



## REGIONAL INTEGRATION IN THE EU COMMON MARKET FROM AGRIBUSINESS PERSPECTIVE

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### Abstract

The process of regional integration of different groups of countries in the European Union (EU) common market have stressed an interdependence of political and economic issues as since the EU enlargement in 2004 and 2007 the concept of Old Member States (OMS) and New Member States (NMS) is still outstanding. The primarily considered for the overall EU positive economic effect from free trade left the agro-food market effects generated by common agricultural policy (CAP) not sufficiently assessed. The method applied for this study is comparative analysis of indicators defined for measurement of regional integration progress related to policy and economic dimensions. The policy indicators show the level of direct support and are analysed in line with current CAP and reform proposals for period 2014-2020. The economic indicators are related to productivity and trade. The hypothesis, that different level of productivity combined with the different CAP conditions for OMS and NMS hinders the regional integration process in the EU common market can be approved by both, theoretical and empirical evaluation. The empirical analysis of support, productivity and trade variables show the asymmetries in both – policy and economic trends related to agribusiness.

### Introduction

The process of regional integration of different groups of countries in the EU common market have stressed an interdependence of economic and political issues as since the EU enlargements in 2004 and 2007 the concept of Old Member States and New Member States are still outstanding. The primarily considered for the overall EU positive economic effect from free trade left the market effects generated by common agricultural policy not sufficiently assessed. Agro-food market is of high economic, political and social importance. The economic



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importance is the strong connection of agriculture with food and non-food processing industry which use raw materials from the primary sector. For those economies driven by use of natural resources agriculture and food production can play an important role in improvement of external trade balance. Political importance is mainly comprised by high share of EU budget spent for financing the CAP. Social importance is defined by food safety and food price issues which in turn are closely connected with economic and political ones. CAP has been reformed by permanent process, and the next reform is set up in Regulations' proposals for planning period 2014-2020 with respect to new challenges for agricultural sector. Policy measures will be re-considered and the funding and distribution of the budget between countries as well [1]. Anyway, the future framework of CAP will remain having strong influence on competition conditions within the EU common economic space. In line with the proposals for EU budget and CAP reform for period 2014-2020, the purpose of the paper is to provide comparative analysis of OMS and NMS regional integration in the EU common market in terms of agribusiness. The interrelation of political and economic aspects and their combined effect on regional integration will be explored as well. The hypothesis is that different level of productivity in agribusiness combined with the different CAP conditions for OMS and NMS hinder the regional integration process in the EU common market. In this paper OMS are considered as EU-15<sup>1</sup>, and NMS are considered as EU-12<sup>2</sup> countries.

The structure of the paper is as follows. The first section describes the theoretical background for analysis of regional integration. The second section explains the methods and methodology applied. The third section is considering the EU policy framework for agribusiness. The fourth section provides an empirical analysis of policy and economic indicators in order to give a picture of integration of NMS and OMS within the EU common market. The last section concludes.

## 1. Theoretical Background for Analysis of Regional Integration

In academic literature there are observed two contiguous aspects – regionalism and regional integration; and the methodological issues for its evaluation. Matthews [2] summarised that the regionalism covers the contributions of economics, international relations and international political economy, and the issues addressed to these disciplines are: motivation for making regions, structure of regions, efficiency of its functioning, impact on economic growth for members, convergence of economic performance between participating countries, sustainability of regions and systemic development by building blocks. Economists' analysis of regions begins with the classic theory of customs unions formulated by Viner [3], where traditional economic approach to regional trade integration started with assumption of perfect competition in markets and has been further developed in the context of imperfect competition. According to Balassa [4] the economic integration can take five forms that represent increasing degrees of integration: a free-trade area (FTA), a customs union, a common market, an economic union, and a complete

<sup>1</sup> Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, Sweden, United Kingdom.

<sup>2</sup> Bulgaria, Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Romania, Slovakia, Slovenia.



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economic integration. The EU has been selected as the only example of economic integration having gone through the various stages up to an economic union thanks to combination of founding treaty that spelled out these various stages (at least from FTA to a common market); a set of common institutions in charge in overseeing the process of integration; and a set of common policies [2]. The research on the common market, transition issues, the Economic and Monetary Union (EMU) and EU enlargement are illustrative that the integration goes in line with the political developments, and is very much a response to the signals emitted by the political centres and actors. According to that an important issues are the degree of structural asymmetries between the members of an integration arrangement; and impact of the agreement on economic development. In several research, the integration processes built on asymmetric groups where a leading country/countries perceives enough benefits to justify the provision of the collective good (the integration agreement) has been expected to be the more dynamic and effective ones. In other research it has been assumed that the basic pre-condition to start a stronger regional integration process is a stronger domestic development experienced by each country in the region combined with the political and social willingness of the majority of the members to build the trade block. And there should not be large margin of difference in the domestic development (political, social, economic and technological) among its members [5].

In respect of the second approach Estrada [6] proposes a multi-dimensional regional integration evaluation (RIE) methodology. The central idea behind the RIE methodology is that regional development promotes regional integration. Mohl and Hagen [7] evaluated the growth effects of European structural funds payments at the regional level. Using a spatial panel approach they have found that regional spillovers do have a significant impact on the regional growth rates. This finding confirms the importance of regional interconnectivity implying that the growth performance of western European regions (OMS) also depends on the GDP growth rate in the neighbouring regions (NMS). Lombaerde and Langenhove [8] have proposed the methodology for System of indicators of regional integration (SIRI) with the particular attention to the translation of the chosen variables into indicators, the structuring of variables and analysing them. Due to multidimensional character, the variables could be organised according to disciplinary fields (political, social, cultural, economic, etc.), and/or policy areas (trade, investment, migration, competition, agriculture, industry, infrastructure, legal cooperation, etc.). The latter is the traditional sectoral approach to integration. A third way of classifying the variables consists of a classification on a functional basis, like in the input-output approach. Integration is then implicitly seen as a process where some variables act as inputs, some as outputs, while others characterise the process. Structural characteristics of the integrating area, asymmetries, capacities to integrate, commitments, governance structure etc., can be considered as inputs. A special category of inputs could be called preconditions for integration. Policy implementation, effects on flows, effects on growth, etc., could be considered as outputs. The advantage of functional classification is the emphasis on the output or the effects of integration. To consider the parallel but interconnected processes of institutional and political economic regional integration also has been proposed by Lombaerde and Langenhove [8].

## 2. Methodology

The SIRI methodology initially proposed by Lombaerde and Langenhove [8] and described in above section has been selected and adapted to be applied for this study.



The method used is quantitative comparative analysis of indicators defined for measurement of regional integration progress and related to policy and economic dimensions. Qualitative assessment of policy framework defined by CAP with respect of competition conditions will be done as well. The economic indicators are related to productivity and trade. The policy indicators show the level of direct support and are analysed in line with current CAP and reform proposals for period 2014-2020. The last ones make strong further consequences for countries' competitiveness in the EU common market. Organization of variables translated into indicators according to SIRI methodology is structured in Table 1.

Table 1

### Organization of variables for comparative analysis of regional integration

Classification of variables according to			Indicators
Disciplinary field	Functional base	Policy area	
Policy	Inputs	Agriculture	Direct support
			Rural development support
Economics	Outputs	Competition	Labour productivity
			Land productivity
		Trade	Net trade of agro-food with EU27
			Net trade of agro-food with countries other than EU27

Source: authors' classification based on SIRI [8] methodology

Eurostat and European Commission (EC) data will be used as informative base for estimation of indicators where results will be obtained in aggregated form for OMS and NMS.

### 3. The EU Policy Framework for Agribusiness

The evolution of the EU is by moving from a FTA to an Economic and Monetary Union, and by expanding from 6 members at the start to 27 members today. The EU enlargement especially in 2004 and 2007, when the poorer countries of Central and Eastern Europe joined the EU, has increased both economic and political diversity between members, and the issue of economic convergence became of increased importance. The various policies were put in place in order to foster economic convergence, and thereby to help an increasingly heterogeneous EU to function relatively smoothly. There has been set a portfolio of internal policies and programmes rather than one single encompassing policy that should contribute either directly or indirectly to a deepening of regional integration – competition and industrial policy, regional policy (in the Structural and Cohesion Funds), agriculture and fisheries, social and environmental policies [9].

Unfortunately the policies don't serve the base for equal competition [10]. Unequal support level for producers in the EU Member States is one of the reasons which determine unequal competition conditions on the market. And the problem inducing the writing of this



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article is not so smooth functioning regarding agricultural policy and it's outcomes considering the grouping of countries as OMS and NMS. The current CAP has been implemented through two pillars. The 1st Pillar provides market and direct support. The 2nd Pillar provides support for rural development in the form of modernization of agricultural production, maintenance of environment and diversification of economic activity in rural areas. The Fischler reform in 2003 changed the form of CAP direct income support by introducing decoupled single payment scheme, though it largely preserved the scope and distribution of funds across Member States and types of agricultural holdings [11].

Table 2

### Economic and policy indicators in 2010 and potential level of EU funding in 2020 in EU15 and EU12

Indicators		EU15	EU12
UAA eligible for direct payments, thsd. ha	(1)	117 612	43 455
Agricultural labour, thsd.	(2)	4 420	4 941
Direct support in 2010, thsd. EUR	(3)	35 924 122	5 641 493
Rural development support in 2010, thsd. EUR	(4)	16 873 708*	6 926 097*
Potential funding for 1st Pillar in 2020, thsd. EUR	(5)	33 316 078	9 464 201
Potential funding for 2nd Pillar in 2020, thsd. EUR	(6)	16 873 708	6 926 097
GVA in actual prices in agriculture, mio EUR	(7)	123 123.7	20 685.9
Labour productivity in agriculture as GVA per person, EUR/person	(8)	27 856	4 187
Land productivity in agriculture as GVA per area, EUR/ha	(9)	1047	476
Direct support, EUR/ha	(10)	305	130
Rural development support, EUR/ha	(11)	143	159
Net trade of food, drinks, tobacco with EU27, mio EUR	(12)	5833	-2633
Net trade of food, drinks, tobacco with other countries than EU27, mio EUR	(13)	-7341	2976

\* including EAFRD and national funding, average per year of period 2007-2013

Source: Eurostat; IACS statistics of EU Member States; EC [1]; authors' calculations

In the current form CAP became contradictory as the EU tax-payers have to pay also higher prices for food products as the market support measures financed by budgetary means are in place. Another contradictory element is direct support for agricultural production becoming a reason for farmers to apply for export subsidies after that. Furthermore, the high costs of decoupled single payment scheme do not ensure equal benefits neither on Member state, or certain farm level. The difference between average level of direct support per ha in OMS and NMS in 2010 is almost two times. As well as allowed national co-financing level for rural development programmes is 50% on average in OMS and 29% in NMS. Those issues could explain the slow progress of regional integration within the EU common market where observed policy asymmetries would lead to economic development asymmetries.



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The EU budget is the main instrument for reaching the EU policy goals. And, however, the states should be powerful actors in shaping the rules of competition in markets [12]; the facts are that countries' payments based on gross national income (GNI) make around 70% of overall budgetary resources while the budgetary spending for agriculture uses around 40% of the total budget. That explains exacerbated attention of Member States to financing, spending and re-distribution aspects regarding the EU budget for next planning period 2014-2020. The proposed sharing of support doesn't make sufficient step to improvement of competition conditions (see Table 2, indicators (5), (6)).

#### 4. OMS and NMS: Comparing the Integration in the EU Common Market

The motivation of countries for making regions are mostly based on expectations how efficient it may function, what will be the impact on economic growth for members and at what extent will be a convergence of economic performance between participating countries. Regional integration in fact is the degree at what those expectation are fulfilled. That can also affect the sustainability of regions and its' further development by building blocks. The following indicators have been defined for measurement of regional integration progress related to policy and economic dimensions. The economic indicators are related to productivity and trade issues: the productivity levels in OMS and NMS reflecting how country blocks would capture the possible fluctuations in product and factor prices; trade balance for food, drinks and tobacco reflecting the dominance and its tendencies of country groups in extra and intra EU market. The last ones make strong further consequences for countries position in the EU common market as well as can show the future potential of agricultural industry in case of trade liberalization according to WTO Doha round development.

##### *OMS and NMS: comparing productivity in agribusiness*

Productivity of production factors is very important to succeed in any market. At the same time it can be compared for different groups of countries in order to find out, is there the case of equal economic development having the good pre-condition to perform a successful integration. Agricultural land and labour productivity show that there has not been observed any convergence in productivity levels for OMS and NMS despite the application of rural development policy which besides environmental and economy diversification goals should enhance competitiveness of agriculture as well. Land productivity in NMS in 2010 is still around twice lower, while labour productivity is more than six times lower than in OMS (see Table 2, indicators (8), (9)).

##### *OMS and NMS: comparing an extra and intra EU trade*

Intra-regional trade has become more prominent following the increase in regional integration agreements not only in the EU, but also in other major areas (NAFTA, ASEAN and MERCOSUR). Nevertheless the share of intra-regional trade in world trade (which also depends on the number of member countries and the trade size of the region) has not grown significantly in recent years [13]. Trade balance for food, drinks and tobacco show that up to 2010 external trade has remained stable and negative for OMS. At the same time joining to the EU has provided the benefits for NMS growing their exporting capacity outside the EU. The opposite situation can be observed in terms of intra trade within the EU. OMS has stable and positive balance; while NMS balance in EU common market is negative (see Table 2, indicators (12),



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(13)) which partially can be explained by different market conditions provided by CAP. That shows that NMS are tended to build up a block of exporting countries while the OMS remain net external importers of food products.

These two opposite tendencies with higher/lower subsidies level together with extra/intra EU trade flows show more the regionalisation process within the EU rather than integration. That reflects also the different directions in institutional and Member states views on further policy development which could influence the regional integration within the EU common market. Nevertheless the policy program making should provide fair conditions for all the countries in order to make countries capable and willing to promote and perform integration process which could contribute to better development of the entire EU.

## Conclusions

1. There are two contiguous aspects – the regionalism and regional integration. Regionalism can be considered mostly as expectations regarding efficiency of functioning of the regions created, regarding economic development or impact on economic growth for members and regarding convergence of economic performance. In case that these expectations are satisfied, it result in regional integration and might lead to sustainability of regions and/or creating new regional blocks inside the existing regions.
2. SIRI methodology selected and adapted to be applied for this study takes into account the multidimensional character of regional integration where particular attention has been paid to the translation of variables into indicators, the structuring of variables and analysing them. The variables were organised according to economic and policy disciplinary fields and classified on input-output functional basis and agriculture, competition and trade policy areas. Indicators for measurement of regional integration progress have been selected the following:
  - a. policy indicators reflecting the level of direct and rural development support;
  - b. economic indicators reflecting productivity and trade level.
3. The hypothesis, that different level of productivity combined with the different CAP conditions for OMS and NMS hinder the regional integration process in the EU common market, can be approved by both, the theoretical and empirical evaluation.
  - a. one of the basic pre-conditions for regional integration – the stronger domestic development of each country in the region, and a small margin of difference in the domestic development among its members for OMS and NMS has not been fulfilled;
  - b. the policy framework and particularly the CAP can be characterised as providing unfair competition conditions for agribusiness in EU common market;
  - c. the empirical assessment of support, productivity and trade variables show the development asymmetries in both – policy and economics trends related to agribusiness and show more the regionalism process within the EU rather than integration.

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