Competitiveness and Employment

A Framework for Rural Development in Poland

Garry Christensen
Richard Lacroix
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Richard Lacroix

The World Bank
Washington, D.C.
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FOREWORD

The rural sector in what are now transition economies was, and often still is, overly reliant on agriculture for the support and welfare of its population. Under the policies of socialist economic management, agriculture received a disproportionate amount of resources while potentially viable non-agricultural activities were constrained by regulatory impediments and centralized investment decisions. Among the challenges of transition in rural sectors, therefore, are the tasks of easing the exit of resources from agriculture and awakening dormant economic opportunities in the rural non-farm sector. A comparison between the economic structures of typical western rural environments and those in the transition economies makes it likely that manifold economic opportunities do indeed exist.

For a long time agricultural and rural development have been seen as, at best, parallel activities, at worst as distinct. This separatism was reinforced, if not caused, by the conviction that excess rural labor had to be absorbed in industrial and service sectors which by their nature were regarded as predominantly urban. The modest rate of development of employment in these urban sectors, indeed often their temporary decline, in most of the transition economies has led to a new emphasis on rural, including off-farm, activities as a means to absorb the labor shed by a transforming agriculture sector. Current developmental policies emphasize a combination of measures to improve the efficiency of the traditional agriculture sector, and at the same time to promote rural entrepreneurship.

The situation in rural Poland, described and analyzed in this paper, has important lessons with respect to rural development that go beyond the country. These lessons have an added urgency because of Poland's application for early membership of the European Union. It is argued here that a potentially effective development strategy should combine the traditional measures to foster agriculture's growth and competitiveness with measures to improve the operational environment for rural entrepreneurs. The latter focuses on physical infrastructure and human development. Policy makers interested in the totality of rural development will have in this study an empirical analysis and specific policy recommendations for potentially effective action.

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ABSTRACT

It is generally accepted, both within Poland and abroad, that structural transformation, modernization and increased market efficiency are key to increase competitiveness and raise farm incomes in a country's rural sector. Parallel investments in physical infrastructure and human capital as the means to stimulate rural, non-farm, development and reduce unemployment and poverty would allow to reap the fruits of these policy and institutional changes. But while the objectives of agricultural policy in Poland are broadly appropriate, many of the means being used to achieve these objectives are not. Five years after reform began key structural problems in the sector remain deeply entrenched. Factor and commodity markets are weak, distorted and inefficient; the size distribution of small-scale private farms has changed little; the competitiveness of farm production has yet to improve; farm incomes remain low; and rural development has yet to make a substantial impact on rural unemployment and poverty.

There is also a need to shift the emphasis of current policy from social issues to initiatives which lead to an increase in competitiveness. While the emphasis on social issues is typical of agricultural policy in western Europe, these countries have the wealth to realize a largely social agenda while Poland does not. In order for the sector to grow and create this wealth Poland will first have to achieve a significant increase in the competitiveness of agriculture. Increased competitiveness is thus a sine qua non for realizing the social objectives of agriculture policy.

Despite the need for policy change, broad-based rural development remains the most appropriate framework for agricultural policy. Rural sector growth is stronger and more widely shared when the traditional focus of agriculture policy is broadened to include the incomes and welfare of all rural people. This is particularly relevant to Poland where excess labor is a major source of low productivity and infrastructure is weak.

Negotiations for EU Accession are likely to begin in 1998. Subsequent entry will follow between 2002 and 2005, bringing huge attendant costs and benefits. The agriculture and food processing sectors face particular problems because of the wide disparity in structure and efficiency compared with equivalent sectors in the EU. Elimination of the protective barriers between Poland and the rest of the EU will thus expose Polish farmers and food processors to more intense competition than they are accustomed. To date, preparation for accession has focused on the alignment of price and trade policy with consensus finally emerging on the following issues: that CAP support prices will probably fall towards the level of current Polish support prices, obviating the need for any major increase in support prices and any post-transition adjustment period; that direct income support will be the principal form of intervention; and that it will be based on environmental services rather than compensation payments. While EU Accession has rightly been given a high profile, some fundamental issues have been neglected by the pre-occupation with aligning price policy. The lack of emphasis on policies and measures to increase efficiency and competitiveness is of particular concern. The alignment of subsidy policies and the associated role of state agencies has also been overlooked, even though these changes may ultimately prove more demanding.
ACKNOWLEDGMENTS

This paper is the synthesis of Economic Sector Work to which substantial contributions have been made by: Tadeusz Hunek, Glenn Pederson, Mariusz Safin, Stefan Tangermann and Alberto Valdes. Comments and suggestions that are gratefully acknowledged were received from Karen Brooks, Timothy Josling and John Nash. Richard Huber prepared the final manuscript.
Acronyms and Abbreviations

ABC Poland  Agro-Business Consulting Poland Ltd.
APA      Agricultural Property Agency
ARMA     Agricultural Reconstruction and Modernization Agency
ARR      Agricultural Marketing Agency
ASAL     Agricultural Structural Adjustment Loan
AVIS     EU Questionnaire for Prospective New Members
BGZ      Bank for Food Economy
CAP      Common Agriculture Policy
CBOT     Chicago Board of Trade
CCC      Commodity Credit Corporation
CEFTA    Central European Free Trade Area
CEM      Country Economic Memorandum
CSE      Consumer Subsidy Equivalent
CV       Curriculum Vitae
ECU      European Currency Unit
EFTA     European Free Trade Association
EU       European Union
FRiOR    Debt Rescheduling Fund (predecessor of ARMA)
FSSF     Farmers' Social Security Fund
FSU      Former Soviet Union
GDP      Gross Domestic Product
GOP      Government of Poland
GTZ      Gemeinschaft für Technische Zusammenarbeit
GUS      Polish Statistical Office
ha       hectare
KRUS     Polish Social Security Agency
LCE      London Commodity Exchange
MAFE     Ministry of Agriculture and Food Economy
NBP      National Bank of Poland
NPC      Nominal Protection Coefficient
ODA      Overseas Development Agency
OECD     Organization for Economic Cooperation & Development
PARR     Polish Agency for Regional Development
PLN      New Polish Zloty
PSE      Producer Subsidy Equivalent
PZZ      (former) State Cereals Monopoly
SITC     Standard Industrial Trade Classification
SME      Small and Medium Enterprises
SMP      Standard Milk Powder
SOE      State Owned Enterprise
STRUDER Structural Development in Selected Regions (EU)
USAID    United States Agency for International Development
WB       World Bank
WTO      World Trade Organization
1. INTRODUCTION

There is broad support for the basic economic and social objectives which motivate Poland’s agriculture policy, both within Poland and from the international community. Structural transformation, modernization and increased market efficiency are viewed as the means to increase competitiveness and raise farm incomes; with parallel investments in physical infrastructure and human capital as the means to stimulate rural (non-farm) development and reduce unemployment and poverty.

However slow progress raises questions about the policy instruments and programs which are being used to achieve these objectives. After five years of change and reform, growth in agricultural productivity is minimal, rural unemployment is increasing, and rural employment has fallen. A more effective basis for implementing the policy agenda is needed, a call given further urgency by the prospect of accession to the European Union (EU) after 2002.

The ensuing review begins by examining the issues which the agriculture sector faces, both now and in the future. These issues are examined within the context of rural development, which is considered the most appropriate framework for locating agricultural policy. Current policy is then critically reviewed in chapters three and four, with an emphasis on discerning the relative importance of social versus economic policy objectives and the efficacy of the policy instruments and programs being used to achieve these objectives. Numerous modifications to current policy are proposed in chapter five, as the basis for attaining the broad policy objectives more rapidly and effectively. These modifications include a greater emphasis on measures to improve efficiency and competitiveness, particularly in commodity and rural financial markets; together with a re-allocation of resources from direct farm support to rural development and more effective use of these and future resources in the context of regional development.

The policy framework proposed differs from existing policy in terms of emphasis and timing rather than in proposing a new set of policy objectives. As noted initially the underlying objectives of agriculture policy remain valid. Some significant changes are required nevertheless, particularly in the role played by key institutions such as the ARR, APA and ARMA and in the policies and programs which they implement. Market forces must be given greater scope to shape the structure of agriculture, and state intervention reduced. An increase in the competitiveness of Polish agriculture is unlikely to occur without such changes, and without an increase in competitiveness the rural sector will find it increasingly difficult to prosper.
2. RURAL DEVELOPMENT: CONTEXT AND FOCUS

The Need for Broad Based Rural Development

There are strong conceptual grounds for locating agriculture policy within the general framework of rural development. Poverty reduction, food security and sustainable natural resource management are more readily attainable when rural well-being in general and a prosperous small-holder agriculture in particular are nurtured and improved. And rural sector growth is stronger and more widely shared when the traditional focus of agriculture policy on measures to increase farm productivity and profits is broadened to include measures which improve the incomes and welfare of all rural people.

Key characteristics of Polish agriculture render these general principles especially relevant to Polish agricultural policy:

- **The Structure of Agriculture:** The small scale private farms which dominate the sector allocate their resources between farm and non-farm activities, and rely heavily on non-farm incomes for their current livelihoods. As these farms are also characterized by excess labor, they will need to transfer even more labor to non-farm activities in the future in order to increase productivity and competitiveness. This more efficient allocation of resources is contingent on changes in the structure and management of both farm and non-farm enterprises.

- **Lack of Public Goods:** Significant investments in physical and institutional infrastructure are needed to address the marked current lack of public goods. But if they are to be productive, these investments will require balanced consideration of the interests of both farm and non-farm people.

- **Rural Poverty:** Although poverty is concentrated in rural areas, it is more pronounced among the non-farm elements of the rural population. It is also uniformly shallow across regions and socio-economic groups. For these reasons poverty reduction is most likely to be effective if based on policies which promote broad based rural growth.

- **Rural Unemployment:** Non-farm rural employment creation must respond to both high unemployment among non-farm elements of the rural population and the high underemployment among farmers.

Broad-based rural development also enhances the competitiveness of farming. Rural sector initiatives which increase non-farm rural employment allow farmers to
reduce labor use and so raise farm productivity. They also improve access to farm services, and raise domestic demand for farm products by boosting rural incomes. And investments in better roads, communications and energy supply improve market efficiency and lower transaction costs.

By responding to both economic and social policy objectives, rural development provides a cogent framework for Poland’s agricultural policy.

It is useful to examine some of these issues further. Consider farm structure first. As most farms are too small to be viable economic units (average farm size 6.7 ha), Poland’s farmers depend heavily on non-farm income for their livelihood. Agriculture is the dominant source of income for only 29 percent of village households and 40 percent of the rural population; with non-agriculture activities as the main source of income for 30 percent of village households, and welfare payments as the main source of income for the rest (Hunek 1996). Policies which focus only on farm incomes are thus not the best approach to raising overall household income and so the capacity to invest in agriculture.

The high level of excess farm labor in Polish agriculture is widely acknowledged. At 26.5 percent, agriculture’s share in employment is very high in both absolute terms and relative to its contribution to GDP, a problem which has been exacerbated by agriculture’s continuing role as an informal safety net during the process of reform. In part, this is due to the fact that approximately two-thirds of the four million employed in agriculture do not get their main source of income from farming. But even for the 1.4 million people for whom farming is the main source of income, labor productivity is much lower than in most EU countries.

Any significant transfer of labor out of farming will require widespread job creation in the non-farm rural sector, on a scale sufficient to absorb not only excess farm labor, but also the unemployment which pervades the non-farm rural sector. Of the 43 percent of registered unemployed living in rural areas (1,257,000 people in 1995) only 40 percent are farmers (453,000 people)¹. (AVIS 1996, Vol I, p. 192). Urban-rural migration is unlikely to contribute much to this process given the historically low mobility of the Polish people and the fact that unemployment rates are even higher in urban areas. Agriculture policy must thus emphasize and encompass rural non-farm employment creation as a means to increase farm competitiveness and rural well-being in general.

The need to reduce rural poverty also predisposes to a policy framework based on rural development. First, although 60 percent of Poland’s poor live in rural areas, only one third of the rural poor are directly linked to farming. For these poor farmers low incomes rather than unemployment are the most frequent source of poverty. Unemployment is the most widely observed source of poverty among rural workers, pension earners and welfare recipients. Second, poverty is uniformly shallow across these

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¹ A further 450,000 agricultural workers are considered to be underemployed in that they are working part-time or are totally redundant.
socio-economic groups and across regions, with a poverty gap\(^2\) from 10 to 18 percent. (Poverty incidence is slightly higher in the southeast and central-west regions). Both sets of factors are consistent with broad-based rural development directed towards economic growth as the basis for poverty reduction, with special emphasis on measures to raise farm productivity and increase rural employment.

Finally, although the justification for using this approach is strong, its application will require careful project conception and implementation. The top down philosophy of “Integrated Rural Development” which failed so widely in the past must be replaced by programs which emphasize consensus building and high levels of local participation to enhance project ownership and commitment. Investments in infrastructure should be directed to improving the environment for private sector activity; and be linked to programs which develop human capital, and policies which promote private ownership and enterprise. This approach promotes growth in rural economies and the creation of employment.

**Sector Issues**

**Weak Productivity Growth**

Despite significant reform within the agriculture sector there has been minimal growth in productivity, with agriculture’s contribution to GDP still very low relative to its share of the labor force (Table 1). In addition, agriculture output in 1995 was from 6 to 7 percent less than in 1990, even with a good harvest\(^3\), and preliminary estimates indicate that it fell by a further 2.5 percent in 1996 and could fall again in 1997.

Of these two trends, low productivity is the major issue rather than declining production. The sector’s current contraction is due to the fall in domestic demand which followed early price and trade policy reforms, and to the restructuring which inevitably follows a major, economy-wide change in incentives. Even allowing for a recovery of domestic demand and trade, agriculture will inevitably become a smaller part of the economy. But once a more appropriate level of output has been established there is no reason that the sector cannot then begin to grow again at rates commensurate with other sectors of the economy.

The sector’s low current productivity is thus the key issue, as it determines the capacity for growth irrespective of the future size of the sector. On average, land productivity is about one third of land productivity in the EU-12, and labor productivity about one-tenth. Available evidence suggests that there has been limited progress in raising productivity, with static labor output and a modest increase in the factor ratio for labor and land (Table 2). And even with this increase, the 1995 labor/land ratio of 0.20

\(^2\) The percentage by which the average income of the poor falls below the poverty line.

\(^3\) The growth observed in 1993 and 1995 is largely due to a recovery of production following poor harvests in 1992 and 1994.
remains significantly above the ratio of 0.06 for the EU-12 (EU 1995). Note also that rural unemployment in 1995 was 12.2 percent, up from 10.2 percent in 1992 (Pederson 1996), indicating that this increase in efficiency has not been achieved by creating new employment.

Table 1. Indicators of Agriculture Performance (1990-95)

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<tr>
<td>Agriculture GDP</td>
<td></td>
<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>PLN (1990 prices)a</td>
<td>4,627.8</td>
<td>4,700.1</td>
<td>4,253.9</td>
<td>4,551.7</td>
<td>3,864.4</td>
<td>4,324.2</td>
</tr>
<tr>
<td>% Change</td>
<td>-3.9</td>
<td>1.6</td>
<td>-9.5</td>
<td>7.0</td>
<td>-15.1</td>
<td>11.9</td>
</tr>
<tr>
<td>As % of Total GDPb</td>
<td>7.1</td>
<td>6.2</td>
<td>6.7</td>
<td>6.6</td>
<td>6.2</td>
<td>6.6</td>
</tr>
<tr>
<td>Agriculture Employment</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Number Employedc</td>
<td>4.4</td>
<td>4.3</td>
<td>4.0</td>
<td>3.9</td>
<td>4.0</td>
<td>4.0</td>
</tr>
<tr>
<td>% of Labor Forceb</td>
<td>28.0</td>
<td>26.0</td>
<td>26.2</td>
<td>26.1</td>
<td>26.6</td>
<td>26.5</td>
</tr>
<tr>
<td>Investment in Agriculturec</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(PLN 1994 prices)</td>
<td>2,640</td>
<td>1,383</td>
<td>965</td>
<td>892</td>
<td>945</td>
<td>n.a.</td>
</tr>
<tr>
<td>Average Farm Sizeb</td>
<td>6.3</td>
<td>6.3</td>
<td>6.3</td>
<td>6.2</td>
<td>6.7</td>
<td>6.7</td>
</tr>
<tr>
<td>PSEb</td>
<td>-20</td>
<td>6</td>
<td>14</td>
<td>16</td>
<td>21</td>
<td>n.a.</td>
</tr>
<tr>
<td>Share of Importsb</td>
<td>7.0</td>
<td>4.4</td>
<td>11.3</td>
<td>11.2</td>
<td>10.3</td>
<td>9.6</td>
</tr>
<tr>
<td>Share of Exportsb</td>
<td>11.1</td>
<td>7.9</td>
<td>13.5</td>
<td>11.1</td>
<td>11.6</td>
<td>9.3</td>
</tr>
</tbody>
</table>

Source: a - World Bank, 1996. Agriculture, Forestry and Hunting; b - OECD, 1996 (refers to all farms, state and private); c - Pederson, 1996

Table 2. Indicators of Agriculture Productivity (1990-95)

<table>
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<tbody>
<tr>
<td>Output/Agricultural Worker</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>PLN (1990 prices)a</td>
<td>1,051.8</td>
<td>1,093.</td>
<td>1,063.</td>
<td>1,167.1</td>
<td>966.1</td>
<td>1,081.1</td>
</tr>
<tr>
<td>Agricultural Labor/Hectareb</td>
<td>n.a.</td>
<td>n.a.</td>
<td>0.26</td>
<td>0.24</td>
<td>0.22</td>
<td>0.20</td>
</tr>
</tbody>
</table>

Source: a - OECD, 1996; b - Pederson, 1996.
These trends indicate that the sector has yet to adjust to the new incentive structure created by changes of price and trade policy early in the reform process, and to the parallel reduction in public support for agriculture. A combination of low farm profitability, structural problems and inappropriate policy has constrained investment and impeded this adjustment, limiting much needed increases in competitiveness and efficiency. It is useful to consider these factors further.

The immediate impact of price and trade policy reform was a dramatic fall in the terms of trade for agriculture (ratio of output to input prices), a fall which continues to impair farm profitability and so the capacity to finance investment in more efficient farming systems and technology. Among the small-scale private farms which account for more than 95 percent of the value of agricultural output (OECD 1996), 70 percent are unprofitable. A further 20 percent are profitable and seeking to adjust, but are not making any new investments in new technology; leaving only 10 percent which are both profitable and actively investing in their farms. Thus, at the most, only 30 percent of private farms are responding to the opportunities created by the new incentive structure, and attempting to increase farm efficiency.

State farms have suffered even more in the aftermath of policy reform. Their large size (average 1800 ha) and high consequent share of farm subsidies, and their greater reliance on capital intensive inputs rendered them especially vulnerable to the cost-price squeeze which followed price and trade policy reform and to the cut in farm subsidies. As a result the state farm sector and most individual state farms have run at a loss since 1991 (Van Zyl, Parker et al 1995, p. 16). But unlike private farms which have other non-farm sources of income to offset their losses, state farms have been obliged to carry these losses in the form of higher indebtedness. The financial burden imposed by this accumulated debt (which averages half the value of all state farm assets) has further reduced farm profitability.

Deep-seated structural constraints, associated with poorly functioning factor markets, have also limited the ability of farmers to alter their resource base in response to new incentives. Of these problems the difficulty of shedding excess farm labor, as discussed above, is perhaps the most visible obstacle to increased farm efficiency. The rural labor market is further constrained by the imbalance between farmers and people in the agriculture service sector. Only one person is employed in the farm service sector for every four farmers, whereas in western Europe this ratio is reversed.

Rural financial markets are characterized by a low level of rural financial intermediation, the lack of a single financial market, and high levels of state intervention effected through subsidized credit and the monopoly powers of the state owned agriculture bank, BGZ. Commercial banks are crowded out of rural financial markets by the administrative allocation of preferential credit, as farmers have little inclination to borrow at the real interest rates which otherwise prevail (9 to 10 percent). The limited

\[\text{Seventy percent of the agro-processing and marketing enterprises which were part of many state farms have been separated and privatized, leaving only the core farming activities.}\]
consequent flow of credit, together with low farm profitability, has led to low and declining levels of investment. A 1993 survey of private farmers found that only 7 percent had received investment loans, and 82 percent of farmers reported using no debt in the 1994 agriculture census (Pederson 1996). Real investment in 1994 was one third of investment in 1990 (Table 1).

Despite a recent increase in activity, an active land market has also been slow to emerge, reducing the opportunities for private farmers to consolidate and expand their small, fragmented holdings. An estimated 248,500 hectares were sold in 1995 (ABC Poland 1997), which is only 1.3 percent of total agricultural land. Farm structure has changed little and average farm size has increased by only 6 percent since 1990 (Table 1), despite incentives to older farmers to sell their land in return for pension benefits, increased access to highly subsidized credit, and a small program to encourage land consolidation. The market for land rentals is also growing (12 percent of all rural land in 1995), but much of this increase is due to the lease of former state-owned land. Further increases in the level of activity on both land sales and rental markets is essential but is constrained by cumbersome administrative procedures and a lack of private sector real estate agents with the knowledge to improve the efficiency of land transactions.

In many cases the policy response to these constraints has become part of the problem rather than part of the solution:

- a heavy reliance on subsidized credit to stimulate investment and land purchase has inevitably led to unfair credit rationing and distorted investment incentives. These measures also reduce the ability and incentives for commercial banks to participate in rural financial markets, further weakening rural financial markets.

- initiatives to reduce poverty and unemployment have relied largely on transfer payments, measures which limit the incentive to move from being a welfare beneficiary to a wage or income earner; and on subsidized credit for investment in rural enterprises, which creates a misleading impression of the viability of new investment. Cash unemployment benefits cost the country 1.9 percent of GDP in 1993, while spending on active labor market policies was only 0.22 percent of GDP (WB Policy and Program Note 1997).

- a deliberate policy to privatize the majority of state farm land through leasing rather than sale, and to dispose of this land in large blocks has reduced the efficiency with which this 4.5 million ha (22 percent of all arable land) is being used.

- finally, there has been a gradual post-reform increase in the overall level of support for agriculture, as measured by the sector-wide producer subsidy equivalent (PSE). High levels of public intervention in key commodity markets and growing levels of import protection are testimony to this trend, which discourages private sector activity, reduces the incentives to increase
efficiency, and discourages a shift to production based on national and regional comparative advantage.

These policies respond to the symptoms of the problems described above, rather than the problems themselves. They also facilitate delays in state farm privatization, land market development, rural finance and interest rate policy reform, and private sector involvement in commodity markets; which have been identified as the basis for increasing competitiveness. This agenda is still valid and must still be implemented, and with EU accession likely to begin in 2002 it must be implemented sooner rather than later. Five years is not a long time to prepare for the increased competition which will come from EU countries. The agriculture sector is already struggling to retain its share of exports and to compete with imports, in spite of increasing protection (Table 1). A more competitive agriculture sector also improves the capacity to expand exports to the FSU, and so the chance to contribute to the export led growth which has characterized Poland’s post-reform economic success.

### Accession to the European Union

Poland’s application for membership of the EU was submitted in 1994, negotiations are likely to begin in 1998 and entry will probably follow between 2002 and 2005. Entry to the EU will bring many problems and opportunities, with huge attendant costs and benefits. A full extension of the current CAP would incur fiscal costs from US$3 to US$5 billion per year and food costs would increase by 30 percent (WB Policy and Program Note 1997). Potential receipts are estimated at 1500-2500 million ECU per year from the CAP in direct support for agriculture, and a further 1000-1500 million ECU per year from the EU’s Structural Fund for regional development (Haynes 1996). Given the magnitude of these potential costs and benefits, the development of an appropriate accession strategy has, not surprisingly, become an overriding influence on agriculture policy.

The agriculture and food processing sectors face particular problems because of the great differences in structure and efficiency as compared with equivalent sectors in the EU. Elimination of the protective barriers between Poland and the rest of the EU will expose Polish farmers and food processors to more intense competition than they have hitherto experienced, which could result in both a period of sustained low incomes and major structural change involving increases in unemployment. (This increase in competition is already happening to some extent. The EU now accounts for more than 50 percent of Poland’s food and agriculture imports, most of which benefit from lower import tariffs negotiated under a 1991 Association Agreement). Adaptation to new policy instruments, to new price levels and to different legal requirements regarding the production and marketing of food will also place stress on both the market and administrative systems.

Balanced against these potential costs of accession are an impressive array of potential benefits, the most obvious being the direct transfers to agriculture from the CAP and the EU Structural Funds. Provided they can improve their competitiveness, Polish
farmers and food processors will also have access to a huge new market for their products. Note however that competition for this market will be very intense as it will come from the other Visegrad countries engaged in the current accession process, as well as existing members of the EU.

To date, preparation of the accession strategy has focused on the alignment of price and trade policy, an exercise of considerable conjecture given the uncertainty as to the form which the CAP will take in the period leading up to accession. Consensus within and outside the Polish government is now beginning to emerge on key aspects of alignment, notably that CAP support prices will probably fall towards the level of current Polish support prices, obviating the need for any major increase in support prices and any post-transition adjustment period; that direct income support will be the principal form of intervention; and that it will be based on environmental services rather than compensation payments. Based on these lower projected levels of CAP price support, economic simulation models suggest that alignment is best left until immediately prior to accession, and that policies which emphasize increased efficiency and competitiveness are the optimal basis for maximizing the benefits and minimizing the costs of accession. Significantly, this "efficiency-based" strategy also leads to the highest rate of growth in non-farm rural employment.

EU accession strategy has also begun to address the need for institutional alignment. All new legislation is now drafted to comply with EU requirements and a program to review and modify existing legislation will be completed by the end of 1998. Product standards and health and hygiene regulations will also be fully aligned by this date. The major institutional changes left to make reside with the role and functions of the public agencies responsible for implementing agriculture policy.

The Polish government is also considering how best to use the EU Structural Funds. To this end it has substantially raised the profile of regional development in national and agricultural policy, as this is the focus for support from the EU's Structural Funds. As a consequence, regional development will become the umbrella for channeling support to rural development. Careful planning is needed in developing programs and policies for rural development however, as EU Structural Funds cannot be used for existing programs, only for new initiatives. Poland will thus either need to find extra resources for the programs supported by EU Structural Funds, or negotiate special conditions for the use of Structural Funds during the accession process.

While EU accession has rightly been given a very high profile, some fundamental issues have been neglected by the pre-occupation with aligning price and trade policy. The lack of emphasis on policies and measures to increase efficiency and competitiveness is of particular concern. Indeed initial "alignment measures" in 1994 were based on introduction of the CAP measures which prevailed prior to the McSharry reforms. The result was an increase in the level of support for agriculture, and increased levels of public intervention in commodity markets. These adverse changes, plus the slow pace of land privatization and financial sector reform have greatly slowed attempts to improve the
efficiency of factor and commodity markets, so reducing the means and the incentive to increase competitiveness.

A tendency to pursue rural development by promoting particular types of rural enterprise is equally misconstrued. Rural development should be directed to creating the general conditions for economic activity to develop, so allowing rural entrepreneurs to choose the activities which warrant investment.

The need to give competitiveness a much higher priority on the policy agenda cannot be over-emphasized, irrespective of whether Poland accedes to the EU or not. Without an increase in competitiveness the sector will continue to decline; with an increase in competitiveness the sector will benefit fully from the recovery of domestic demand and the growth of export opportunities. Accession to the EU will simply accelerate whichever one of these two scenarios eventually prevails. The need for broad-based rural development, with or without EU accession, is equally important. But the resources available for rural development will be markedly increased by access to EU Structural Funds so enhancing the scope for non-farm employment creation through investment in infrastructure, training and support for rural enterprise.
3. CURRENT POLICY: OBJECTIVES, INSTRUMENTS AND OUTCOMES

Policy Objectives for the Agricultural Sector

Explicit policy objectives, as presented in recent GOP submissions to the EU, are as follows:

"(1) To ensure food supplies of appropriate quality to the population, adjusting them according to the changing income situation.

(2) To stabilize prices for basic farm products and to improve the income situation of the rural population

(3) To stimulate the processes of raising efficiency and modernization in the food sector with the aim of the emergence of viable farms and companies capable of competing on international and domestic markets

(4) To create working and living conditions for farming families which correspond to the standards of modern society, and to reduce the disparity between the incomes of rural and urban communities

(5) To support infrastructural and multifunctional development of rural areas, reducing differences and disproportion in the economic development of individual regions

(6) To provide social support to the retired agricultural population

(7) To maintain an ecological balance in agricultural ecosystems; to conserve natural resources"

The EU submissions also state that ...

"Implementation of this policy should ensure:
- Profitability of farm production in efficient, market oriented farms. This should provide long-term prospects for maintaining jobs in agriculture,
- Creation of favorable living and working conditions for the rural population employed outside farms (services and other non-agricultural activities)."

(AVIS 1996; unedited)

Further implicit policy objectives include accession to the EU, and support for the family farm as the basis for rural life.

To the extent that they respond to the needs of all rural people, not just farmers, these are appropriate objectives. But the emphasis on social objectives as opposed to
raising efficiency and so competitiveness is cause for concern. Of the seven objectives presented only the third is unambiguously directed to raising efficiency. The second objective is ambiguous, and the remainder have a pronounced social orientation. This emphasis is typical of agricultural policy in western Europe. Unlike Poland however, western European countries have the wealth to realize such an ambitious social agenda while Poland does not.

In order to grow and so create this wealth Poland will first have to achieve a significant increase in productivity and competitiveness in all sectors -- including agriculture. Increased competitiveness is thus a *sine qua non* for realizing the social objectives of agriculture policy. Note also that while the need to raise “farm profitability and create efficient, market oriented farms” is acknowledged, “direct support for farm producer prices and stabilization of the agriculture market” are viewed as the principal means to this end (AVIS 1996). Yet these policies are more likely to impair efficiency and competitiveness than to enhance them.

A clearer distinction between the immediate need to increase competitiveness as the basis for growth and wealth creation, and the longer term need for social policies to guide redistribution of this wealth, would lead to a more realistic set of policy objectives. Greater emphasis should be placed on improving the efficiency of factor and commodity markets by reducing public sector intervention and improving the enabling environment for private sector activity. These measures lead to more efficient production and marketing and encourage private sector investment, which in turn provide the basis for a sustainable increase in farm incomes.

Shifting the immediate emphasis of agricultural policy to improved efficiency and competitiveness does not reduce the importance of social issues, or the importance of public involvement in the sector. There is a role for measures to redistribute wealth in order to reduce rural poverty and unemployment, and for measures to redistribute economic activity in order to reduce regional disparities in income and wealth. Social transfers are implicit in both types of redistribution, from rich to poor and from urban to rural. But these social policy initiatives should not reduce the incentives for private sector activity or compromise initiatives designed to increase competitiveness and efficiency.

While the need for increased competitiveness is recognized in Poland, the lower priority given to this need, the adoption of some ineffective “efficiency-raising” policies and slow policy implementation have resulted in disappointing progress. As discussed below, the reliance on measures such as price stabilization, interest subsidies and loan guarantees has reduced the incentives for private sector activity and distorted the behavior of private sector agents. These measures are also highly inefficient transfer mechanisms in that they benefit larger, wealthier farmers rather than poor ones, and discriminate against part-time farmers and the non-farming members of the rural population. Slow progress with privatization has also been a major constraint. The tendency for rural and

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5 Although price stability per se may contribute to increased efficiency, it invariably becomes price enhancement. Rural incomes can be improved by either social transfers or increased efficiency, or both.
regional development initiatives to promote particular types of rural enterprise rather than to improve the general conditions for economic activity is also an inappropriate basis for policies designed to redistribute economic activity.

**Policy Instruments and Implementation**

Price support, income support and support for structural change are the principal vehicles for implementing agricultural policy, each of which draws on a wide range of policy instruments. Price support is effected through a combination of import protection and public purchases to maintain intervention (floor) prices, plus limited use of input subsidies; income support derives from direct subsidization of the Farmers Social Security Fund plus the benefits of price support; and a combination of subsidized credit and loan guarantees are the primary means to support structural improvement and investment in infrastructure.

The major public agencies involved in policy implementation are:

- The *Agricultural Marketing Agency (ARR)* which is responsible for stabilizing agriculture and food markets and protecting farm incomes; and for the acquisition, management and disposal of strategic food reserves.
- The *Agency for Reconstruction and Modernization of Agriculture (ARMA)* which promotes rural development by providing financial support for investment in rural infrastructure, rural institutions, job creation and training; and working capital and investment for farms, agro-processors and farm services;
- The *Agricultural Property Agency (APA)* which is responsible for transferring state-owned agricultural assets to the private sector;
- The *Farmers Social Security Fund (KRUS)* which provides social security in the form of retirement and disability pensions; and accident, sickness and maternity insurance.

The following key agriculture policies are described below: trade and price policy, rural finance, land policy, privatization, rural development and the Farmers Social Security Fund. Further detail is also provided on the public agencies involved in policy implementation.

**Trade Policy**

Trade in food and agriculture products is a small part of total trade, with 9.3 percent of all exports and 9.6 percent of all imports in 1995 (OECD 1996). Agriculture trade policy is of greater political import than this suggests however owing to a desire to protect Polish farmers on the one hand and to increase exports on the other. There is also concern among farmers and politicians at the fact that the sector has moved from being a net exporter prior to reform to a net importer (Table 9).
Following heavy cuts early in the reform process, import protection for agriculture was then restored in 1991 to the level extant prior to reform (Table 3). Although protection has since fallen slightly, agriculture remains the third most protected sector after armaments and cars. Currently, imports are subject to a combination of ad valorem and unit tariffs which provide an total nominal rate of protection of 20 percent which is scheduled to fall to 18.6 percent by the year 2000 (OECD 1996). Variable levies were terminated in mid-1995 and a 6 percent border tax was phased out at the end of 1996. There is little use of direct export subsidies but indirect subsidization of exports occurs whenever the ARR exports stocks at a loss.

Table 3. Evolution of Custom Tariff Structure (Trade Weighted)

<table>
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<tr>
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</tr>
</thead>
<tbody>
<tr>
<td>All Products</td>
<td>18.3</td>
<td>5.5</td>
<td>18.4</td>
<td>9.0</td>
<td>9.4</td>
<td>-</td>
</tr>
<tr>
<td>Agricultural Products</td>
<td>17.2</td>
<td>4.0</td>
<td>26.2</td>
<td>26.2</td>
<td>19.5</td>
<td>23.6</td>
</tr>
<tr>
<td>Industrial Products</td>
<td>18.7</td>
<td>-</td>
<td>16.3</td>
<td>17.0</td>
<td>8.0</td>
<td>-</td>
</tr>
</tbody>
</table>


These policies are conditioned by membership of WTO and bilateral trade agreements with the European Union, EFTA and CEFTA. Poland is also seeking to formalize trade relations with the FSU countries through further bilateral agreements. As a member of WTO Poland has accepted the Uruguay Round conditions to remove quantitative restrictions on trade and to reduce import protection, export subsidies and the level of public support for agriculture. But thus far the impact has been limited. The agreement imposes no real pressure to reduce prevailing levels of import protection as base tariffs have been bound at very high levels and are well above most existing tariffs. Similarly, Poland negotiated generous conditions for the expansion of tariff quotas for imports (with in-quota duty rates which range from 10 percent for oilmeals to 50 percent for apples and potatoes), the reduction of export subsidies and the reduction of Aggregate Measures of Support. The only real impact has been the replacement of variable levies with tariffs.

Bilateral agreements with the EU, EFTA and CEFTA have a more direct impact on agricultural trade as these countries account for 60 to 65 percent of agricultural imports and exports (Table 4). Moreover, these agreements have led to a significant opening of trade between Poland and other member countries. It should be noted, however, that preferential reduction of trade barriers among member countries, while maintaining high tariffs against imports from countries outside the regional groups, may have a net negative impact on economic welfare if it causes importers to purchase from high cost producers inside the groups instead of from low cost producers outside.
Table 4. Agriculture Trade by Partners (Average 1992-1994)

<table>
<thead>
<tr>
<th>Partner</th>
<th>Imports (ECU million)</th>
<th>% of Imports</th>
<th>Exports (ECU million)</th>
<th>% of Exports</th>
</tr>
</thead>
<tbody>
<tr>
<td>EU-12</td>
<td>980</td>
<td>50.0</td>
<td>851</td>
<td>55.0</td>
</tr>
<tr>
<td>EFTA</td>
<td>131</td>
<td>7.2</td>
<td>106</td>
<td>6.8</td>
</tr>
<tr>
<td>FSU</td>
<td>75</td>
<td>4.1</td>
<td>366</td>
<td>23.6</td>
</tr>
<tr>
<td>CEFTA</td>
<td>83</td>
<td>4.6</td>
<td>34</td>
<td>2.2</td>
</tr>
<tr>
<td>Other</td>
<td>620</td>
<td>34.1</td>
<td>192</td>
<td>12.4</td>
</tr>
<tr>
<td>Total</td>
<td>1818</td>
<td>100</td>
<td>1548</td>
<td>100</td>
</tr>
</tbody>
</table>

Source: EU, 1995

_Europe Agreement._ Implemented from 1992-96 this agreement led to a progressive opening of trade between Poland and the EU, based on a 50 percent increase in the tariff quotas applied by the EU and a corresponding 50 to 75 percent reduction in EU import levies and tariffs. Poland in turn agreed to a 10 percent reduction of import tariffs on agricultural products which originate in the EU, a reduction which is not quantitatively restricted. Since joining this agreement Poland has moved from being a net exporter of agriculture products to the EU to a net importer, although actual movement in the relevant trade balances is modest (from +28 million ECU in 1992 to -94 million ECU in 1994). Of more concern is the fact that Poland has been unable to take advantage of the increased tariff quotas allowed by the EU, owing to the inability of Polish products to compete on EU markets. Exports to the EU have been well below the allowable quotas.

_EFTA._ This agreement is similar to the Europe Agreement but has a more limited impact on agricultural trade. Only processed agricultural products are covered, and the trade preferences apply only to the non-agricultural component of these products.

_CEFTA._ Signed in 1992 by the Visegrad countries, this agreement will result in a significant reduction of protection on trade between member countries by 2001. More than 50 percent of all agro-food commodities traded between member countries are now duty free, and protection of most of the remaining commodities will be reduced by 20 to 50 percent by 2001.

_Price Policy_

The objective of price policy is to stabilize markets and support farm incomes, through intervention by the ARR in selected commodity markets. It is applied mainly to cereals (wheat and rye), dairy products (butter and skim milk powder) and meat (pork and beef); and to a lesser degree to sugar, potato starch, honey, wool and linen. In most cases producer prices are allowed to vary within a band defined by _maximum_ and _minimum_ prices which are fixed annually by government. These prices are fixed before the production season on the basis of costs of production, world market prices and the

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6 Also referred to as the Association Agreement
budgetary resources available for market intervention. A further intervention price is then set once the season begins, usually at a level 10 to 30 percent above the minimum price, and supported by state purchases.

The ARR acts to reduce seasonal price variation by buying when stocks are high and prices are low (below the minimum price), and then selling again later in the season when stocks are lower and prices are higher (above the maximum price). Regional price variation is also minimized by making minimum, maximum and intervention prices pan-territorial. To further stabilize prices, the ARR also has the power to import or export relevant commodities in the event that prices exceed seasonal norms as a result of variability on world markets. The level and system of intervention varies by commodity.

Very high levels of intervention characterize public involvement in wheat markets. ARR purchases accounted for 52 percent of the marketed surplus in 1994/95, up from 23.4 percent in 1993/94. Intervention occurs in three ways:

1. Direct purchases by the ARR at their own silos. In 1994/95 this accounted for 14 percent of total grain intervention.

2. Purchases through a system of authorized warehouses. Authorized warehouses which purchase cereal from farmers at the intervention price are eligible for subsidized credit for working capital, based on ARR loan guarantees. In 1994/95 this form of intervention accounted for 58 percent of total intervention.

3. Indirect intervention through commodity loans to larger farmers. A system of advance payments for delayed deliveries was introduced in 1993/94 to encourage farmers to store their own grain and hold it off the market during the post-harvest period of peak deliveries. Farmers with production of at least 100 mt of grain or a minimum cereal area of 20 ha are eligible for subsidized credit to a value up to 45 percent of the value of their grain, on the condition that this grain is held in storage for at least three months. In 1994/95 this accounted for 28 percent of total deliveries.

Meat intervention occurs on a smaller scale. It is generally limited to pork, with state purchases equivalent to 8 percent of total registered purchases in 1993 (EU 1995). Beef is of even less importance as it is a byproduct of dairy production. The method of intervention is the same for all meat commodities, with ARR purchasing carcasses from processors on the understanding that these processors then purchase live animals from producers at the equivalent price. A similar system is used for dairy products with the ARR buying butter and SMP from those processors which buy milk from producers at the minimum price. (Most dairy processors meet this requirement). From 1992 to 1994 ARR purchases of butter represented 12-15 percent of total butter production (EU 1995).

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7 This system of intervention also applies to rye.
BOX 1. THE AGRICULTURAL MARKETING AGENCY

The ARR was established in 1990 as a means to stabilize agricultural markets during the period of price volatility and uncertainty which followed initial reforms. Since then its mandate has gradually been broadened to include income support, the management of state reserves, support for the development of wholesale markets and the provision of market information. In principle, its price support and stabilization activities are patterned after the US Commodity Credit Corporation (CCC) which supports prices through a system of non-recourse loans. (Producers lend grain to the CCC in return for the loan price, and may default on the loan without penalty, losing the grain which is treated as collateral).

In fact the ARR lacks the resources and the marketing instruments available to the CCC, and so is unable to operate in this manner. Moreover, the management of state reserves absorbs most of the ARR budget (EU 1995). Market intervention is thus effected through a system of loan guarantees and preferential credit (from the ARMA) to selected warehouses and producers, a system which allows the ARR to exert considerable influence on the market with limited resources.

As of 1995/96 price support for sugar is based on the CAP system of production quotas, with an A Quota of 1.5 million mt for domestic production and a B Quota of 300,000 mt for export. These quotas are distributed among producers according to previous levels of production. A minimum price is set for Quota A production and the exports allowed under Quota B receive an export subsidy which is financed by a levy on sales from the A Quota. Production above these two quotas must be exported without support (it is subject to a penalty tax of 100 percent if sold on domestic markets).

Rural Finance

Intervention in financial markets is effected through the use of preferential credits (i.e., interest rate subsidies) and loan guarantees and is the principal form of government support to the rural sector. This support is extended to cooperative and commercial banks through the ARMA, the ARR and the APA. Total expenditure for these interventions declined in real terms from 1992 to 1994, then increased sharply in 1995 and again in the 1996 budget plan (Table 5). ARMA interest subsidies for preferential credit account for more than 90 percent of this expenditure and most of the growth, followed by a small but growing program of support for regional banks and support for loan guarantees.

Preferential credit is extended through the cooperative and commercial banks. Loans are disbursed at “normal” market rates of interest but borrowers pay only part of this interest, with the balance being paid by the relevant state agency. As the volume of subsidized credit which a bank may write in a given year is based on the agricultural lending activity of that bank in the previous year, cooperative banks (particularly the
BGZ) dominate the allocation of preferential credit and so receive the largest share of the subsidies.

Table 5. Public Sector Interventions in Rural Financial Markets (PLN thousands)

<table>
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<tr>
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</tr>
</thead>
<tbody>
<tr>
<td>Interest Subsidies</td>
<td>165,870</td>
<td>283,080</td>
<td>272,799</td>
<td>566,042</td>
<td>978,680</td>
</tr>
<tr>
<td>Farm Modernization &amp;</td>
<td>67,800</td>
<td>11,700</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Working Capital</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Debt Restructuring</td>
<td>85,000</td>
<td>54,500</td>
<td>360</td>
<td>0</td>
<td>10,000</td>
</tr>
<tr>
<td>Credit Guarantees</td>
<td>n.a.</td>
<td>n.a.</td>
<td>20,000</td>
<td>1,208</td>
<td>4,000</td>
</tr>
<tr>
<td>Regional Bank Bonds</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
<td>5,000</td>
<td>40,000</td>
</tr>
<tr>
<td>Total</td>
<td>318,670</td>
<td>349,230</td>
<td>293,159</td>
<td>572,250</td>
<td>1,032,680</td>
</tr>
<tr>
<td>Total (US$ Thousands)</td>
<td>234,316</td>
<td>192,972</td>
<td>129,145</td>
<td>236,467</td>
<td>397,185</td>
</tr>
</tbody>
</table>

Note: Excludes financing activities of the APA, which amounted to 24 million PLN in 1996.

Source: Pederson 1996

In addition to budget expansion, the increased expenditure on preferential credit is also due to a higher utilization of available resources. In mid 1996 these subsidies appear to be fully utilized, whereas only 30 percent of the available subsidy was allocated by banks in 1993 and 87 percent in 1995. Growth has also been boosted by an increase in the number of preferential credit lines extended by the ARMA. Twenty-two categories of ARMA loans qualified for interest rate subsidies in 1996, up from seven in 1995 and three in 1994. As a result of these factors the proportion of preferential loans outstanding in the agriculture and food industry has increased from 58 percent in 1993 to about 70 percent of total loans outstanding in 1996 (Pederson 1996).

ARMA loan programs accounted for 98 percent of this credit in 1996 and APA loans for the rest. The ARMA loans can be classified into eight major areas of activity: basic investment loans (for agriculture, food processing and agriculture services), land purchases, investments by young and beginning farmers (for real estate and equipment loans), sector program loans (milk, cattle, poultry, potatoes, grain storage, horticulture and irrigation), loans to resume farm production, loans to restructure farm debts, regional development loans to the voivods (to restructure and develop the poultry sector), and loans to create non-farm jobs in urban and municipal areas (in nonagricultural production, services, trade and distribution). Most of the increase in expenditure on preferential credits has been for basic investment loans and loans for working capital (purchase and storage of agricultural products), which are now the two largest categories of intervention (Table 7). Recently, the ARMA has also begun to purchase the bonds of the regional cooperative banks as a means to assist them with debt restructuring and to increase their
levels of reserve capital. The APA provides subsidized credit for the lease or purchase of farms.

Interest rates vary according to loan category. For each loan type the ARMA (or APA) establishes a maximum rate that a bank can charge, which is some multiple of the NBP (National Bank of Poland) rediscount rate. (In 1996 the rediscount rate was 23 percent). Borrowers then pay one quarter to one half of this maximum rate, according to the loan type, and the ARMA or APA pays the rest. The effective rate of interest paid by the borrower is thus well below the market rate for comparable loans, being 20-60 percent of the minimum rate charged by the BGZ on 1-3 year investment loans for instance. This is equivalent to a real interest rate which is less than or equal to zero. Borrowers also benefit from a grace period for repayment of up to two years.

Credit Guarantees. Loan guarantee and surety facilities are provided by the ARMA, ARR and the APA, although the aggregate credit guarantee obligations extended are small in comparison with the total amount of agricultural credit outstanding. The largest program is that implemented by the ARR in association with price stabilization activities, in which credit guarantees are extended to enterprises involved in intervention purchases and for importing food and agricultural commodities. These guarantees are extended through the banks with which ARR has separate agreements, and agro-processing firms apply for a guarantee through the participating bank. The volume of credit guarantees provided by the ARR increased from 94 million PLN in 1992 to 151 million PLN in 1995. Currently, most of these guarantees (90 percent) are used for the purchase of grain in association with price stabilization activities. Practically all of the enterprises receiving guarantees through ARR are in the public sector (Pederson 1996).

The guarantee programs of the ARMA and APA are even smaller. At the end of 1995 the ARMA had outstanding guarantee and surety obligations of 4.4 million PLN on 26 agreements. To date only two of these agreements have had to be honored due to borrower default. The APA provides loan guarantees to support the borrowing activities of the former state farms and the cooperatives. About 90 percent of the loans to these entities is through the Bank for Food Economy (BGZ).

Costs and Benefits of Financial Intervention. For purposes of economic analysis the cost of intervention is the increase in the cost of intermediation relative to disbursement of the same amount of credit at market rates of interest. This has three components: the net budget subsidy actually paid to the banks, the administrative costs incurred by the public agencies which administer the relevant programs, and the loss of interest income by the banking sector -- an indirect cost associated with the effect of interest rate subsidies on the lending market. Two interest rates can be used to calculate this cost, the market rate or the risk-adjusted market rate (which allows for the lower rates of market interest facilitated by guarantee programs and the larger consequent payment of interest to participating banks).

These costs are presented in Table 6 below for the ARMA for 1995 and 1996. They show that intervention increases the costs of lending as compared to lending at
market interest rates, owing to the additional costs which intervention imposes on the process of financial intermediation. These net costs were higher when calculated on the basis of risk-adjusted market rates. For both interest rates, the net cost also increased from 1995 to 1996 as a result of the larger volume of lending and a decline in market interest rates relative to the maximum bank lending rate established by the ARMA (Pederson 1996).

Table 6. Net Incremental Cost of Financial Intervention (PLN million)

<table>
<thead>
<tr>
<th></th>
<th>1995</th>
<th>1996</th>
</tr>
</thead>
<tbody>
<tr>
<td>ARMA</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Market Interest Rate</td>
<td>68.1</td>
<td>89.7</td>
</tr>
<tr>
<td>Risk-Adjusted Market Interest Rate</td>
<td>243</td>
<td>392.8</td>
</tr>
</tbody>
</table>

Source: Pederson 1996

The concept of additionality is used to estimate the benefits derived from intervention. That is, the benefits which are attributable to the additional loans granted to agriculture which are the direct result of intervention, and which would not have occurred in the absence of intervention. Although there is no quantitative estimation of these benefits they are probably small as many of the farmers and agro-processors who qualified for preferential credit would also have qualified for loans at market interest rates. (Pederson 1996).

Although further analysis is needed to obtain a more accurate estimate of these costs and benefits, it would appear that the net costs of intervention greatly exceed the benefits.

Land Policy

Land policy is subsumed under the umbrella of structural policy, which has its objectives: to develop a private land market for the sale and leasing of agricultural land; to improve farm structure through privatization; and to create new jobs for rural people (AVIS 1996). The first of these objectives is the principal thrust of land policy. Development of a private land market is viewed as an important means to enlarge and consolidate the land holdings of private farmers, thus creating a structure more conducive to efficient agriculture production.

Implementation of this policy is based on measures to update and modernize the cadastre; improve the efficiency and transparency of legal procedures associated with land transactions; develop new laws and debt instruments suited to the operation of an open, efficient land market; and to increase the activity of private sector agents in land transactions. Further, related initiatives include programs to improve the age structure of the farming population, and a pilot program to resettle farmers on “family farms” created from former state farms in the north and western regions of the country (agricultural colonization).
Most of this agenda is supported by access to preferential credit and loan guarantees from the ARMA; and where former state-owned land is involved, from the APA. The interest rate on preferential credit for land lease and purchase is one quarter of the re-discount rate of 23 percent, which is highly negative in real terms (inflation is approximately 20 percent). No interest is charged at all if loan repayment is made through in-kind payments of wheat to the ARR. The program to improve the age structure of farming is supported by KRUS.

Privatization

Poland's policy stance towards privatization, the second component of structural policy, is characterized by its ambivalence. Although current policy aims to restructure and modernize the sector with the aim of creating "viable farms and companies capable of competing in the international and domestic market" (AVIS 1996), there is a continued reluctance to locate these 'viable farms and companies' entirely in the private sector. The approach to privatization of the former state farms, and slow progress with the privatization of key components of agro-industry and rural banking are indicative of this ambivalence.

The private sector dominates agricultural production nevertheless, due mainly to Poland’s legacy of small-scale private farms which accounted for 75 percent of land ownership and 80 percent of production even before reform began. In 1995 private farmers accounted for more than 95 percent of the value of agricultural output (OECD 1996). In aggregate, private entrepreneurs also dominate agro-industry although their presence varies widely by sub-sector, with the State retaining control of the production and marketing of commodities considered important for strategic or social (i.e., employment) reasons.

Land privatization began in January 1992 with creation of the APA. This agency was made responsible for the management, restructuring and privatization of the assets and accumulated liabilities of 1,667 former state farms and a total land area of 4.48 million hectares. Note that implementation of this mandate takes place outside the ambit of the MAFE as the APA is a self-funding (i.e., off-budget) agency which derives its revenues from the sale or lease of land and from other assets.

Rather than privatize state land the APA has chosen to lease most of it, so privatizing production rather than ownership. As of February 1997 64 percent of APA land had been distributed on long term (10-15 year) leases and 11 percent had been sold to private sector owners (ABC Poland 1997). However it appears that many farmers are now beginning to exercise a pre-emptive right of purchase conferred with their lease, at very favorable prices, so effecting the final element of land privatization (Box 2). Although this trend is promising there is a significant area to be transferred before privatization is complete.

A further 2 percent of APA land has been transferred to the state forest administration and municipalities. Of the remaining 1.04 million ha, approximately 750,000 ha is unsuited for farming and the rest is being prepared for privatization. Most
BOX 2. APA LAND RENTAL AGREEMENTS

Of the land leased to private farmers by APA, an estimated 90 percent is covered by 10-15 year leases which give a pre-emptive right of purchase to the lessee at favorable prices, and which allow payment for this land in installments. The purchase price is normally set at a minimum of 15 times the rental (which is expressed in quintals of wheat), but it may be up to 20-25 times the rental depending on local demand and land prices in the area.

Lessees have two options for purchasing their land: (a) if the land is purchased during the first seven years of the lease the quintal price is converted to zloty and repayments are made in zloty, which can be borrowed at an interest rate of one quarter of the NBF rediscount rate. The area which a farmer can buy under this option is limited by region, from 100 ha in the south up to 500 ha in the north; or (b) if the land is purchased after the first seven years of the lease the purchase price is expressed in quintals of wheat but the buyer pays no interest.

As real rates of interest under option (a) are negative, it is the preferred option. Since 1994 APA has retained the right to take back up to 10 percent of the land purchased by tenants, in order to sell or lease it to other private farmers. This change addresses criticisms from private farmers who were unable to acquire APA land, and of the large blocks privatized by APA.

Source: ABC Poland

Note also that the APA has shown a marked preference for the sale or lease of large blocks of land. As of December 1995, 37 percent of all land sold by APA was in blocks of 100 ha or more, with an average size of 389 hectares; compared to 22 percent sold in blocks of less than 10 hectares (average size 1.7 ha). Of the land leased, 81 percent was in blocks of 100 hectares or more, with an average size of 509 hectares; compared to 7 percent leased in blocks of 10 hectares or less (average size 1.6 ha). (AVIS 1996).

Agro-Industry Privatization. Agro-processing is important for the Polish economy, contributing 21 percent to total industrial output in 1993. The most important sub-sectors are meat processing, dairy, fruit and vegetables, sugar and confectionery, milling and bakery. Total employment amounted to 441,000 people in December 1994. As labor productivity is much lower than in western Europe, considerable technical adjustment will be needed if agro-processing is to expand and absorb rural labor, particularly in the face of increased competition from the EU (EU 1995).

As 70 percent of agro-industry was state-owned prior to reform, a three part privatization program was initiated in cooperation with the World Bank ASAL. It consisted of: the break-up and divestiture by the Anti-Monopoly Office of Poland’s 18 largest cereals and storage SOEs (PZZ); the privatization and restructuring of SOEs involved in poultry and egg production, potatoes and starch, the sugar industry, cereals and feeds, and vegetable oils; and preparation of a strategy to prepare unsold SOEs for privatization and policies to govern the supervision and management of enterprises still
operating under public ownership. This program was only partially implemented with limited progress made in the privatization of the key cereals and sugar sub-sectors.

Most direct support for agro-processing comes from preferential credit from ARMA, including designated lines of preferential credit for the dairy, sheep, poultry, potatoes and grain storage sub-sectors. The government also has a deliberate policy to encourage co-operative ownership and management of agro-processing enterprises.

*Rural Development*

Rural development is the third component of structural policy. The broad objective is to create non-farm employment and raise rural incomes through: investment in the physical and institutional infrastructure of rural areas, support for non-farm rural enterprises, and job training. To this end support is directed to farmers, agro-processors and farm-service enterprises; to schools, universities, training centers, agricultural advisory centers and experimental stations; to local authorities (gminas) and to entities seeking to establish agricultural exchanges and wholesale markets.

Most of this support is directed through the ARMA which was set up in January 1994 to take over the activities of the Debt Rescheduling Fund (FRiOR) and to promote rural development through support for the modernization and restructuring of agriculture. This mandate is implemented in two ways. First through the provision of preferential credit for farmers, processors and farm service enterprises for investment, working capital and disaster relief; and second through grants and co-financing programs for training, extension, agricultural information and consultancy services, and for physical infrastructure. Loan guarantees are also provided for investment and working capital loans. ARMA's planned expenditure of 1,411.8 million PLN for 1996 (Table 7) is equivalent to 48 percent of the entire agriculture budget for transfers and subsidies, indicating just how important this agency is for rural development. Note however that a third of this allocation is for interest subsidies on working capital, an activity which at best has only marginal impact on rural development.

Rural development is also funded from other components of the agricultural budget and from a counterpart fund set up for the World Bank ASAL to finance rural infrastructure (water supply, waste disposal and rural telephones). Further support for employment creation is provided by the Labor Fund through loan guarantees, public works programs, wage subsidies to employers in rural areas, preferential credit for people wanting to establish enterprises which create new employment, training programs and various forms of social assistance.

Ostensibly, the total planned allocation of resources for rural development from ARMA, ASAL and the MAFE for 1996 amount to PLN 1,531.1 million (Table 7), equivalent to US$567 million. But of this amount, only 29 percent (PLN 425 million) is 8

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8 Note that ARMA's expenditures do not correspond exactly with the agriculture budget as it funds a large proportion of its expenditures from its own resources.
allocated to investment in physical and institutional infrastructure and this allocation may fall in the future as this is the final year of the ASAL.

Table 7. Expenditure for Rural Development (1996 Plan)

<table>
<thead>
<tr>
<th>Amount (PLN Thousands)</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>I. ARMA</strong></td>
<td></td>
</tr>
<tr>
<td>FRiOR</td>
<td>16,500</td>
</tr>
<tr>
<td>Loan Guarantee Fund</td>
<td>4,000</td>
</tr>
<tr>
<td>Interest Subsidies</td>
<td>965,180</td>
</tr>
<tr>
<td>Working Capital</td>
<td>476,000</td>
</tr>
<tr>
<td>Agric Investment</td>
<td>380,000</td>
</tr>
<tr>
<td>SME Rural Employment</td>
<td>45,000</td>
</tr>
<tr>
<td>Other</td>
<td>64,180</td>
</tr>
<tr>
<td><strong>Financing</strong></td>
<td>305,715</td>
</tr>
<tr>
<td>Training Extension Workers</td>
<td>52,715</td>
</tr>
<tr>
<td>Rural infrastructure</td>
<td>164,000</td>
</tr>
<tr>
<td>Agricultural Research</td>
<td>80,000</td>
</tr>
<tr>
<td>Rural Advisory Services</td>
<td>9,000</td>
</tr>
<tr>
<td><strong>Total ARMA</strong></td>
<td>1,411,824</td>
</tr>
<tr>
<td><strong>II. ASAL (Infrastructure)</strong></td>
<td>77,000</td>
</tr>
<tr>
<td><strong>III. MAFE Public Services</strong></td>
<td>42,350</td>
</tr>
<tr>
<td><strong>TOTAL (I + II + III)</strong></td>
<td>1,531,174</td>
</tr>
<tr>
<td><strong>Of Which for Physical and Institutional Infrastructure</strong></td>
<td>425,065</td>
</tr>
</tbody>
</table>

Source: Pederson, 1996

It is difficult to reconcile the low priority given to investment in physical and institutional infrastructure with the emphasis which current agricultural policy rightly accords to rural development. Most of the resources allocated through the ARMA are in fact directed to farmers. A more convincing commitment to rural development is needed, backed by a substantial re-allocation of public resources to initiatives which promote growth of the non-farm sectors of the rural population. Increased support for investment in physical and institutional infrastructure provides an obvious means to this end; and the ARMA’s success in actively involving local government in the choice, implementation and financing of current infrastructural projects provides a sound basis for expanding this form of investment.

Current rural development policy also has a strong regional character. This reflects official recognition of the pronounced regional variation in Poland and the consequent need for tailored solutions to unemployment, rural poverty and privatization; and government’s decision to support a decentralization of decision making and increased financial autonomy for local government. It also anticipates the basis for much of future
EU support to the agriculture sector. A regional approach to agricultural policy is also justified on economic grounds given wide observed differences in the comparative advantage for various types of production; a result of differing agro-climatic conditions and proximity to different domestic and foreign markets (Safin and Guba 1996). The Polish Agency for Regional Development (PARR) is responsible for this mandate and administers two main programs, one supported by the PHARE-STRUDER initiative and the other a Polish-Swiss initiative. Both are directed to voivods with particularly difficult problems of economic restructuring and involve training and advisory services, financial assistance in the form of grants and guarantees for SME’s and for small infrastructure projects.

Other aspects of regional development are less well directed, notably the preferential credit extended by ARMA to promote specific production, agro-processing and employment activities in selected areas. This includes sheep and goat raising in Krosno; poultry production and processing in Bydgoszcz, Kalisz, Konin, Poznin, Krosno, Suwalki, Legnica and Torun; horticulture in Krosno; and sugar beet production and processing associated with the Slaska Spolka Cukrowa SA. The mountain and hill farming areas of southern Poland have also been targeted for support in the form of assistance for developing crafts, small industry and agro-tourism (AVIS 1996). There is ample evidence, in and outside the EU, that regional development is only effective when it is directed to improving the general conditions for employment creation rather than to specific activities (Haynes 1996).

The Farmers Social Security Fund

The Farmers Social Security Fund (KRUS) was established in 1990 to provide pensions and medical insurance for the rural population. It also has a mandate to encourage alternative forms of insurance and to reduce the incidence of occupational injuries and disease. To meet these responsibilities KRUS provides two types of social security: retirement and disability pensions and accident, sickness and maternity insurance. These schemes provide social security for over 2 million rural people of whom 1.4 million are farmers and their families (AVIS 1996). Men are eligible for the retirement pension at age 65 years and women at age 60 years, on the condition that they have contributed to the pension for at least 100 quarters. Farmers must also give up all of their land except for one hectare.

In order to improve the age structure of farming and encourage younger farmers onto the land provision has also been made for farmers to qualify for retirement benefits at age 60 years. To be eligible farmers must have contributed to the scheme for at least 120 quarters; and agree to transfer their land free of charge to a successor who is less than 40 years old (and then discontinue farming). Where farmers who wish to retire are unable to sell their land, the APA will buy it. Data on the number of farmers who have used this program vary widely according to the source, but the official figures are as follows (AVIS 1996):
1993 ........................................ 48,822 farmers
1994 ........................................ 63,049 farmers
1995 ........................................ 76,645 farmers

Ninety percent of the finance for these programs is provided by the state - a substantial income transfer to rural people, which accounts for 73 percent of the agriculture budget. The remaining contribution derives mostly from annual premiums paid by beneficiaries, which in 1996 amounted to PLN 335.6 (US$124) per beneficiary for the Pension Fund and PLN 168 (US$62) per beneficiary for accident, health and maternity insurance. Although the heavy burden which the KRUS imposes is recognized by government, it is unlikely to be reduced substantially in the medium term (AVIS 1996).

Support for Agriculture

Overall public sector support for agriculture derives from both budget and off-budget assistance. State budget support (including selected food processing and rural sector expenditures) increased in nominal terms from PLN 3.4 million in 1992 to just under PLN 10.8 million in the 1996 budget plan (Table 8). In real terms this represents an increase of approximately 16 percent.\(^9\) The budget also increased as a share of total state expenditure (net of debt servicing) from 9.7 percent in 1992 to 11.5 percent in the 1996 plan.

As noted above, the Farmers’ Social Security Fund (FSSF) is the major component of budgetary support, with 73 percent of total spending in the 1996 budget plan, up from 69 percent in 1992. Increased support for the FSSF has accounted for 94 percent of the increase in overall support for agriculture, owing to an increase in the number of people receiving the pension (from 1.3 million in 1989 to 2.0 million in 1993), and efforts to hold its value against inflation. As a result the Social Security Fund has increased from 6.7 percent of the total state budget (net of debt servicing) in 1992 to 8.4 percent in 1996.

State expenditures for agricultural transfers and subsidies include interest subsidies, transfers to voivodships for regional projects, support to MAFE, the ARMA and ARR and support for investment. This expenditure has increased from PLN 1.05 billion in 1992 to PLN 2.9 billion in the 1996 plan, an increase of approximately 5 percent in real terms, but has remained at just over 3 percent of the national budget. However transfers and subsidies have declined slightly as a proportion of total support, from 31 percent in 1992 to 27 percent in the 1996 plan. Farmers also benefit from numerous tax exemptions, although this support is to be phased out by the year 2000 under a program of tax reform (Package 2000). Recapitalization of the Bank for Food Economy (BGZ), the major rural credit institution, has contributed a further US$1.2 billion to public expenditure on agriculture since the early 1990’s.

\(^9\) In contrast, Pederson (1996) finds that budget expenditure decreased for the same period.
Off-budget support for agriculture derives from the ARMA, ARR and the APA. These agencies have built up substantial resources from their own operations, which they use together with annual budget allocations. For instance of the 1.56 billion PLN which the ARMA had at its disposal in 1996, approximately 0.8 billion PLN (51%) came from its own resources.

There is little comparable information for the ARR which operates in some secrecy, due to its responsibility for strategic food reserves which are regarded as a matter of national security. The total cost of ARR’s activities increased from 175.5 million PLN in 1992 to 288 million in the 1996 Plan (Table 8). In real (US$) terms this is a decrease of 17 percent. Further data for 1994 show that 73 percent of the original budget allocation was used to purchase and hold State Reserves, and 23 percent was used for market intervention\(^\text{10}\) (EU 1995). The seemingly low and declining budget for ARR market intervention is a misleading indicator of the level and trends of intervention however. Note first that this allocation pays for the net cost incurred after buying (at low prices) and selling (at higher prices), rather than total purchase activities; second that any profits generated by these activities obviously increase the capacity for market intervention; and third that the system of loan guarantees provides a means to extend ARR’s market influence at minimal direct cost. Thus while these combined resources are still not sufficient to support prices in the event of major instability, they nevertheless allow the ARR to have a significant influence on the level of normal seasonal prices.

The APA budget has increased from 182 million PLN in 1993 to 758 million in the 1996 plan. About 70 percent of total APA revenues are derived from asset sales and another 25 percent is from rental income of property (farm land, farm non-real estate and apartments). Of this revenue about 63 percent is spent annually to repay the outstanding liabilities of the associated state properties. Loans and subsidies for interest on lending activities of the APA accounted for 14-17 percent of APA expenditures during 1994-96. In 1996 loan subsidies to the business units of the agency (the state and cooperative farms) amounted to about 24 million PLN.

Excluding the FSSF, budget support for agriculture would initially appear to be reasonable in a relative sense. It accounts for 3.0 percent of the total state budget (net of debt servicing) as compared to agriculture’s contribution to GDP of 6-7 percent. Measured as a percentage of agriculture GDP it is comparable to observed levels of support in the EU however\(^\text{11}\), which casts the appropriateness of this level of support in a different light. It is doubtful that Poland can afford to subsidize and support its agriculture sector at the same level as these much wealthier countries with their more efficient agriculture sectors. This anomaly is even more apparent when the level of additional, non-budget support is taken into account.

\(^{10}\) A further allocation of 89.7 million PLN was used to cover debts from grain elevators which were taken over from the PZZ (EU, 1995).

\(^{11}\) Subsidies and transfers (including rural investment) are equivalent to 17.6 percent of agriculture GDP in the EU-15, versus 14-16 percent of agriculture GDP in Poland.
### Table 8. Budget Support for the Agriculture, Food and Rural Sectors

<table>
<thead>
<tr>
<th></th>
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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>PLN '000</td>
<td>%</td>
<td>PLN '000</td>
<td>%</td>
<td>PLN '000</td>
</tr>
<tr>
<td><strong>Farmers Social Security Fund</strong></td>
<td>2,345,250</td>
<td>69.0</td>
<td>3,167,000</td>
<td>69.2</td>
<td>4,808,700</td>
</tr>
<tr>
<td><strong>Support for Current Operations</strong></td>
<td>889,990</td>
<td>26.2</td>
<td>1,230,600</td>
<td>26.9</td>
<td>1,508,420</td>
</tr>
<tr>
<td>Interest Subsidies</td>
<td>161,070</td>
<td>4.7</td>
<td>214,880</td>
<td>4.7</td>
<td>248,540</td>
</tr>
<tr>
<td>Fuel Subsidies</td>
<td>0</td>
<td>0.0</td>
<td>147,420</td>
<td>3.2</td>
<td>0</td>
</tr>
<tr>
<td>Lime Production/Transport Subsidies</td>
<td>35,320</td>
<td>1.0</td>
<td>29,920</td>
<td>0.7</td>
<td>112,010</td>
</tr>
<tr>
<td>Transfers to MAFE for ARMA</td>
<td>43,440</td>
<td>1.3</td>
<td>53,240</td>
<td>1.2</td>
<td>133,100</td>
</tr>
<tr>
<td>Transfers to ARR</td>
<td>175,480</td>
<td>5.2</td>
<td>189,520</td>
<td>4.1</td>
<td>257,740</td>
</tr>
<tr>
<td>Transfers to Voivodships</td>
<td>205,470</td>
<td>6.0</td>
<td>256,020</td>
<td>5.6</td>
<td>314,650</td>
</tr>
<tr>
<td>Research Education Extension</td>
<td>255,390</td>
<td>7.5</td>
<td>321,830</td>
<td>7.0</td>
<td>417,310</td>
</tr>
<tr>
<td>Contingencies &amp; Other Support</td>
<td>6,700</td>
<td>0.2</td>
<td>17,770</td>
<td>0.4</td>
<td>25,070</td>
</tr>
<tr>
<td><strong>Support for Investments</strong></td>
<td>161,760</td>
<td>4.8</td>
<td>180,700</td>
<td>3.9</td>
<td>409,080</td>
</tr>
<tr>
<td><strong>Total Budget Support for Agriculture Nominal</strong></td>
<td>3,397,000</td>
<td>100.0</td>
<td>4,578,300</td>
<td>100.0</td>
<td>6,726,200</td>
</tr>
<tr>
<td><strong>Real (1990 = 100)</strong></td>
<td>1,392,213</td>
<td>na</td>
<td>1,391,581</td>
<td>na</td>
<td>1,542,704</td>
</tr>
<tr>
<td><strong>As % of State Expenditure (Net of Debt Servicing)</strong></td>
<td>9.7</td>
<td>10.2</td>
<td>11.3</td>
<td>11.4</td>
<td>11.5</td>
</tr>
<tr>
<td><strong>Non FSSF as % of State Exp.</strong></td>
<td>3.0</td>
<td>3.2</td>
<td>3.2</td>
<td>3.0</td>
<td>3.1</td>
</tr>
</tbody>
</table>

*Source: Pederson, 1996*
4. THE IMPACT OF CURRENT AGRICULTURE POLICY

An examination of post-reform trends in agricultural trade, commodity markets, factor markets, farm structure, agro-processing and farm incomes provides considerable insight into the impact of the policies described above. Related trends also allow some more general observations on the extent to which the current rural development program has succeeded in boosting growth and employment in the rural sector -- so reducing poverty and unemployment. The analysis suggests that there are ample grounds for re-focusing policy in a manner which both strengthens competitiveness and enhances rural development.

Agricultural Trade

Trends in agricultural trade show that both imports and exports have increased since 1992, but that imports have increased at a faster rate (Table 9). The increase in imports can be attributed to strong growth in the domestic economy, which has increased the demand for agricultural products at a time when domestic agricultural production is largely static. At the same time the depressed economies of western Europe, Poland’s major market, have reduced the demand for exports. Continued real appreciation of the zloty has also contributed to the increase in both imports and exports, creating further unfounded pressure to increase import protection (Box 3). The recent removal of currency restrictions has also encouraged the increase in both imports and exports.

Table 9. Polish Agricultural Trade 1992-1995
(US$ million)

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
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</thead>
<tbody>
<tr>
<td><strong>EXPORTS</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Food and Live Animals</td>
<td>1,683.075</td>
<td>1,450.648</td>
<td>1,737.933</td>
<td>2,105.593</td>
</tr>
<tr>
<td>Beverages &amp; Tobacco</td>
<td>74.903</td>
<td>135.74</td>
<td>239.979</td>
<td>163.216</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>1,757.978</td>
<td>1,586.387</td>
<td>1,977.912</td>
<td>2,268.809</td>
</tr>
<tr>
<td><strong>IMPORTS</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Food and Live Animals</td>
<td>1,550.950</td>
<td>1,814.494</td>
<td>1,877.239</td>
<td>2,338.847</td>
</tr>
<tr>
<td>Beverages &amp; Tobacco</td>
<td>162.424</td>
<td>145.770</td>
<td>186.166</td>
<td>217.085</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>1,713.374</td>
<td>1,960.265</td>
<td>2,063.405</td>
<td>2,555.931</td>
</tr>
<tr>
<td><strong>TRADE BALANCE</strong></td>
<td>+44.604</td>
<td>-373.877</td>
<td>-85.493</td>
<td>-287.123</td>
</tr>
</tbody>
</table>

Source: GUS (SITC Statistics)
The element of concern in this situation is not the consequent trade deficit per se. This is in fact quite modest in relative terms (agricultural exports were 88.8 percent of imports in 1995), and would be further reduced by the inclusion of cross-border trade (OECD 1996). The real problem is the inability of Polish agricultural products to compete more strongly on domestic and export markets. Imports have increased despite the reintroduction of pre-reform levels of protection in 1992 (Table 3), and Poland has been unable to take advantage of expanded tariff-quotas allowed under the Europe Agreement as the basis for increased exports. The anti-trade bias of current trade policy, which favors importables and discriminates against exportables (Safin and Guba 1996) compounds this problem and encourages a misplaced allocation of resources from exportables to importables.

**BOX 3. EXCHANGE RATES, IMPORT PROTECTION AND AGRICULTURE**

The combination of rising nominal exchange rates and falling real exchange rates has wide ranging implications for Polish agriculture. Expressed in terms of US dollars (converted at nominal exchange rates), producer prices have risen substantially for all major agricultural commodities, so reducing the competitiveness of Polish agricultural exports on world markets. Moreover, if this trend continues domestic prices will continue to approach EU prices, obviating the need for any major adjustment in agriculture prices for EU accession.

The impact of real exchange rate appreciation is of equal concern as it reduces real producer prices. This effect will continue for the medium term as the exchange rate is viewed as the “anchor” of macro-economic stabilization, so the rate of nominal devaluation will continue to lag domestic inflation, leading to real appreciation. Since a real appreciation makes competing imports cheaper, this creates pressure within the agriculture sector to reverse trade and price policy reforms and increase protection. However real producer prices have in fact increased since 1991 for most products, indicating that increased protection for agriculture has more than offset the impact of real exchange rate appreciation.

**Procurement Prices per Tonne in US$ (at nominal exchange rates)**

<table>
<thead>
<tr>
<th>Year</th>
<th>Wheat</th>
<th>Rye</th>
<th>Potatoes</th>
<th>Sugar Beets</th>
<th>Oilseed Rape</th>
<th>Cattle</th>
<th>Pig</th>
<th>Milk</th>
</tr>
</thead>
<tbody>
<tr>
<td>1990</td>
<td>85</td>
<td>64</td>
<td>17</td>
<td>18</td>
<td>129</td>
<td>448</td>
<td>835</td>
<td>66</td>
</tr>
<tr>
<td>1991</td>
<td>74</td>
<td>46</td>
<td>31</td>
<td>22</td>
<td>137</td>
<td>548</td>
<td>921</td>
<td>97</td>
</tr>
<tr>
<td>1992</td>
<td>120</td>
<td>64</td>
<td>81</td>
<td>29</td>
<td>171</td>
<td>658</td>
<td>943</td>
<td>134</td>
</tr>
<tr>
<td>1993</td>
<td>134</td>
<td>96</td>
<td>33</td>
<td>24</td>
<td>211</td>
<td>673</td>
<td>868</td>
<td>128</td>
</tr>
<tr>
<td>1994</td>
<td>109</td>
<td>77</td>
<td>43</td>
<td>24</td>
<td>272</td>
<td>792</td>
<td>1126</td>
<td>123</td>
</tr>
<tr>
<td>1995</td>
<td>146</td>
<td>93</td>
<td>99</td>
<td>33</td>
<td>235</td>
<td>957</td>
<td>1064</td>
<td>181</td>
</tr>
</tbody>
</table>

**Real Procurement Prices per Tonne in PLN (at 1990 prices)**

<table>
<thead>
<tr>
<th>Year</th>
<th>Wheat</th>
<th>Rye</th>
<th>Potatoes</th>
<th>Sugar Beets</th>
<th>Oilseed Rape</th>
<th>Cattle</th>
<th>Pig</th>
<th>Milk</th>
</tr>
</thead>
<tbody>
<tr>
<td>1990</td>
<td>81</td>
<td>61</td>
<td>16</td>
<td>17</td>
<td>122</td>
<td>426</td>
<td>793</td>
<td>63</td>
</tr>
<tr>
<td>1991</td>
<td>46</td>
<td>28</td>
<td>19</td>
<td>13</td>
<td>85</td>
<td>340</td>
<td>572</td>
<td>60</td>
</tr>
<tr>
<td>1992</td>
<td>67</td>
<td>36</td>
<td>45</td>
<td>16</td>
<td>96</td>
<td>368</td>
<td>528</td>
<td>75</td>
</tr>
<tr>
<td>1993</td>
<td>74</td>
<td>53</td>
<td>18</td>
<td>13</td>
<td>116</td>
<td>371</td>
<td>478</td>
<td>71</td>
</tr>
<tr>
<td>1994</td>
<td>57</td>
<td>40</td>
<td>23</td>
<td>13</td>
<td>142</td>
<td>413</td>
<td>588</td>
<td>64</td>
</tr>
<tr>
<td>1995</td>
<td>64</td>
<td>40</td>
<td>43</td>
<td>15</td>
<td>102</td>
<td>417</td>
<td>463</td>
<td>79</td>
</tr>
</tbody>
</table>

*Source: Safin and Guba, 1996*
Commodity Markets

The combination of import protection and market intervention has certainly been instrumental in raising producer prices. Table 10 below shows that, with the exception of beef and potatoes, producer prices for most commodities are above border prices, as measured by the Nominal Protection Coefficient. The level of support is still modest relative to the EU however, in that domestic prices remain well below EU intervention prices for all commodities except potatoes.

<table>
<thead>
<tr>
<th>Commodity</th>
<th>Wheat</th>
<th>Pork</th>
<th>Beef</th>
<th>Milk</th>
<th>Potatoes</th>
<th>Sugarbeet</th>
<th>Oil Rape</th>
</tr>
</thead>
<tbody>
<tr>
<td>Percentage EU</td>
<td>1.315</td>
<td>1.050</td>
<td>0.737</td>
<td>1.278</td>
<td>0.625</td>
<td>1.757</td>
<td>1.074</td>
</tr>
<tr>
<td>% EU Price</td>
<td>68.8</td>
<td>63.6</td>
<td>40.9</td>
<td>28.4</td>
<td>100.0</td>
<td>48.0</td>
<td>na</td>
</tr>
</tbody>
</table>

Source: NPC (Safin and Guba 1996); EU, EU Intervention Prices, 1995

The objective of improved price stability has not been achieved. While the ARR provided a stabilizing influence on commodity markets during the period immediately after reform, its current influence is less favorable. A recent analysis of the domestic wheat market finds that monthly price variation is similar to or greater than comparable variation in world market prices for the period 1990-1995 (Table 11). This suggests that at best market intervention by the ARR has little impact on seasonal price variation, and at worst it exacerbates price variation - so becoming a source of instability. Moreover, the limited funds available to the ARR for intervention restricts its capacity to stabilize prices in the event that world prices depart significantly from medium-term trends, as occurred in 1995/96.

<table>
<thead>
<tr>
<th>Production Year</th>
<th>Poland</th>
<th>CBOT</th>
<th>LCE</th>
</tr>
</thead>
<tbody>
<tr>
<td>1990/1991</td>
<td>4.1</td>
<td>4.5</td>
<td>na</td>
</tr>
<tr>
<td>1991/1992</td>
<td>26.7</td>
<td>9.7</td>
<td>4.1</td>
</tr>
<tr>
<td>1992/1993</td>
<td>14.0</td>
<td>8.9</td>
<td>9.6</td>
</tr>
<tr>
<td>1993/1994</td>
<td>5.0</td>
<td>6.5</td>
<td>5.4</td>
</tr>
<tr>
<td>1994/1995</td>
<td>15.9</td>
<td>7.3</td>
<td>6.4</td>
</tr>
</tbody>
</table>

* Polish procurement prices  
* Chicago Board of Trade Futures prices  
* London Commodities Exchange Futures prices


The problems caused by current price policy and the activities of the ARR go well beyond the adverse impact on price stability. The whole process of price formation is in
fact compromised, and so the ability of commodity markets to function efficiently. As a result prices do not play an allocative role, marketing margins are much higher than they should be and the competitiveness of agricultural production is reduced.

The most obvious of these effects derives from the imposition of pan-territorial intervention prices and the associated actions to minimize normal seasonal price variation. These measures preclude private sector spatial and temporal arbitrage, and so the conventional private sector channels for distributing farm production across space and time. Traders don’t move wheat from surplus production areas in the north to deficit areas in the south; and the producers, processors and traders of pork and cereals are unable to engage in commercial storage activities without access to preferential credit for working capital. Marketing efficiency thus falls and rural people are deprived of legitimate private sector enterprise and employment.

Other, less obvious consequences of ARR activity are equally important. A recent feasibility analysis for a commodities exchange for wheat concludes that the price instability caused by ARR intervention creates risks which are too high for a commodities exchange to be viable. In addition, an analysis of rural financial intermediation finds that by distorting the normal seasonal pattern of producer prices, the ARR precludes the use of much needed inventory finance instruments such as warehouse receipts (Pederson 1996). Both outcomes of ARR intervention deprive the rural financial sector of valuable ways to expand the level of rural financial intermediation and deprive farmers of financial instruments which they could use to reduce risk, raise incomes and improve efficiency.

The ARR has also made limited progress in fulfilling its mandate to improve the flow of market information and develop wholesale markets. For instance it still takes 3-4 months for Polish wheat markets to reflect trends in world wheat prices. Moreover, the lack of primary (farm to processor) and secondary (processor to retailer) wholesale markets continues to create significant bottlenecks in the marketing chain. It also deprives buyers and sellers of an important means to put pressure on processors and traders to pay a fair price, and impedes the flow of market information -- both of which raise marketing margins.

Note also that as the ARR must generate revenues from its own activities in intermediary markets, its capacity to fulfill these roles -- so encouraging competition -- is inevitably compromised. Moreover, it uses public resources (elevators, transport, intervention and reserve management funds) to engage in these activities giving it an unfair advantage over competing farmers, processors and traders. Both factors accentuate private sector disincentives to operate in intermediary markets.

The other main source of market inefficiency is the high assembly costs which result from the small size of Polish farms and the inadequacy of current physical (roads, phones etc.) and institutional (marketing cooperatives, wholesale markets etc.) infrastructure. Price policy cannot respond to these problems. A broader mandate is needed, linked with rural development.
Factor Markets

Policies directed to land markets and rural credit have also had disappointing and frequently adverse effects on factor markets, both individually and in combination.

Credit

Public intervention in rural financial markets is viewed as the principal means to stimulate investment and promote rural development. The consequent high and increasing use of public resources is justified on the grounds that post-reform conditions render commercial credit unaffordable. Without preferential credit, the private sector would underinvest in the inputs needed to raise farm productivity and rural development would be slowed.

Available post-reform data on the level of investment in agriculture provide little support for this argument. Total investment in agriculture fell from 1992 to 1994 despite a partial recovery from 1993 to 1994. Increased private sector investment accounted for this partial recovery but remained constant in real terms on a per hectare basis (Table 12). This supports the view that the additionality generated by preferential credit is quite small. In other words, most of the 30 percent of farms which are viable and profitable would have been able to borrow at current market interest rates; and the remaining farmers would have been unable to borrow at even the highly subsidized interest rates charged on preferential credit.

Table 12. Investment in Agriculture

<table>
<thead>
<tr>
<th></th>
<th>1992</th>
<th>1993</th>
<th>1994</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Investment</td>
<td>965</td>
<td>892</td>
<td>945</td>
</tr>
<tr>
<td>(PLN Million in Constant 1994 Prices)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>% Public</td>
<td>n.a.</td>
<td>14.8</td>
<td>13.5</td>
</tr>
<tr>
<td>% Private</td>
<td>n.a.</td>
<td>85.2</td>
<td>86.5</td>
</tr>
<tr>
<td>Investment per Hectare (US$)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Public</td>
<td>n.a.</td>
<td>25.35</td>
<td>33.19</td>
</tr>
<tr>
<td>Private</td>
<td>n.a.</td>
<td>24.78</td>
<td>25.51</td>
</tr>
</tbody>
</table>

Source: Pederson, 1996

While this negligible response to such a large allocation of the public resources available for agriculture is a significant problem in itself, it has been compounded by the marked distortions which preferential credit and loan guarantees have created on both the demand and supply sides of Poland’s rural financial markets. These distortions are perhaps an even more serious problem in that they limit rural sector growth and prejudice the viability of rural financial institutions.

---

12 Low farm profitability due to adverse terms of trade in farming, and high nominal and real market interest rates
The distortionary effects of preferential credit on borrowing are well known and there is nothing in Polish agriculture policy or the sector itself that would preclude these effects. At best preferential credit allows borrowers to invest in activities which generate a low return, so lowering the overall growth of the sector. At worst it encourages rent-seeking behavior among borrowers, with the result that the rationale for borrowing has little relation with investment. Poland’s situation is especially conducive to this latter effect as the spread between market interest rates and subsidized interest rates is wide (up to 30 percent for land purchase loans) and borrowers are paying negative real interest rates. Further distortions occur where market interest rates do not serve as the basis for allocating credit, with the result that it is allocated administratively to preferred borrowers. These are usually existing clients and/or larger borrowers. This is certainly happening in Poland. Most of the preferential credit for working capital provided by the ARMA (the largest component of public financial interventions) is going to agro-processors rather than farmers, and almost all of the loan guarantees provided by the ARR are going to public sector enterprises (Pederson 1996).

In the medium to long term the distortionary impact of preferential credit and loan guarantees on rural financial institutions is of even more concern. By weakening the viability of these institutions such interventions preclude any significant increase in the low level of rural financial intermediation which is the fundamental problem for rural credit. The immediate impact is the crowding out of commercial banks from rural financial markets owing to the allocation of preferential credit. These loans, which have increased from 58 percent of total lending in 1993 to 72 percent 1995, are allocated administratively on the basis of previous lending; with 75-80 percent going to the cooperative banks, particularly the BGZ. As a result the commercial bank share of total lending fell from 24 percent in December 1995 to 21 percent in mid-1996, and the corresponding share of preferential credit for working capital fell from 20 percent to 15.6 percent (Pederson 1996). There is no “level playing field” in the operation of the rural financial sector.

Numerous other factors constrain the growth of rural financial intermediation by all rural financial institutions. The increasing use of loan guarantees increases the risk of moral hazard in that lenders are likely to become less careful in their assessment of borrower risk. The pre-occupation with credit rather than a more balanced promotion of both lending and savings mobilization does little to increase the level of rural financial intermediation. There has also been little progress in developing legislation to allow a more rational scheduling of bank debt, and more efficient loan recovery in the event of default; and in developing new types of lending instruments such as warehouse receipts.

This tendency of current policy to weaken rather than strengthen the rural financial sector is of further concern in the context of EU Accession. The EU’s recent Investment Services Directive establishes a policy of open competition in the provision of financial services, which will allow single entities to provide banking, brokerage and insurance services cross-border with prior licensing required only in the home country of the institution. Unless significant policy changes are introduced in the very near future,
Poland's weak rural financial sector will have great difficulty surviving in these circumstances.

**Land Market**

The land market remains thin despite numerous policy measures to create an active, efficient private sector land market, and a recent increase in private land market transactions (Table 13). The 248,500 hectares sold in 1995 represent only 1.3 percent of total agriculture land (18.6 million hectares), although this is a 15.9 percent increase on the area sold in 1994. Of the area sold in 1995 approximately 68 percent (170,000 ha) was sold privately and the rest by the state (ABC Poland 1997).

**Table 13. Number of Rural Land Transfers in Poland**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Non-Market Transfersa</td>
<td>128,309</td>
<td>91,038</td>
<td>98,466</td>
<td>113,225</td>
<td>105,435</td>
</tr>
<tr>
<td>Market Transfers</td>
<td>69,411</td>
<td>58,710</td>
<td>68,084</td>
<td>78,479</td>
<td>95,644</td>
</tr>
<tr>
<td>State</td>
<td>17,800</td>
<td>4,801</td>
<td>13,301</td>
<td>17,645</td>
<td>24,020</td>
</tr>
<tr>
<td>Other</td>
<td>51,611</td>
<td>53,909</td>
<td>54,783</td>
<td>60,834</td>
<td>71,624</td>
</tr>
<tr>
<td>Total Transfers</td>
<td>197,220</td>
<td>149,748</td>
<td>166,550</td>
<td>191,704</td>
<td>201,079</td>
</tr>
</tbody>
</table>

a Includes inheritance, gifts, transfer of ownership (including disposal on retirement).

Source: ABC Poland, 1997

A land rental market operated prior to the initiation of economic reform, amounting to 8-9 percent of total agricultural land. Following reform this market has expanded from 1,137,000 ha in 1991 to 1,825,000 ha in 1995. From 1991 to 1993 the area leased increased by 23-26 percent annually, driven by private transactions. The rate of increase then accelerated to 44-50 percent annually in 1994 and 1995 owing to the extensive leasing of land by APA.

A further increase in the level of activity on both land sales and rental markets is essential but is constrained by cumbersome administrative procedures and the paucity of private sector real estate agents with the knowledge to improve the efficiency of land transactions. Measures to improve the cadastre system have also made limited progress, and there is still considerable uncertainty as to the ownership of land.

Nominal land prices (excluding buildings) for private land increased by 16 percent to 2250 zl/ha (US$930/ha) from 1994 to 1995, suggesting that they may have decreased in real terms by as much as 12 percent, although anecdotal evidence suggests that land prices then increased substantially in 1996 (ABC Poland 1997). The apparent fall in real prices from 1994 to 1995 could be the result of land sales by the APA at a lower average price of 1578 zl/ha (US$650/ha). But prices for private land also varied widely by region and by quality, ranging from 1350 zl/ha for poor land to 3150 zl/ha for good land (ABC Poland 1997). The market is still too thin and information too limited to draw any real conclusions.
Despite the heavy reliance on preferential credit to effect much of the land policy agenda, there has been little consideration of the extent to which interest subsidies have raised and distorted land prices. Experience in western countries shows that public support for agriculture is inevitably capitalized into land prices, and that land prices fall if this support is reduced. In countries such as the USA and New Zealand the fall in land prices which followed agricultural policy reform during the 1980's created major problems for both farmers and rural financial institutions. Farmers found themselves insolvent as a result of the loss of equity and income/debt servicing capacity; and financial institutions found themselves insolvent due to the lower value of their loan portfolios' and their inability to collect non-performing loans en masse. Given that accession to the EU will be contingent on terminating preferential credit for farmers, the substantial recent increase in preferential credit may be creating a growing bubble which could burst with adverse results after accession. The use of preferential credit should thus be reduced rather than increased during the next few years.

The privatization of former state farm land by APA has made a mixed contribution to the land policy agenda. On the one hand it appears that most of the land suited to farming (3.38 million ha) has now been privatized, either by sale (0.49 million ha) or lease (2.90 million ha). Of the remaining 1.035 million ha, approximately 750,000 ha is considered unsuitable for farming, and the rest comprises state seed and animal breeding farms which will probably be privatized in the near future. There are reservations about the way this progress has been achieved however, notably: the preference for lease rather than sale, the preference for disposing of this land in large blocks (see next section), and the failure to establish a timetable for dismantling the APA.

The preference for land privatization by lease rather than sale has been criticized on the grounds that it privatizes production rather than ownership, and so limits the capacity of the private sector to put these assets to full private use. But given that this process is now virtually complete the issue for future policy is how to effect the transfer from private lease to full private ownership. Widespread exercise of the purchase rights conferred by most existing leases, would obviously complete this substantial unfinished agenda without the need for direct public intervention. But it remains to verify just how fast this process is moving, and the extent to which it can and should be promoted in the event that it moves slowly.

The pending completion of APA’s mandate sharpens the focus on its future. Planning should now begin to accelerate the privatization of remaining assets (including leases), to liquidate or transfer its debts and to terminate its current role and activities. Future policy should also involve the reduced use of preferential credit for land transactions, not only because it distorts land prices but also because it decapitalizes the agency and reduces its capacity to discharge its existing debt.
Farm Structure

Policy measures to encourage farm enlargement and consolidation have made little apparent impact on farm structure (Figure 1), although leasing may have resulted in a somewhat higher level of consolidation than is indicated by official figures\(^\text{13}\). The average size of private farms has increased by only 7 percent since 1990, from 7.1 ha to 7.6 ha (Pederson 1996), despite the activities of the APA, the incentive for older farmers to sell their land in return for pension benefits, increasing access to highly subsidized credit, and a program to encourage land consolidation which transfers about 100,000 ha annually\(^\text{14}\) (AVIS 1996). In addition the total number of farms has only declined by 4.2 percent, from 2.296 million in 1990 to 2.048 million in 1995 (Pederson 1996).

Figure 1. Polish Farm Structure by Size

![Graph showing Polish Farm Structure by Size](image)

Source: MAFE

The Polish perception that economies of scale render large farms more efficient, as reflected in APA privatization policy, is continued cause for concern. There is sound empirical evidence from the Srodkowo-Zachodni region that larger private farms are no more efficient than smaller farms, with optimal efficiency occurring on farms of 10-15 hectare (Van Zyl & Parker 1995). Moreover, smaller farms are found to be more labor intensive, indicating that policies which lead to increased farm size may displace farm labor without any corresponding increase in the efficiency of production. Where

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\(^{13}\) The increase is unlikely to be substantial however as new peasant leases by neighbors accounted for only 350,000 ha in 1995 (ABC Poland, 1997).

\(^{14}\) The ASAL review reports a much lower figure of 25,000 ha annually.
diseconomies of scale are observed, they are the result of weak factor markets -- notably for land and capital. Such diseconomies disappear once these factor markets begin to operate more efficiently.

There are grounds for raising farm size and reducing land fragmentation but these reside in the potential for increasing marketing efficiency as a result of lower assembly costs on the one hand, and in the desire to create farms which are able to support a farm on the other. However these factors do not justify the deliberate current preference for the lease and sale of former-state owned land in large blocks of 100 hectares or more. Given that these much larger farms will inevitably be more highly mechanized, the immediate result of this “directed” farm enlargement policy will be the displacement of farm labor, typically into the ranks of the unemployed; with probable increases in marketing efficiency but no increase in production efficiency. Thus one sub-optimal farm structure is being replaced by another.

The most appropriate policies are those that support a flexible farm structure with a range of farm sizes, where market factors and managerial ability determine individual size preferences. Creation of this flexible structure relies on developing an appropriate incentive structure based on the removal of policies and distortions which favor larger farms over smaller farms; and the development of markets to service smaller farmers in the areas where they are missing. At a minimum this would entail the provision of land for sale or lease in smaller blocks (5-20 ha) which can then be aggregated to the level deemed optimal by the purchaser; plus a more efficient and transparent system for effecting and registering land transactions. An active, efficient land market rather than government fiat is also more likely to achieve the desired increases in marketing efficiency without unnecessary displacement of farm labor.

Farm Income

Various available indices suggest that farm incomes have still not recovered to the levels extant prior to reform (Table 14), although they have been probably more or less stable since 1992. Terms of trade (output prices/input prices) have been stable since 1992, albeit at a level well below the pre-reform situation. As agricultural production fell by an estimated 2.5 percent in 1996 and the terms of trade deteriorated further, farm incomes have deteriorated somewhat since 1995. Note also that farm incomes (gross value of production less expenses) are currently around 85 percent of urban incomes. (This last index is somewhat misleading in that it excludes the non-farm income of rural households).
Table 14. Indicators of Farm Income

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross Production</td>
<td>100</td>
<td>94.5</td>
<td>93.0</td>
<td>83.0</td>
<td>89.7</td>
<td>80.0</td>
<td>89.6</td>
</tr>
<tr>
<td>Terms of Trade</td>
<td>100</td>
<td>42.1</td>
<td>30.6</td>
<td>34.8</td>
<td>33.4</td>
<td>35.4</td>
<td>35.9</td>
</tr>
<tr>
<td>Income Parity</td>
<td>100</td>
<td>66.3</td>
<td>60.6</td>
<td>75.2</td>
<td>84.4</td>
<td>78.7</td>
<td>83.3</td>
</tr>
</tbody>
</table>

Source: OECD, 1996

The inability of current policy to substantially raise farm incomes is of even more concern in that there has been a significant increase in income transfers to farmers since 1991, as measured by the Producer Subsidy Equivalent (PSE). Consumers have paid the price for these income transfers, as reflected in the increasingly negative values of Consumer Subsidy Equivalents (CSEs) during the same period (Table 15). Non-farm members of the rural population have been especially hard hit by these policy changes, especially the rural poor. Not only do they not benefit from producer subsidies, they must also pay a high and growing implicit tax on food -- an especially regressive form of taxation for low income people. Larger, wealthier farmers also benefit more from these transfers than small farmers (Safin and Guba 1996).

Table 15. Producer and Consumer Subsidy Equivalents for Agriculture

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>PSE (%)</td>
<td>9 -20</td>
<td>6</td>
<td>14</td>
<td>16</td>
<td>21</td>
<td>na</td>
<td></td>
</tr>
<tr>
<td>CSE (%)</td>
<td>26</td>
<td>35</td>
<td>2</td>
<td>-10</td>
<td>-15</td>
<td>-18</td>
<td>na</td>
</tr>
</tbody>
</table>

Source: OECD, 1996

**Agro-Processing**

Unfortunately there is little recent data with which to accurately assess progress with the privatization and growth of agro-processing. Nevertheless, it appears that the retail and wholesale trade sector is now almost entirely in private hands, and the number of new private retail firms has increased significantly. In contrast, wholesale activity remains underdeveloped and inefficient. There has also been steady growth in private sector food processing activity although this is due more to the emergence of new small and medium-scale firms than to the privatization of 70 percent of all state-owned agro-processing enterprises. Progress also varies widely between sub-sectors. Privatization of the meat processing (including poultry and egg), brewing and oilseeds crushing industries was almost complete by mid 1996. In contrast, privatization of the cereal, sugar, fruit and vegetable processing industries has been slow, and the State continues to control output markets for many major commodities through the activities of the ARR. The most recent data for the input supply side of agribusiness indicates that SOE's still accounted for 45-50 percent of the sales of fertilizer, seeds and chemicals in 1993.

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15 A portion of PZZ storage facilities were transferred to the ARR instead of being privatized.
This mixed progress with privatization has contributed to the low level of efficiency in the agro-processing sector. It penalizes agricultural production with high processing margins and, hence, depresses farm incomes. Note however that slow privatization and the continued consequent inefficiency of SOE’s has also created opportunities for private initiative, with new agro-industries leading growth in the sector’s production, value-added and employment.

The overall progress with privatization has not been matched by improvements in product differentiation and value added. Much of the agro-processing sector continues to produce commodities rather than products, and there is still much to be learned about assessing demand for more differentiated products and promoting them. If the agro-processing sector is to become more competitive it will have to invest more resources in this downstream side of operations, in addition to improvements in the costs and efficiency of production.

**Rural Development**

Rural development is an amorphous, multidimensional concept and so difficult to measure directly. However indicators such as employment and unemployment, and farm and non-farm incomes provide some insight into progress. Unfortunately the picture painted by these indicators indicates that little progress has been made. Rural employment has declined from 6.17 million in 1992 to 5.76 in 1995, a fall of 6.5 percent, while urban employment increased slightly by 0.4 percent during the same period. Rural unemployment increased from 10.2 - 12.2 percent from 1992 to 1995, while urban unemployment fell from 15.8 percent to 13.7 percent (Table 16). Effective rural development should lead to increased employment and reduced unemployment. Farm incomes have certainly not increased since 1993 and may even have fallen recently based on provisional data for 1996 and 1997 from the MAFE. Comparable data on rural non-farm incomes are not available.

**Table 16. Characteristics of Rural and Urban Labor Forces**

<table>
<thead>
<tr>
<th></th>
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<tbody>
<tr>
<td><strong>Rural Labor Force</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Active Labor</td>
<td>6874</td>
<td>7033</td>
<td>6726</td>
<td>6566</td>
</tr>
<tr>
<td>Number Employed</td>
<td>6166</td>
<td>6189</td>
<td>5892</td>
<td>5765</td>
</tr>
<tr>
<td>Number Unemployed</td>
<td>708</td>
<td>844</td>
<td>834</td>
<td>801</td>
</tr>
<tr>
<td>Unemployment Rate %</td>
<td>10.3</td>
<td>12.0</td>
<td>12.4</td>
<td>12.2</td>
</tr>
<tr>
<td><strong>Urban Labor Force</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Active Labor</td>
<td>10671</td>
<td>10361</td>
<td>10412</td>
<td>10453</td>
</tr>
<tr>
<td>Number Employed</td>
<td>8985</td>
<td>8610</td>
<td>8871</td>
<td>9021</td>
</tr>
<tr>
<td>Number Unemployed</td>
<td>1686</td>
<td>1751</td>
<td>1541</td>
<td>1432</td>
</tr>
<tr>
<td>Unemployment Rate %</td>
<td>15.8</td>
<td>16.9</td>
<td>14.8</td>
<td>13.7</td>
</tr>
</tbody>
</table>

**Source:** GUS Labour Force Survey (November data)

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16 Farm incomes fell in 1996 and are projected to fall again in 1997.
As noted above, the disappointing response to rural development initiatives may result from the low current allocation of public resources, despite their high apparent priority in agricultural policy. Most of the public support ostensibly allocated to rural development goes to farmers rather than non-farmers, and the farmers who do benefit from this support are larger and so less likely to be under the poverty line. The non-farm rural sector receives much less public support either directly for employment creation or indirectly for infrastructural development.

Wider sectoral influences may also be a factor. For instance the limited incentives for private sector activity in commodity and factor markets which results from the high level of public intervention in these markets has almost certainly impeded the growth of private sector agricultural services. It is not by chance that Poland has only one person employed in the agriculture service sector for every four farmers, while elsewhere in western Europe this ratio is reversed. Policy changes which free up markets and promote the development of market infrastructure will in themselves lead to the creation of employment as traders, transport operators and real estate agents, and in the construction and operation of wholesale markets. The increased competitiveness which these changes should bring will also stimulate rural development in response to the consequent growth of farm incomes. Recall that as the poverty gap is relatively small in rural areas, economic growth is the best way to reach the rural poor and improve their well-being.

In the current drive to further rural development through direct policy initiatives the substantial potential impact on employment creation of more general sectoral measures to improve market efficiency and raise productivity and competitiveness may well have been forgotten.
5. A FRAMEWORK FOR FUTURE POLICY

The preceding review indicates that while the broad objectives of Polish agricultural policy are appropriate, many of the policies being used to achieve these objectives are not. Five years after reform began key structural problems in the sector remain deeply entrenched. Factor and commodity markets are weak, distorted and inefficient; the size distribution of small-scale private farms has changed little; the competitiveness of farm production has yet to improve; farm incomes remain low; and rural development has yet to make a substantial impact on rural employment and unemployment.

This lack of progress is obvious cause for concern, and the rapid approach of EU accession heightens this concern. The sector is clearly not ready for the increased competition which will come with membership of the EU. Major changes to current policy are required and these changes should be made sooner rather than later.

Re-focusing the Policy Agenda

Policy reform must focus on measures which increase competitiveness on the one hand and lead to a faster and more effective level of rural development on the other. Two broad themes translate this revised agenda into action.

(1) A reduction of public intervention in factor and commodity markets and a re-allocation of at least part of the associated resources to rural development programs for infrastructure and employment, integral with a public expenditures review.

New policies to increase competitiveness should be based on less government intervention in commodity and factor markets rather than more. Not only has the current policy emphasis on high levels of intervention done little to raise competitiveness or rural incomes, it has also created major market distortions. These distortions reduce the incentives for private sector activity, and so the means to achieve a sustainable increase in the profitability and competitiveness of farm production and agro-processing. In addition to allowing markets to function more efficiently, a reduction in public intervention will also allow substantial resources to be re-allocated to rural development. These additional resources will boost investment in infrastructure and programs associated with employment creation. Increased private sector activity in factor and commodity markets will also in itself lead to increased employment, a trend boosted by growth in farm incomes.
(2) Increased emphasis on measures to improve the enabling environment and incentive structures for private sector activity.

While removal of policy induced market distortions will do much to enhance market efficiency, there remain many underlying structural problems which weaken market operations and further constrain growth. There is still much to be done in terms of improving marketing structures, property legislation and administrative procedures, and financial systems in order to create a more effective enabling environment; and in re-defining the role of public agencies and strengthening their capacity to fulfill new roles. A clearer distinction between public and private sector roles and the capacity for each to fulfill these respective roles will enhance the incentives for increased private sector activity and investment. Reform of public agencies is also needed to prepare them for their future role in a post-EU Accession environment.

Specific Policy Initiatives

Three general areas of policy reform follow from this revised policy focus: improving the efficiency of factor and commodity markets, restructuring existing institutions, and the creation of employment through rural development. The first two areas are the basis for increasing the competitiveness of the agriculture sector and a greater role for the private sector. The third area continues the existing thrust of rural development (with some exceptions), but uses additional resources re-allocated from market intervention activities to strengthen current initiatives and enhance their effectiveness.

Factor and Commodity Markets

Strengthen Rural Financial Markets. While the development of a complete, competitive rural financial market relies ultimately on overall financial sector reform, implementation of the following measures would significantly enhance this process and contribute to increased factor market efficiency. This in turn would increase the capital available for investment and the incentives for rural people to borrow.

(1) Phase out Financial Intervention

The existing system of financial intervention in agriculture has distorted credit allocation, weakened the competitive position of commercial banks and their incentives to participate in rural financial markets, prevented effective targeting of credit and failed to raise investment and farm incomes. It has also weakened the rural financial system and so its ability to compete with the intense competition which will result from the single financial market policy of the EU. Thus, rather than increasing the level of public financial intervention as the government did in 1996, it should be progressively reduced and phased out.
Initial steps towards this objective should involve a rationalization of the financial interventions by the ARR, ARMA and APA preferably by placing them under the authority of one agency. This would increase the transparency and efficiency of existing public financial interventions, provide more accurate information on their total cost (both present and future), and provide the basis for better targeting and a more efficient exchange of information. A time-bound program for phasing out interest subsidies should then be established, which emphasizes the rapid removal of interest subsidies on working capital. This will create a more level playing field for commercial and co-operative banks and so the basis for stronger competition between them; and remove one of the disincentives to expanding financial intermediation through the introduction of warehouse receipts (see next section). Loan guarantees provided to individual enterprises should also be terminated.

The resources saved by terminating these interventions should re-allocated to rural development.

Note that as direct interest subsidies are precluded under the CAP, the termination of interest subsidies on loans to individual enterprises will be a condition of EU Accession (see Box 4). Hence it is better to begin this process early in order to give farmers, processors and rural financial institutions as much time as possible to adjust to the conditions which will prevail once accession is complete.

(2) Expand the Range of Financial Institutions and Financial Services

Several important financial institutions are missing from rural financial markets in Poland, or exist but are only weakly active. This applies to commodity futures and options exchanges, and equity capital markets to serve the transactions, risk management, and venture capital needs of agriculture and rural business.

High listing requirements (substantial capital and a minimum of 300 shareholders) for the growing Warsaw Stock Exchange exclude most of the agriculture sector from existing equity markets, other than larger agro-processing companies which account for 9 percent of total capitalization. Foreign investment funds and National Investment Funds are the only other source of equity capital. Further constraints to the use of equity capital include laws which prohibit foreign entities from owning more than one hectare of land without special permission from government, and laws which prohibit insurance companies from investing premium income in rural land (investment in urban land is permitted). A review of the need for these laws is required, plus the establishment of a third tier equity market with lower capital requirements which would allow an immediate increase in the access of agri-business and agro-industry to equity capital.

Despite considerable interest in developing a commodities futures exchange for agricultural commodities as a means to hedge price risk, little progress has been made. The high price instability, uncertainty and lack of transparency in price formation which result from ARR market intervention is the principal constraint. Further problems include a lack of precise standards for commodities being traded.
and stored, low volumes of output by individual farmers, and the lack of licensed warehouse system. These are all problems which could be resolved by policy initiatives to terminate seasonal price intervention by the ARR, develop and enforce appropriate product standards, and establish marketing co-operatives and licensed warehouses.

Rural financial markets currently lack the instrument of warehouse receipts as a means to secure the financing of inventories and improve the liquidity of the sector. If established this system would improve the cash flow of participating farmers and reduce the interest rate paid on working capital. By providing an alternative form of collateral it would also lead to an increase in the quality of bank credit, an increase in the level of commercial bank participation in agricultural financing, and an increase in the overall level of financial intermediation in rural areas.

(3) Improve the Legal Framework Regulating the Use of Collateral

Current collateral law reserves seniority for the state in all secured debt (for the purposes of collecting back taxes), and treats all banks equally whether their debt is secured or not. Both requirements reduce the ability of banks to recover bad loans. Furthermore, there is no central registry for registering debt which has resulted in widespread fraud as borrowers use the same collateral to secure loans at several banks. This legislation reduces the incentive for banks to lend, and leads them to require very high levels of collateral when they do lend (typically twice the value of the debt) -- so reducing the incentive and capacity of their clients to borrow.

A new law has been drafted to address these problems. If passed it will allocate priority to registered debt based on the order in which it is registered, irrespective of whether this debt is to banks or the state. This law also provides for the establishment of a centralized pledge (collateral) registry to be maintained by the regional courts. It remains to ensure that this law is enacted as soon as possible, followed by timely establishment of the centralized pledge registry.

Continued Support for the Development of an Active Land Market

Although increasingly active the land market remains thin and in need of further support, particularly to improve the enabling environment for land transactions. A well functioning land market is the best means to obtain an optimal farm structure and improves private sector incentives to invest. Note that many of the measures which need to be taken in this regard have already been initiated. Where this applies it remains to accelerate their implementation. Essential measures include:

(1) The establishment of an active private sector real estate industry in rural areas as a means to increase the flow of land transactions, improve market transparency and arbitrage regional price differences efficiently.
(2) A simplification and streamlining of the administrative procedures associated with land transfers, which typically take 1-2 years to effect.

(3) Further legislative change and administrative action to clarify remaining uncertainty as to land ownership rights.

(4) Improvement of the cadastre. This is currently based on two registries (Land and Mortgage Register, and Land and Building Register) which are poorly co-ordinated, incomplete, cumbersome, unnecessarily expensive and ill-suited to computerisation. The recommend response to this situation is the creation of a completely new single cadastre, but the estimated cost of this option (US$ one billion) demands further, active consideration of a range of alternative solutions.

In addition, two further emerging issues associated with the lease of 2.9 million hectares of APA land, most of it with right of purchase conditions, warrant study:

(a) Estimate the speed with which this land is likely to be privatised through exercise of the right-of-purchase conditions under different interest rate scenarios (e.g., current rates versus unsubsidized rates); and the impact which this process is likely to have on land prices.

(b) Determine the extent to which the lease (and eventual sale) of this land in large blocks by the APA has introduced an artificial rigidity into farm structure. If these large blocks are composed of many smaller areas, each with their own title, then the land market will eventually resolve this problem. But if the blocks comprise few titles then market activity is less likely to be a solution. In this case there may be grounds for subdivision of these blocks, under existing ownership, to allow the land market to eventually exert its influence.

**Improve Incentive Structures for Participation in Commodity Markets**

Two sets of factors currently reduce the incentives for increased private sector activity in commodity markets. The first of these are price distortions caused by the level and form of public intervention in commodity markets. Pan-territorial and de facto “pan-seasonal” prices preclude spatial and temporal arbitrage by private sector agents and increase rather than reduce price instability. Further disincentives arise from ARR’s competitive advantage in intermediary markets due to its use of state resources. The second set of factors is the weakness of marketing infrastructure, both physical and institutional, which reduces competition and raises marketing margins. The following policy initiatives address these problems:

(1) **Terminate Seasonal Price Intervention by the ARR**

The current practice of seasonal buying and selling should be terminated. Future public intervention in commodity markets should be restricted to the purchase of farm commodities in support of a single intervention price.
(2) Develop a Rule Based Mechanism for Establishing Intervention Prices

The current system of minimum, maximum and intervention prices should be terminated. A single intervention price for each commodity should be used instead, which is set by a rule based mechanism \(^{17}\). Once established, this mechanism would operate independently of political influence and intervention.

(3) Terminate ARR Loan Guarantees for Seasonal Storage

If fully competitive markets are to evolve, all marketing costs should be reflected in marketing margins and all market agents should operate on a level playing field.

(4) Develop a System of Licensed Warehouses

Licensed warehouses provide a cost-effective system for controlling and standardising agricultural commodities held in storage, and increase farmer access to high quality storage. This system is also a pre-requisite for the introduction of warehouse receipts.

(5) Increase Support for the Establishment of Wholesale Markets

More wholesale markets are needed, more quickly. Where necessary these wholesale markets should be established with support from the ARMA, but should be owned and operated either by local government bodies or private sector interests.

(6) Increase Support for the Development of Marketing Co-operatives

More sophisticated institutions are needed to reduce assembly costs, improve product standardisation and quality, and increase the bargaining power of producers -- and ultimately to reduce marketing margins.

(7) Increase Support for Raising the Added-Value of Agricultural Products

Agro-processors and marketing institutions need to increase the value added to their products, particularly through increased product differentiation, as the basis for increased competitiveness.

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\(^{17}\) A rule based system should preferably be such that actual intervention would be rare, triggered by a price that would be substantially below an average border price.
**Institutional Reform.** The need to change policy leads inevitably to changes in the state agencies responsible for policy implementation. EU Accession provides further impetus for institutional reform in that many of the roles and activities performed by existing public institutions are incompatible with the CAP (see Box 4). As both of these influences lead institutional reform in the same direction, they should be initiated as soon as possible.

**Box 4. SUPPORT POLICIES, STATE AGENCIES AND THE CAP**

Membership of the EU will be contingent on aligning all aspects of agriculture policy with the CAP, including the roles played by the state agencies responsible for policy implementation. While this requirement allows for considerable heterogeneity in the national institutions of member countries, key aspects of their activity are tightly circumscribed. The following requirements are of particular relevance for Polish agriculture policy:

1. Interest subsidies and loan guarantees directed to private sector entities are not permissible as they violate EU competition rules. This also applies to input subsidies.

2. Structural policy provisions within the CAP do allow interest subsidies and grants to be used in the context of regional development, but this assistance cannot be extended to private sector entities.

3. While it is permissible to hold strategic reserves, they must be acquired and managed quite independently of intervention activities. For practical purposes this implies separate state agencies for intervention and strategic reserves.

4. State ownership of land is permissible (e.g., by the APA) but EU competition laws forbid any special treatment in the use of this land or the operation of state farms (subsidies, market access etc.).

5. The ARMA would be suited to administration of EU Structural Funds but would have to terminate all interest subsidies and loan guarantees to the private sector and focus its programs on regional development.

**Agricultural Marketing Agency (ARR).** The policy changes proposed above lead to a much reduced role for the ARR in that it would no longer be involved in seasonal market intervention and the promotion of seasonal storage through loan guarantees. To comply with the CAP, responsibility for the acquisition, management and storage of strategic reserves should also be transferred to a separate institution. Its role would thus be restricted to support for a rule-based intervention price, the function it would perform in a post-EU Accession environment.

Unlike current practice, all intervention should be conducted so as to minimize its influence on normal seasonal price patterns, and the level of intervention and associated costs should be completely transparent. To minimize any conflict of interest with private sector agents the ARR should also relinquish its current responsibility for promoting the development of wholesale markets and its current interest in developing a commodities exchange. These responsibilities should be wholly assumed by the ARMA. However
ARR could legitimately retain its responsibility for improving the provision and flow of market information.

_Agricultural Property Agency (APA)._ Now that the APA has largely fulfilled its mandate to privatize all assets of the former state-farms, the key issues revolve around whether it has a legitimate role to play in the future. Given the need to transfer as much economic activity as possible into the private sector it is difficult to justify any continued role. The focus should thus be on how best to close it down.

A time-bound program should be established for this action, which allows sufficient time for the efficient transfer of all its remaining assets and liabilities to appropriate public and private sector agents. At a minimum this should be affected before negotiations for EU Accession begin. In the first instance this would involve the transfer of all loans to the ARMA and all remaining debts to the State treasury. Disposition of the leases (and associated land) requires further consideration as there are two possible options: the sale of these leases to private enterprise, or their transfer to local government on the condition that the leases be terminated and the assets sold before expiry of the existing lease. While this second option postpones the eventual full privatization of these assets, it would create an additional source of revenue which local governments could use for rural development.

_Agency for the Reconstruction and Modernization of Agriculture (ARMA)._ The ARMA is already the principal state agency involved in policy implementation, with responsibility for most aspects of rural financial intervention and most of the programs directed to rural development. This mandate would be increased by the proposal to transfer all of the financial intervention activities of the ARR and the APA to the ARMA. Unlike these other institutions its role is also likely to become more important following EU accession, as it will probably become the principal agency responsible for administering EU Structural Funds for regional development. In this context the key issues facing the ARMA are the development of institutional structures best suited to these changing roles, and development of the institutional capacity to fulfill them.

The inevitable changes in institutional structure caused by these changes could follow many paths, all leading eventually to a structure consistent with the post-EU accession environment. To date however there has been little thought as to how institutional structures should evolve, as most attention has been directed to analysis of how best to align price policy. The following path for institutional reform of the ARMA is proposed as the basis for discussion (see Figure 2).

Implementation of the policy reforms outlined in section 4.2.1 would have the following immediate impact on the ARMA:

- An initial increase in financial intervention activities due to assumption of the credit programs presently implemented by the ARR and the APA; and
- The subsequent phasing out of interest rate subsidies to private sector entities enterprises and the re-allocation of these funds to rural development programs;
An associated re-allocation of human resources and administrative capacity from unsubsidized credit programs for private enterprise to the subsidised credit programs and other interventions which are associated with rural development.

This would, as an interim measure, create an agency with two functions: the provision of unsubsidized credit for private sector enterprises in the rural sector; and the provision of subsidized credit, grants and loan guarantees to public agencies involved in rural development (municipalities, schools, training programs etc.). Eventually, the unsubsidized credit programs should be discontinued as this is a private sector lending activity.

The aim should be to create a state agency responsible for rural development, before negotiations for EU Accession begin, which has the institutional capacity to administer EU Structural Funds during and after the accession process. Note also that its mandate would shift from rural to regional development to be consistent with EU policy, although this is unlikely to require a substantial change in operation. One way to boost institutional capacity would be for the ARMA to absorb the PARR, which already has experience in the administration of regional development programs financed by external sources. But further support will still be needed for staff training and a decentralized expansion of administrative capacity.

Figure 2. Re-Organisation of ARMA

Rural Development

Sustainable rural development has proven an elusive target throughout western Europe, a fact best illustrated by the disappointing response to the huge expenditure on EU Regional Development programs (Haynes 1996). Thus while Poland’s rural development program has certainly been constrained by a lack of resources, the measures proposed to increase available resources will not in themselves lead to a more positive response.
The Lessons of Experience. The lessons learned from rural development programs elsewhere in western Europe provide a sound basis for the use of current and future resources for rural development in Poland. Future policy initiatives should be based on these principles.

(1) The highest returns occur when expenditure is directed to the provision of infrastructure to make areas more attractive to businessman looking for a location and more pleasant for people to live. Infrastructure programs should thus have priority for the use of additional resources.

(2) The government’s job is to improve the general conditions in rural areas, not to target particular types of enterprise or to try and pick “winners”. Current programs directed to particular sub-sectors (dairy, poultry, sugar etc.) should be replaced by more general support for all small and medium scale enterprise; with selection of activities and enterprises for support based first on economic viability and second on the capacity to generate additional employment.

(3) Rural development should be based on a balanced allocation of resources to all rural activities, rather than the heavy bias towards farming which is evident in Poland.

(4) Rural development is most successful where local government is actively involved in the choice and implementation of development programs.

(5) The most sustainable increases in rural employment and business activities occur in rural areas which are located close to major urban centres. These centres provide a larger client base and markets, and stronger and more stable access to labour, communications and services.

(6) Efforts to locate rural development around growth points have been unsustainable; while deliberate programs to relocate major government institutions or bodies close to rural areas have had a sustained impact on rural development.

(7) Growing regional differentiation may be an inevitable result of economic change. The targeting of regions for development should thus take account of the natural and human resource base in the area and the long-term potential for sustainable growth.

(8) Resources should be directed to regions which have potential for growth due to proximity to markets or urban centres, comparative advantage in production and/or processing due to agro-climatic conditions and/or location, or the probability that public services will be relocated there; but which are constrained by: poor physical infrastructure, a poorly trained labour force, or a lack of processing or marketing facilities. (The eastern border region is a good example of this principle as it will become the new eastern perimeter of the EU and will inevitably be the object of increased government activity to monitor and control the flow of people and
commodities). But regional targeting should focus on the provision of infrastructure and general support for SME’s rather than any attempt to support particular sub-sectors or types of enterprise.

EU Structural Funds and Regional Development. Access to increased resources through the EU Structural Fund will be one of the major benefits of EU Accession. While these funds are directed towards regional (urban and rural) development this does not restrict their use for rural development, merely the regions where they can be directed to this end. (Rural development needs in regions which fall outside this plan will require funding from other sources). However access to these funds is conditional on their use for additional public support rather than substituting for existing programs of expenditure.

Thus the volume of EU Structural Funds used will depend in the first instance on Poland’s ability to generate the extra human resources, administrative capacity and associated fiscal resources to manage these funds. Note however that there is provision to negotiate for the partial use of EU Structural Funds to fund existing investment on regional development programs during the process of accession, in order to release resources to finance an expansion of institutional capacity.

Planning for the Future. While the importance of rural development to agricultural policy is clear, the magnitude of both the problems to be addressed, the resources which will become available to address them, and the difficulty of using these resources effectively make wise policy choice and good planning essential. Anticipating these needs the Polish government has already to prepare medium-term national regional and rural development plans. These national plans will also allow an accurate assessment of the additional institutional capacity needed, and provide an essential tool for negotiating EU Accession. The donor community could make a substantial contribution to this process through guidance and support.

Sequencing Policy Reform

The preceding recommendations represent an ambitious and complex program of policy reform. It is made even more demanding by the limited time frame available for implementation. Much of it is essential prior to EU Accession: first to increase the competitiveness of the sector, and second in order to align policies and institutions with the CAP as the basis for smoothing accession. The sequencing of such a program will thus play a major role in its effectiveness.

While there are countless ways to implement such a program, its sequencing should be guided by the following considerations:

(1) Policy initiatives which lead to increased competitiveness should be the immediate priority, particularly the proposals for improving the efficiency of commodity markets and strengthening rural financial markets.
Where the adjustment will be painful for the rural sector -- as with the phasing out of interest rate subsidies -- it is better to start early and move gradually.

Where the adjustment may incur significant increases in public expenditure -- as with the alignment of price policy -- it should be delayed.

Throughout the reform program the emphasis should be on gradually shifting public support for agriculture from direct subsidies to farmers to more general forms of support for rural development, with an associated shift of human resources and administrative capacity.

Proposal for Reform. Based on these guidelines, the following sequence of reform is proposed as the basis for discussion.

1997-1998

Emphasis on measures to increase competitiveness and to enhance the incentives for private sector activity in commodity and financial markets

- Terminate seasonal price intervention by the ARR
- Terminate ARR loan guarantees for seasonal storage
- Develop a rule based mechanism for the establishment of intervention prices
- Initiate a program to phase out interest rate subsidies
- Develop a system of licensed warehouses
- Subject to these changes - introduce and promote the use of new financial instruments such as
- warehouse receipts.

1997-2000

Support for development of an effective enabling environment, appropriate physical and institutional infrastructure for market activity; and institutional reform.

- Promote the establishment of a private sector real estate industry
- Effect legislative reform for the use of collateral
- Improve the legal and administrative efficiency of land market transfers
- Improve the cadastre
- Clarify remaining uncertainty as to land ownership
- Support for development of financial markets, particularly new sources of capital for investment in agriculture, agro-processing and agriculture services; and new financial instruments.
- Establish wholesale markets and marketing co-operatives, and develop measures to increase the value-added to agriculture products, particularly through increased product differentiation
- ARR: Transfer all credit and loan guarantee programs to the ARMA and establish a separate agency for the management of state reserves.
• APA: Phase it out
• ARMA: Transfer all private sector credit programs to a separate agency(s), preferably in the private sector, and expand programs for rural development particularly for rural infrastructure and job training.
• Complete preparation of long-term national regional and rural development plans as the basis for use of EU Structural Funds

2000-2002

Negotiation and final preparation for EU Accession.

• Align price policy with CAP (just prior to accession).
• Align institutional structures with CAP
• Strengthen institutional structures of the agencies to be responsible for EU program implementation (ARR, ARMA)
• Negotiate pre-accession program of support for rural development
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