agriculture. Based on a multi-regional CGE-Model, BANSE and TWESTEN (2002) find evidence that Eastern Enlargement will entail substantial changes in trade flows. Hungary will be one of the main beneficiaries, with a substantial increase in net exports. Net exports of countries outside EU25 will be negatively affected. However, the authors stress that the outcome of this simulation experiment is quite sensible to changes in trade elasticities.

In a similar attempt to quantify the agricultural trade effects of enlargement KUHN and WEHRHEIM (2002) concluded that trade diversion may be of substantial magnitude. However, export commitments agreed in the URAA will not be violated even when third countries should demand compensatory import quotas. A similar position is held by FROHBERG et al. (2001), yet under the restraint that the "blue box" is maintained. Frohberg also considers compensation claims of third countries to be very likely, as currently the accession countries have bound most of their tariffs below EU levels. However, due to the overwhelming share of imports from EU15 these claims will remain manageable.

4.3. Factor movements between East and West

Foreign direct investment (FDI) is a dominant element of the rapid growth of international trade. In order to open up a market, in many sectors FDI is more important than trade today. On a global scale, FDI has grown by a factor of almost 60 since 1970, while global trade volumes have only increased by a factor of about 10 (UNCTAD, 2003). Particularly for the EU, which holds about a third of the worlds stock of inward FDI, this mechanism is extremely important. Also for the larger member states the share of foreign owned firms is substantial, with e.g. about 26% in the case of France or still 16% for the UK. For smaller countries like Ireland this share reaches almost 50%.

The major direct effect of FDI in the host country is an increase in factor endowments through an inflow of capital, technology and management know-how. Particularly these factors are often in short supply in newly developing market economies. FDI is likely to create additional output growth through rising productivity of local factors, e.g. labor and land, and falling production costs. On the other hand, there is also a loss of national supremacy.

FDI flows are expected to increase substantially after full integration of the first group of Eastern European Accession countries, being mainly caused by a more reliable legal and institutional setting after full adoption of the "aquis". However, the extent to which these flows will benefit agriculture is highly dependent on spatial characteristics. It can be expected that FDI inflows will look for optimal conditions, which are mainly provided by core regions. Only in exceptional cases less favoured and remote regions will be targets for foreign investment activities.

Part and parcel of EU membership is the right of citizens to individually determine the place of living and working. So the other important factor movement could be labour, which is expected to flow mainly from east to west. What in general determines the decision to leave the home country? In the case of Eastern European countries, where political pressures are a matter of history, mainly economic factors are part of this decision, among them

- wage differentials,
- expected economic development,
- labor market situation,
- cultural differences and geographical distances.

Though, migration decisions are not proportionally related to these criteria, but exhibit a distinct threshold effect: as a rough rule of thumb – which can be derived from southern enlargement - migration flows begin to increase if per capita income levels differ by more than 50%. They dry out if the welfare gap, expressed in GDP per capita, falls below 25-30%.

So far, the main target countries for migration flows have been Germany and Austria, together absorbing about 80% of migrating people, followed by UK, Italy, and Sweden. BOERI and BRÜCKER (2001) estimate that within the first eight years in sum about 2.9 Mill. people could move from the CEECs to the west. However, accession negotiations have brought about a transition period for fully liberalized movement of people of seven years after accession. After 2012, however, the welfare gap between east and west should have narrowed considerably, at least for the economically most advanced accession countries. So, despite the fact that wage differentials between EU15 and the new member countries are currently significant, migration will not be an inevitable consequence.

4.4. Single market effects and policy incentives

Interestingly, so far the long-term effect of European integration has not led to a perceptible increase of sectoral specialisation (VENABLES and WINTERS, 2003). All EU countries except the Netherlands have, since the late 1970s, seen their industrial structure becoming more dissimilar from that of other EU countries (MIDELFART-KNARVIK et al, 1999). This pattern changed only slightly after the completion of the EEA in 1992. As a matter of fact, EU countries and regions remain much less specialised than comparable geographical units in the US (VENABLES and WINTERS, 2003). This will remain valid after Enlargement.

The observable pattern of specialization quite strictly follows the predictions of economic theory: for example, skilled labor intensive activities moved towards countries with abundant skilled labor, and R&D intensive activities relocated towards "scientist abundant" countries (MIDELFART-KNARVIK and OVERMAN 2002). Although these reallocations are widely in line with intra-union comparative advantage, they are not necessarily welfare increasing, as they are in some cases accompanied by internal trade diversion (VENABLES and WINTERS, 2003).

Although the process of economic integration strengthens the weight of market forces, policy incentives still remain relevant. Yet, they have to be adapted to the changed framework. Regulative measures for domestic firms e.g. will loose effectiveness as they are to be undermined either by imports or the increased mobility of enterprises. Consequently, effective government measures have to concentrate more on improving the market power of firms by strengthening their comparative advantages, and less on discouraging foreign competitors. Yet, this must not be done by naïve subsidising; as such a strategy is explicitly prohibited by the Treaty of Rome (Article 92, 93) as well as the GATT.

Empirical studies indeed unveil that specialisation in the EU is mainly taking place according to comparative advantage, and surprisingly rarely follows the availability of state aids (MIDELFART-KNARVIK and OVERMAN, 2002).

4.5. Budgetary consequences of Enlargement

As already mentioned, a large portion of public discussion surrounding eastern enlargement did focus on budgetary issues. Taking into account the large farm population and the comparably low level of GDP per capita in the CEECs it seems very likely that most or even all of them will be net beneficiaries of payments under the CAP and the structural funds.

In the Commissions' official proposal until 2006, published in January 2002, projections ranged between 6.5 bn € in 2002 and 16.8 bn € in 2006, including expenses for agriculture of 3.9 bn € in 2006 (in 1999 prices). While earlier studies had regularly stated alarming values for the additional burden of EU budgets, more recent analyses supported the Commissions view (e.g. HOFREITHER and KNIEPERT, 2003). Additionally, rural areas were expected to benefit from money out of structural funds at an average of 137 euro per capita. In sum, the new member States should receive and be able to absorb amounts in the magnitude of 2.5% of their GDP. The European Parliament assessed these estimates as a short-term view and maintained that the enlargement proposal of the Commission beyond 2006 could cause annual budget cost of 39 bn euros in 2013 with unchanged CAP and structural funds. However, the following section tries to illustrate that all attempts to exactly gauge the "cost of enlargement" could well miss the mark.

4.6. Political economy perspective

From a political economy point of view this enlargement process is seen somewhat different. The key problem of a cost-benefit analysis-like judgement of enlargement is that the effects will occur in historic time, with costs being clear and immediate, and benefits remaining opaque and mostly postponed to the future. So the main concern ahead of enlargement – at least if the content of public discussions is considered – has been the expected burden for the EU budget, followed by worries about migration flows, security problems, traffic increase, etc.

Although these concerns were mainly confined to particular groups or sectors, they nevertheless seemed to dominate public discussions.
The European Union was well aware of the potential problems of enlargement related to the EU budget and tried to mitigate these threats by adjusting the relevant community policies. However, adapting the CAP during the Mid-Term Review discussions appeared to be quite a troublesome task, as most member countries did focus mainly on their actual, individual situation instead of the long term implications of this important set of policy rules.
However, the basic rationale of this approach, no matter how successful it may have been realized, may be fundamentally flawed. Taking into account the voting power of the new member countries after accession, sooner or later these rules may be changed. In a recent article KANDOGAN (2000) showed that not only there is a considerable chance that this may actually happen, but also that such a mechanism was a common element of nearly all previous accessions. The key conclusion of Kandogans study is that in order to avoid increasing budgetary outlays after the accession of new members it is advised not to chance community policies in advance, but the voting rules, which are relevant to decide upon these policies.

5. Enlargement vs. Integration in the case of Agriculture

5.1. Importance of agriculture

Agriculture was and still is a particularly sensitive field of the enlargement process at least due to three factors (EU COMMISSION, 2002):
Agriculture is not only embedded in the probably most complex framework of instruments under the Common Agricultural Policy, but also subject to veterinary and phytosanitary and commercial policies, which in sum touch quite a lot of important accession issues (e.g. budget, prices, trade, WTO, consumer protection).
In quite a few of the accession countries agriculture makes up a large share of employment and also value added. Nevertheless, agriculture in those countries is still characterised by low productivity levels and a substantial magnitude of hidden unemployment, which results in low

farm incomes and also land prices. However, the diversity between the accession countries with respect to these characteristics is enormous.
Even after ten years of a successive association process the remaining trade restrictions between CEEC-10 and the Union are relatively more important in agricultural and food products than in other sectors, so opening up markets will have a relatively stronger impact.
It is also to be mentioned that with respect to the commodities produced there is a high level of congruence between EU15 and accession countries, which will accentuate competition in food markets. Last, but not least, the strong influence of political interests in agriculture, being a very special characteristic of this sector in many countries of the world, will multiply the public dimension of all arising problems during the integration process. Nevertheless, in the very long run the economic factors, which have been discussed in the previous section, will gain in importance relative to policy impacts.

5.2. Situation of Agricultural and Structural Policies

Although in the long run the market forces will drive the development of the agricultural sector in a EU25, particularly in rural regions politically created incentives will remain an important element for the pace and direction of development. Due to the share and the problems of agriculture, the CAP and structural policies will be of tremendous relevance for quite a while.
While the political framework for the accession of the new members already has been agreed in December 2002, the long overdue adjustments of the CAP, which were already expected for the Berlin Summit 1999, were settled half a year later. On 26th June 2003, EU farm ministers adopted another reform of the Common Agricultural Policy (CAP), which fundamentally changed the form of granting support to EU agriculture.
The new rules put EU farmers in a better position to produce in line with market demands, as subsidies are granted independently of production volumes (“decoupling”). At the same time, this change will increase income stability, as production risks have less impact on income levels. To reduce the risk of abandoning farming in vulnerable marginal areas, member states may establish well defined links between subsidies and production activities, mainly through criteria related to

environmental, food safety and animal welfare standards ("cross compliance"). This reform brought about revisions for the milk, rice, cereals, durum wheat, dried fodder and nut sectors. A newly introduced financial discipline mechanism is meant as a safeguard with respect to the tight budgetary ceiling for the EU-25 in the financial perspectives until 2013 (EU COMMISSION, 2003).

So, although the sequencing of reform steps in front of enlargement may not appear to be very fortunate, the combined outcome of the Copenhagen summit and the recent CAP reform makes sense, because

- it induces a fundamental change in the way support is provided to the farming sector, which brings about a stronger market and consumer orientation and at the same time eliminates important problems with respect to the WTO,
- it allows accession countries to gradually adjust to the new setting, while in the short to medium run giving emphasis to the structural adjustment needs of these countries.

5.3. Output and Factor Markets

So far, the success of the quite bumpy macroeconomic recovery of CEECs to a large extent resulted in increased demand for consumer goods from the EU. Hence, the balance of processed food was negative for CEECs and even worsened during transition. The key factors which explain this outcome is low effective competitiveness, and – at least for a limited time – the existence of a convenient outlet for lower quality food surpluses in the NIS (former Soviet Union).

In the meantime, agricultural price gaps between EU15 and the CEECs have widely levelled out. This was mainly caused by the price cuts of the last two CAP reforms, the rising agricultural protection levels in the accession countries, but also the appreciation of their real exchange rates. Yet, by fully entering the single market the accession countries will also profit from the elaborated system of protection and support for farming within the community, which over time will lead to higher production volumes and probably also higher surpluses. Yet, due to deficiencies in the legal and institutional setting of the new entrants this process may take more time than expected (FROHBERG et al, 2001).

In imposing stricter regulations linked to quality, hygiene and health requirements the competitive position of CEEC products on EU15 markets may gradually improve, if the increased costs are paid off by a rising propensity to consume. In future, improving the trade balances of the new members will increasingly depend on entrepreneurial skills, as the removal of trade barriers and other political obstacles will gradually level the playing field.

The problems to be solved on factor markets are probably even more difficult. Although there was a substantial reduction of the agricultural workforce during the first years of transition, hidden unemployment in agriculture is still a substantial problem. The chance to find jobs in other sectors is limited, partly due to the overall employment situation and partly due to the lack of individual education levels or regional mobility.

In addition, if EU integration progresses along the lines of basic economic reasoning, even in agriculture an improvement in the allocative efficiency of labor will – or better must - occur. This will first be visible in regions where large-scale farms still dominate and will add to the pool of unemployed people in the rural regions. This problem could put up the basis for severe economic and social problems in the future, as in many EU15 member states migration seems to be one of the key concerns of the man in the street.

In a recent calculation (EU COMMISSION, 2002) it is estimated, that between 800.000 and 1.7 mio. people will leave agriculture in the CEECs. However, it is expected that a substantial share of them will retire and most of the remaining younger people will have opportunities to find jobs in other sectors within their home countries. Moreover, the obstacles to find adequate jobs will be more or less the same in "old" and "new" member states, which too will have a dampening effect on migration.

5.4. Long-term development trends of the CAP

As already mentioned in this paper, in the long run European farming will experience further increases in productivity and hence production volumes. At the same time, the spatial diversity of farming in a EU25 is enormous, which entails a highly uneven potential to profit from production and price increases. This setting requires a very balanced approach of improved market orientation in combination with a strong role of public policies to secure the non-commodity output society demands from agriculture and also to mitigate regional imbalances.

With respect to the competitive segments of European agriculture process of bridging the gaps between domestic and world market prices, which was part of all CAP reforms since 1992, will and has to continue. This requires a rethinking of current means to protect less favoured areas and structurally disadvantaged holdings, if such conservation objectives are backed up by society.

In an attempt to develop a viable long term development scenario for the CAP the following key elements can be distinguished (EUROPEAN COMMISSION, 1997):

1. *Market Stabilization*, primarily in order to provide a safety net for producers.
2. *Environment and cultural landscape measures* aiming at protecting against depletion and destruction of resources and landscapes in rural areas in cases where society signals demand.
3. *Rural development measures* addressing all possibilities of improving the viability of rural areas.
4. *Adjustment assistance* to new market conditions in the form of temporary payments with a clearly stated objective.
5. *Intra-sectoral income distribution issues*, mainly related to historically derived compensation demands, have to be explicitly checked for their compatibility with non-agricultural distribution conventions.

In looking at the last reforms, particularly the one which was decided in June 2003, a great deal of congruence with the principles stated above is evident. The changes of the CAP seem to recognize the most important problem areas in

- curbing policy induced production incentives (decoupling)
- making first steps to mitigate distribution problems through modulation,
- better acknowledging the spatial functions of agriculture through its rural development initiative as well as cross-compliance,
- following a promising approach to solve WTO-related problems.

While this reform appears to be a valuable step in the right direction, the current weight of enlargement remains of secondary importance. Despite the relatively higher share of farming in GDP and employment of the accession countries, it will have only minor impacts on the development of the farm segment of the current member states. In the long run, the main effects will be

- a pro-competitive effect due to the expected productivity increases of farming in the accession countries,
- a still unknown, but likely manageable flow of people searching for work in the current member states, which will be driven by a complex interchange of market forces and political incentives in the next decade,
- a very selective inflow of FDI into the most attractive regions of the accession countries, whose positive economic impact in the regions concerned could reinforce the imbalances with respect to less-favoured areas.

6. Conclusions

In general, the impacts of eastern enlargement are smaller than frequently supposed. Under the current rules of the game

- the macroeconomic impact on GDP will remain in the range of 0.2 – 0.7%;
- the budgetary costs of this process will amount to about 0.3% of EU`s GDP, and furthermore are confined through the cap on outlays for agricultural and structural policies for a limited time;

the expected migration flows will also be of minor importance.

However, as these figures are averages this does not imply that nobody will win or lose considerably. Firms with successful engagements based on the new trading opportunities may be able to reap high profits. On the other hand, spatial reallocation of production activities may cause hardship for mainly the less educated and less mobile part of the workforce in certain regions.

Agriculture is one of the most debated areas in the process of enlargement. In general, the effects which are relevant at the macro scale will also work in the farming business. However, due to the specific characteristics of this sector some differences remain. Mainly, these differences are related to the unique production environment of this sector as well as the unparalleled treatment through policy:

- the relocation of production activities may be hindered through the immobility of land, and to some extent also of the people in this sector;

- this effect will be supported through the different agricultural and structural support measures provided by the Copenhagen agreement in December 2002.

The CAP will continue to adjust in the future. Often this process appears discontinuous through its dependence on reform decisions at a particular point in time. However, in looking at the long-term development of the CAP, quite distinct patterns are easily observable, which will carry on in the future:

Since 1992 the mode of support is changing from commodity related payments to "decoupled payments", which gives farmers not only much more freedom to respond to market forces, but also provides a safety net with respect to price induced fluctuations of income levels.

With the broadening of environmental and rural initiatives the CAP shows a slow but steady reorientation from the historically dominating sectoral focus towards a more pronounced recognition of the spatial dimensions of farming.

In the very long run, the CAP has to align with the basic principles of sustainable development. Yet, this requires a much broader approach then the one which is currently presented under the heading of "multifunctionality". There, agriculture is portrayed as a sector which mainly produces non-commodity outputs with high values for the welfare of the whole population (landscape amenities, rural economic viability, cultural heritage, biodiversity, food security). However, making agriculture a truly "multifunctional" sector requires integrating the non-commodity outputs of agriculture with the traditional functions of producing food and fibre in a much more consistent way, and also to respect the social and cultural roles of this sector on a broad scale.

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