

## **STRATEGY AND THE RISKS MANAGEMENT FOR INTEGRATION THE POLISH FOOD ECONOMY INTO EU STRUCTURES**

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### **Abstract**

*The economic development of the European Union in the last few years was the main subject for debating inside European forum. Different positions and conclusions were the results of the analyses-still a major conclusion is the fact that the newcomers in the space of European Union (Poland, Hungary, Bulgaria, Romania, etc.) are at the same time resource developers and consumers. The natural resources of these economies should be easily integrated in the European circuit market, but at the same time, the difference between fund management, programming, governmental control and evaluation at the level of the Union, aside national economy circuit, draw attention about possible risk/danger for a extended period of the time. This article debates about the complex process for the Poland food sector integration in the EU structure.*

**Keywords:** development strategy, structural policy, risk management, food industry

**JEL Classification:** Q18, R58

Poland joined the EU in 2004, in the hope of obtaining assistance from the EU for the development of rural areas and the agric-food sector. One of the reasons in favour of the accession was the stabilisation of foundations of agricultural policy which would enable farmers to make long-term plans and ensure predictability of the production and investment operations. The accession to the EU raised hopes of deep restructuring and modernization of the agric-food sector, increasing competitiveness of the food production and reaching the significant growth of surplus in the balance of foreign trade in agric-food products as well as an improvement in income situation of rural inhabitants, multi-functional development of the rural areas and conservation of precious natural resources. To achieve these goals substantial funds were needed both from the EU and the national budget in the form of financial support for investments, direct payments and further actions to enhance competitiveness.

There were also some reasons for concern of the Polish farmers and institutions associated with agriculture about the integration with the EU, among others because of : unequal conditions of competition (lower level of direct payments in comparison with the old EU member states), lower competitive position due to lower labour productivity in the agriculture and the food industry than in the EU-15 on average, limitation of the production capacities by production quotas and other limits, restructuring of the agricultural sector on the basis of the structural policy of the old member states (e.g. reduction of support funds for the investments which indirectly cause the growth in production potential of agricultural holdings) and the CAP reform approved in June 2003 without Poland's (and the other candidate countries') participation.

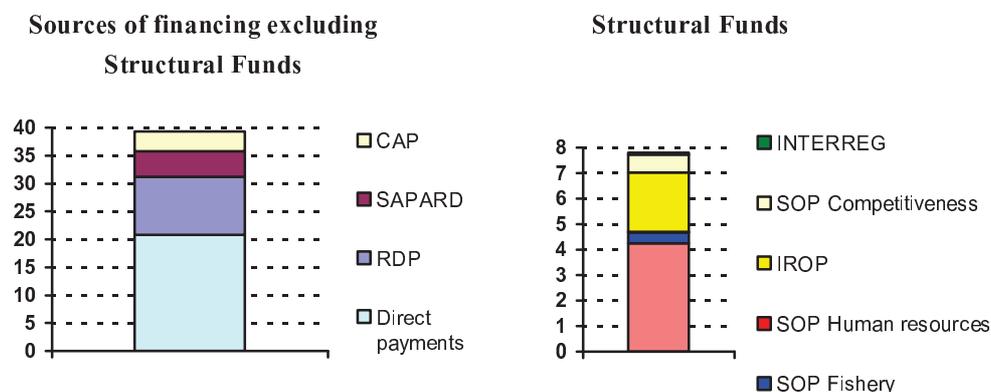
However, Poland's accession to the EU has exerted more beneficial influence on the agricultural and food sector and the rural areas than expected. As a result, the growth in exports and the increase in domestic demand were observed, followed by the growth in agricultural incomes and the improvement in profitability in the food industry. Although the global agricultural production stayed at the similar level in the years 2001-2003 and 2004-2007, but the signs of revival appeared, among others, in the production of live cattle, poultry and eggs. At the same period the commercial agricultural production was on the increase (by 6-8% per annum) and its linkages with the market strengthened. In 2004, as a result of introducing direct payments, the agricultural incomes more than doubled and in the following years the tendency of growth by approx. 3% per annum has been noted (in relation to the year 2004). The main reasons of the situation favourable to the farmers whose incomes grew faster than production costs were: significant development of production techniques, replacement of more expensive production means by cheaper ones, improvement in the agrarian structures and the growth in the commercial agricultural production.

Also the economic results and the position of the Polish food industry in the years 2004-2007 show that also that sector of the national economy was very well prepared for the integration with the European Union. The processes of restructuring and modernization of the food industry in the whole transition period and the adjustments of food processing plants to the EU standards have proved that the food industry made good use of the chances that had appeared as a result of the opening of the lucrative EU market. Starting from 2003, the sold production of the food industry has been growing at the pace of 7-9% per annum. Exports of agric-

food products in the years 2003-2007 increased from 4 billion euros to 9.8 billion euros, while imports from 3.6 billion euros to 7.8 billion euros. The surplus in the foreign trade of the agricultural and food products grew fourfold, to almost 2 billion euros. The long-standing trend towards improvement and stabilization of the economic and financial results of the main segments of the food production was observed. It was accompanied by the stabilization of the organizational structures of the food sector. The high competitiveness of the Polish food producers resulted from the lower costs of the production factors, in particular lower labour costs, as well as the huge investments in modernization of the food industry and technological innovation, estimated at 5-6 billion zlotys per annum in recent years, which led to their cost and price advantages.

The positive trends in the food sector and in the rural development had their source in the utilisation of the Structural Funds (SF) and the financial support within the Common Agricultural Policy (CAP). Their beneficial effects were related to agriculture, fishery, food processing, entrepreneurial activity, development of human resources, modernization of physical infrastructure, environmental protection and other more complex actions. The investments conducted in the pre-accession period and during the membership contributed to the modernization, the increase in competitiveness and the adjustment to the EU sanitary and veterinary standards of almost 3,000 food companies. Over 140,000 agricultural holdings invested in modernization and new production techniques or in diversification of the sources of incomes. Approximately 1.5 mill. farmers receive the direct payments every year. The total value of financial support to agriculture, food economy and rural areas in the period from May 2007 to the end of September 2007 was above 48 billion zlotys of which almost 40 billion zlotys was disbursed from the CAP funds. The value exceeded fivefold the total value of payments for rural areas within the structural funds (8 billion zlotys). The transfers via the agricultural fund, i.e. the FEOGA fund, exceeded 44 billion zlotys, while the remaining transfers of SF directed to rural areas (apart from the SOP Transport programme) amounted to over 3 billion zlotys. The support funds and the capital flows progressively contribute to increase competitiveness of the food sector as well as to improve the situation of the rural areas lagging behind in development, although the present capabilities to finance much needed infrastructure and other projects are still too small.

**The financial transfers to the food economy and rural areas (in the period from May 2004 to September 2007, in billion zlotys)**



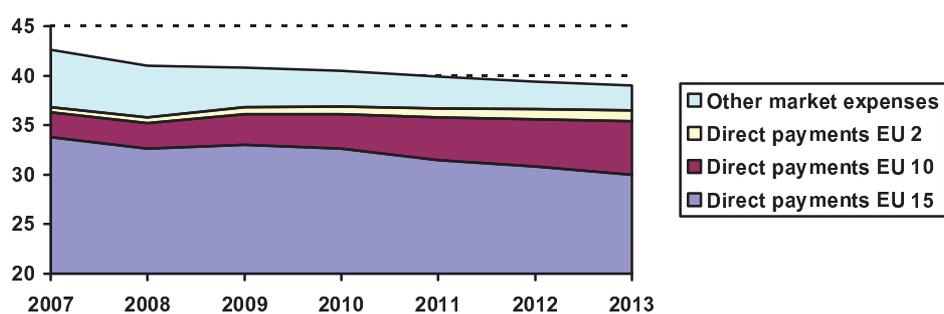
The shift from closed markets to open and competitive markets was not, however, an easy task for agriculture and the food economy. The fact that the prices of agri-food products in Poland edge up to the level recorded in the “old” EU member states has a negative impact on the economy which leads to the growing inflationary pressure and the decrease in price competitiveness of the Polish food products. The price relations on the agricultural and food market were also unfavourable for the agriculture. The downward tendency in the prices of agricultural products, in relation to both prices of means of production and prices of processed food products has been observed. As a consequence, the index of price relations was on the decrease, which meant that the suppliers of the means of production gained a greater part of the additional income of agriculture.

The specialization and concentration of production and the requirements in the scope of standardization and quality of food products required many structural changes which resulted in the decline in biological diversity in farming environments. As a consequence, there are fewer species in intensive agricultural production regions with little diversity in the landscape structure due to among others the decrease in grazing and cattle husbandry. In the past years, agricultural landscape has lost many of its features: cows grazing in farms’ surroundings have become increasingly rare, horses are replaced by farm tractors, meadows and pastures – by plantations of conifer trees. The process of depopulation in peripheral rural areas is also observed. Young people often leave their villages to look for jobs and a higher living standard in urban areas. This outflow of young people deprives the villages of their valuable human capital. The social and cultural picture of

villages is dynamically changed. Cultivation of energy crops is harmful to the environment and probably to health of people too. This problem can manifest itself when the cultivation becomes more popular. These actions will have also their consequences in the form of pressure for the further growth of food prices.

When considering the development strategy of the Polish food economy in the EU structures the forthcoming „health check”<sup>1</sup> on the existing CAP policies and the review of all aspects of EU budgetary spending planned for the period 2008/2009 should be taken into account. The “health check” of CAP will be a continuation of the debate over the reforms initiated in 2003 with regard to: the introduction of the single payment system (SPS), the principle of modulation and further decoupling of direct payments, the changes in Pillar 2 of the CAP and the reforms on the sugar market (2006) and the fruit and vegetable market (2007). Therefore the „health check” will include a debate about future CAP reforms. They will be focused on further simplification of the CAP, the increase in efficiency of the direct support system, the adjustment of the existing market support instruments to the needs of the enlarged EU-27, highlighting the major challenges for future agricultural and rural policy, such as climatic changes, bio fuel, water resources management and maintaining the biological diversity. The European Commission hopes that some of them will enter into force in 2008. The aim of the reform will also be the limitation of the EU budgetary spending for agriculture.

#### Proposal for changes in the net expenditure from the FEOGA agricultural budget (in billion euros)



<sup>1</sup> fr. bilan de sante

There are a range of options available for the renewed CAP, among others the evolution scenario and the scenario of full liberalization. The former means further decoupling of support from production, the higher rate of compulsory modulation for direct payments, the limitation of the payments for the biggest holdings, the gradual decline in intervention on the agricultural markets and the moderate liberalization of the world trade. The latter means the application of the market economy in agriculture, i.e. the abandonment of intervention purchases and direct payments and the liberalization of the world trade in agricultural and food products. The scenario also assumes the reinforcement of Pillar 2 of the CAP and the evolution of the CAP into the policy stimulating structural changes in agricultural holdings, directing the stream of support payments to market-oriented production only and on the basis of the *cross-compliance* criteria. The numerous analyses show that the mixed model for the future CAP from the perspective of the European agriculture would be optimal. Nevertheless, it seems that all actions both undertaken and planned are necessary to create a stable and balanced model of the European agriculture for the 21<sup>st</sup> century in spite of the fact that the EU member states (especially new ones) are not quite agreeable to some instruments.

Poland so far has been lagging behind the „old” EU member states in development of production and economic structures of agriculture. The average economic farm size, measured in ESU<sup>1</sup>, is significantly lower in comparison with agricultural holdings in most of the EU-15 member states (except for the similarly weak holdings in Greece, Ireland and Portugal). Poland is therefore still at the beginning of the transformation path that the majority of the „old” member states passed in previous decades. They underwent the fundamental structural transformation in agriculture before under cover of the intervention and protection policy. Obviously, it was not possible to create so excellent conditions for development of the Polish agriculture as for the „old” member states till the end of the 1980s. It is advisable to exploit to the maximum the existing EU agricultural policy in order to enhance the competitiveness of the Polish agriculture within a possibly short time.

On accession to the EU in 2004 Poland became a member of one of the multinational systems which exert influence on the European and the world food markets. The future shape of the CAP should therefore be an effect of a compromise between all member states taking into account the country-specific problems in order to strengthen the EU negotiating position and to enhance the competitiveness on the global market. Taking into consideration the Polish

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<sup>1</sup> eng. European size unit

experience from the process of transformation of the economy a certain hierarchy of objectives in relation to the renewed CAP should be defined:

- to maintain its community character (the common rules of functioning and financing from the EU budget). Otherwise the fair competition within the Community would be threatened. The further reforms of CAP, resulting both from the internal and external conditions, should be implemented in accordance with the basic principles of this policy, i.e. the principle of the Single European Market, the principle of preference for the Community members, the principle of uniformity of instruments and the principle of financial solidarity;
- to ensure equal conditions of competition in the enlarged EU, e.g. to reduce differences in the amounts of direct payments;
- to support investments in the agriculture and the food industry directed at quality, competitiveness as well as production growth;
- to simplify the existing market instruments;
- to unify the tax laws in agriculture and then in the whole EU economy;
- to increase the support for multifunctional and sustainable development of rural areas;
- to stimulate investment activity aimed at environmental protection, animal welfare, conservation of the countryside and natural resources of agriculture.

The main area of trade in the Polish food products is (and will continue to be) the single market of the EU together with the domestic market. For that reason the investments in the food sector co-financed from the public funds should be directed to the improvement of food quality and competitiveness of production, adoption of new technologies, expansion of trade into new markets, innovative activities and better waste and by-product management. The necessity for the EU to abolish export refunds, as a result of the negotiations led within the Doha Round (by the end of 2013), the tariff reductions by at least 50% and the reduction of domestic support disturbing the agricultural trade (by approx. 70% in the form of Aggregate Measure of Support – AMS) will speed up the EU decision to abolish production quotas also. The system of production quotas is a market instrument, adjusting supply to existing demand, but simultaneously it creates barriers to market development. The growth of production and exports is limited by the amounts of production quotas even in the conditions of competitive advantages over other countries. As a result of the elimination of quotas and the expected growth of agricultural production, the producers from the non-EU countries will not be able to capture a large share of the EU food market.

Future national rural policy, related also to agriculture, ought to take into account the continuous process of polarization of rural areas into agricultural and

non-agricultural spheres. This polarization concerns rural inhabitants, households and individual enterprises (including also agricultural enterprises). The tendency to harmonise these two spheres of economic activity of the rural inhabitants is growing in importance. The support for development of rural areas from public funds should be allocated according to the concept of integrated development of rural areas. This concept is based on the comprehensive approach that takes into account the production, social and environmental aspects of development. The strategy of integrated development embraces activities that are launched at different levels: the EU, national, regional and local ones. It is essential that the resources available for the support are used so that they yield the maximum amount of positive influence in the rural areas.

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