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Abstract

Poverty and unequal income distribution increased dramatically within the last decade in the transition economies of Europe and Central Asia. While the percentage of the population living in absolute poverty (based on available 2.15 US$ per day) is close to nil in Slovenia, the Czech Republic and Croatia, between 40 and 70% of the population in Tajikistan, Kyrgyz Republic and Armenia fall below the poverty line. In principle, all transition countries experienced an economic breakdown at the beginning of the transformation process. However, this breakdown was more severe and more prolonged in some regions. Various reasons may be given to explain the dramatically increasing poverty. On the one hand, the transformation process caused a collapse of the social and economic infrastructure. The declining domestic production, on the other hand, put pressure on the public budget due to reduced tax revenues and private income. The sharp drop in demand for labour entailed large declines in employment and wages. Particularly in rural regions, hidden unemployment in the agricultural sector can be observed. The probability that a rural household falls below the poverty line is thus 50% higher than for an urban household in a transition country.

This contribution focuses on the extent of rural poverty in the Balkans, specifically Bulgaria and Romania. Based on the structure of the private agricultural sector in these two countries and based on the programs and instruments favoured by the European Union (EU) for rural development, the contribution outlines ways how rural poverty can be reduced by strengthening the non-farm sector. The unsatisfying development in the agricultural sector of these two countries and other transition countries will require strategies to secure rural livelihoods. The importance of the non-farm sector needs thus attention as the EU will adopt a more agricultural and rural face than ever before.

RURAL POVERTY ALLEVIATION THROUGH NON-FARM INCOME IN TRANSITION ECONOMIES

JUDITH KNÜPFER and GERTRUD BUCHENRIEDER*

1 Introduction

Poverty and income inequality have increased dramatically in the transition economies of Europe and Central Asia over the last decade. Whereas the percentage of the population living in absolute poverty (defined as an income level of US$ 2.15 per day or less) hovers around the zero mark in Slovenia, the Czech Republic and Croatia, between 40% and 70% of the population in Tajikistan, Kyrgyzstan and Armenia fall below the poverty line. Virtually all transition countries experienced a collapse in economic output in the initial years of transition, but the drop was much sharper and the recovery slower in some parts of the region. Various reasons can be cited for the spiralling poverty. Firstly, the transition process has triggered the collapse of social and economic infrastructures; secondly, declining output has exerted substantial pressure on states' budget revenues and on private incomes. In particular, the fall in demand for labour has resulted in a drop in private incomes and wider income disparities. In rural areas, a high level of disguised unemployment in the agricultural sector and an increased risk of poverty can be observed. Indeed, in transition countries, the likelihood that a rural household will fall below the poverty line is as much as 50% higher than for an urban household. The increase in productivity in the private agricultural sector is likely to intensify pressure on the labour market. For this reason, the non-farm sector in particular will play an important role in reducing rural poverty.

The present paper discusses the scale of rural poverty in the Balkans, especially Bulgaria and Romania. At Helsinki in December 1999, both countries were invited to open accession negotiations with the European Union (EU). Starting with the structure of the private agricultural sector in these countries, the paper will critically examine the opportunities and limits of the EU's rural development programmes and instruments, especially as regards their potential to reduce rural poverty. Reducing rural poverty is immensely important for EU enlargement, which will give the EU a more agricultural and rural profile.

After outlining the urgency of the poverty problem - especially in the rural areas of the transition economies - in Section 2, Section 3 describes how the introduction of non-farm work can maximize the rural population's earned income. The transition in the agricultural sector and the rural labour market in Bulgaria and Romania, and the EU's funding programmes, will then be discussed (Section 4). Section 5 analyses the limits to the development of a non-farm sector in transition economies empirically, and examines the extent to which the economic situation of diversified family farms differs from that of non-diversified farms. The article finishes with conclusions and recommendations.

2 Poverty in rural areas during transition

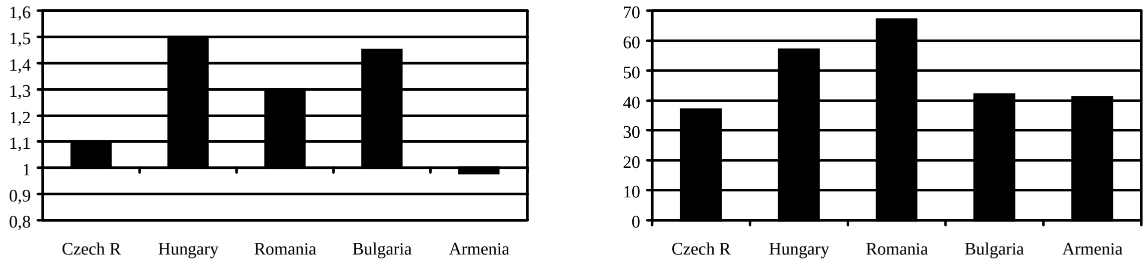
According to an estimate by the WORLD BANK (2000a), around 20% of the transition countries' total population live in absolute poverty, i.e. they have to survive on less than US$ 2.15 per capita per day. However, the share of the population living in absolute poverty varies

* We would like to thank Birgit Schäfer and Frank Litzka of the University of Hohenheim for their comments during the revision of the manuscript. Also we would like to point out that this is an extended version of a presentation given at the Conference on International Agricultural Research and Development in Bonn, October 9-11, 2001.

in the individual countries. Whereas the percentage of the population living in absolute poverty hovers around the zero mark in the more affluent transition countries such as the Czech Republic and Croatia, 40% of Armenia's population live below the poverty line. The relative poverty risk index[1] is also generally higher for rural areas (Figure 2.1). With few exceptions, the risk that a rural household in Central Europe and the Baltic in particular will become poor is 50% higher than for the population as a whole.

Figure 2.1: Relative poverty risk affecting the rural population; the poor as a share of the rural population

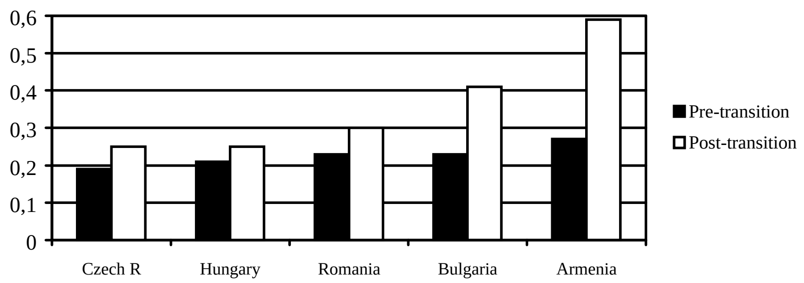
Relative poverty risk affecting the rural population — Percentage of persons living in poverty in rural areas



Source: WORLD BANK (2000a: 76 & 97)

Alongside the sometimes drastic slump in output during the first years of transition, the increasingly unequal distribution of a shrunken national income has caused a rapid and widespread increase in poverty. In Central Europe, e.g. Hungary, income inequality has increased relatively little. The Gini index[2] rose from a mere 0.21 (1987) to 0.25 ten years later. In South Eastern Europe, the situation is already very grave. In Romania, the Gini index rose from 0.23 to 0.30 and in Bulgaria, indeed, from 0.23 to 0.41 during the same period (Figure 2.2).

Figure 2.2: Changes in income distribution before and after transition, Gini coefficient



Source: WORLD BANK (2000a: 140)

The tendency for incomes to be distributed less "fairly" during the transition to a market economy was to be expected in view of the egalitarian starting position and was even desirable to some extent. In some countries, however, distribution patterns have emerged within a matter of years which are comparable with conditions in South America. For example, the Gini coefficient in Armenia soared from 0.27 (1987-90) to 0.59 (1996-99)

[1] Relative poverty lines define poverty relative to national living standards and are usually set as a fixed percentage of median or mean equivalent household income. A relative poverty index of rural areas greater one implies that the incidence of poverty among rural households is greater than among urban (World Bank 2000a).
[2] The Gini index of income is a measure of the degree to which income among a population is unequally distributed. The Gini coefficient ranges from 0 to 100%. If the income is perfectly even distributed, the Gini coefficient is 0%. If the income is perfectly concentrated, the Gini coefficient is 100%.

(WORLD BANK 2000a). There seems to be a tendency for income inequality to become more pronounced when structural reforms are hesitant and fragmented and when the country becomes mired in corruption. The comprehensive social security systems have also collapsed. In some countries at least, there is a risk that poverty will become entrenched at a high level and develop into a political and social tinderbox (KFW 2001).

Historically, South Eastern Europe[3] has been the least developed region in Europe. Initial conditions at the onset of the transition process were less favourable than in other transition countries in Europe (WORLD BANK 2000b). Even towards the end of the 1990s, average per capita income in South Eastern Europe only amounted to around half that of the more advanced European transition countries (Table 2.1). Whereas CEE's productivity in 1998 was almost 1.5 times higher than the 1989 level, in the SEE economies it reached just 90% of its 1989 level. Deeper enterprise restructuring and new investment will be needed to sustain productivity improvements achieved primarily through the shedding of jobs during the early years of transition (WORLD BANK 2000b).

Table 2.1: South Eastern Europe's income compared with other European transition countries

	1998 population (million)	1998 GNP (bill. US$)	Per capita income (US$)
South Eastern Europe (SEE)			
Albania	3.4	3.1	810
Bosnia-Herzegovina	4.2	4.0	920
Bulgaria	8.2	12.5	1230
Croatia	4.6	21.3	4520
FR Yugoslavia	10.6	17.4	…
Macedonia	2.0	3.5	1290
Romania	22.5	38.1	1390
SEE-7	55.5	99.9	2223
CEE-5	66.4	274.1	4329
SEE-7 as a % of CEE-5	84	36	51

Source: WORLD BANK (2000b: 11)

Note: GNP = Gross National Product; CEE = Central and Eastern Europe; CEE-5 = Slovak and Czech Republics, Slovenia, Hungary and Poland

3 Utility-maximizing labour allocation in the rural economic area

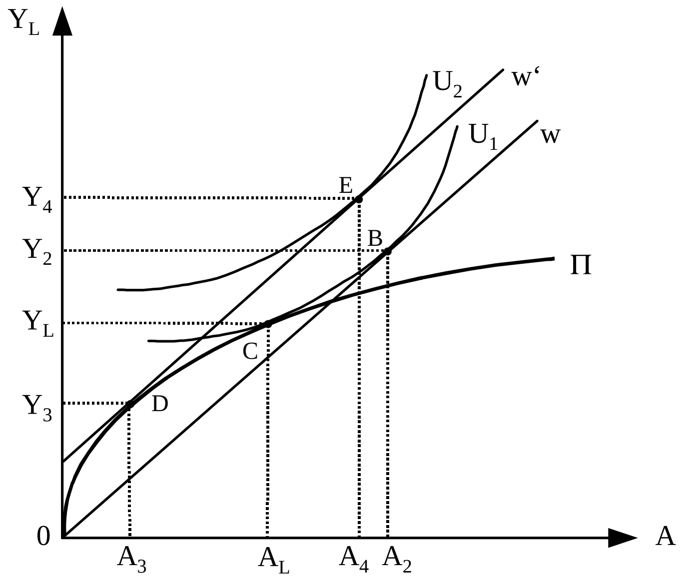
In neo-classical theory, the agricultural household divides its total time between labour, e.g. working on the farm and working off-farm, and leisure. The division depends on the potential to generate agricultural income, the opportunity costs of farm labour (non-agricultural wages) and the household's utility function (BAUER 2000). There are two main employment alternatives: specialization in a single occupation, and diversification (MUNDLACK 2000). Figure 2.2 describes the decision-making process of the utility-maximizing agricultural household. Total available time is depicted on the x-axis. The income opportunity function Π describes how much (income) the farm can produce with a given level of labour input (in working hours and/or number of people). At a given utility function U_1 and without the opportunity to work off-farm, the farmer would spend AL time working the farm, earn Y_L, and

[3] South Eastern Europe comprises Albania, Bosnia-Herzegovina, Bulgaria, Croatia, the Federal Republic of Yugoslavia (Serbia and Montenegro), Macedonia and Romania (World Bank, 2000b).

reach the utility in point *C*. If employment were available outside agriculture, the farmer could reach the same utility level on U_1 in point B, where the off-farm wage line *w* touches the utility function U_1. The optimal decision would be to divide the working time between agriculture and non-agriculture because in this case the farmer would be able to reach the higher utility function U_2. The tangent *w'* of the off-farm wage line *w* touches the utility function U_2 in point *E*. This corresponds to the marginal farm wage in point *D*. In this labour allocation model, the farm household now works off-farm for A_4-A_3 units and on-farm for A_3 units. The farm household reaches the combined income level Y_4 which is higher than in either alternative: exclusively agriculture or off-farm employment (BAUER 2000). If employment opportunities in the form of self- or wage-employment exist outside agriculture and if labour demand exceeds the farm demand, it is this higher utility level that makes the coexistence and diversification of employment so attractive to an agricultural household (BAUER 2000, MUNDLACK 2000).[4]

The theoretical optimum of combined on- and off-farm work, described above, depends on the availability of employment opportunities outside agriculture or independent non-farm opportunities in rural areas of transition countries (Figure 3.1). Agricultural labour is often described as a quasi-fixed production factor because high investments in human capital lead to high sunk costs when leaving the sector (BAUER 2000). The opportunity costs of farm employment decrease with increasing age. In Romania and Bulgaria respectively, 58% and 38% of the labour force in family farms is older than 55 years. Despite the age structure of private family farms, 41% of the farms in Romania are part-time farms, as are 86% of Bulgarian farms. This is largely due to decollectivization together with imperfect land markets which have resulted in small-scale subsistence-oriented farms (GREIF 1997, MACOURS and SWINNEN 1998).

Figure 3.1: Utility maximization through diversification of employment in the agricultural sector



Source: HENRICHSMEYER and VON WITZKE (1991: 359)

[4] The non-farm sector includes all income creating activities in rural areas, except agriculture, livestock, fishing and hunting(LANJOUW und LANJOUW1997).

[5] The percentage of agricultural employees has increased in both absolute and relative terms. If the number of agricultural employees in 1990 is equal to 100, the number of persons employed in agriculture had risen by 16% four years later. This figure had fallen to 5.6% in 1996 (OECD 1998).

4 Restructuring the rural economic area

Section 4 begins by describing the transition in the agricultural sector and rural labour market in the CEE. This is followed by an overview of rural policy in the context of EU enlargement.

4.1 Transition in the agricultural sector and rural labour market

In 1995, GDP per head purchasing power standard (PPS) in the CEE-10 amounted to just 38% of the EU average. The lowest levels could be observed in Romania (32% of the EU average) and Bulgaria (28%). The lowest overall level was reached by Lithuania, where per capita GDP amounted to just 25% of the EU average. Between 1995 and 1997, growth in the CEE-10 increased by an average of just under 4% per annum, thus decreasing the GDP gap from 38% to 40% of the EU level. However, the gap has not decreased in all countries. In Romania and Bulgaria, per capita GDP fell from 32% to 31% and in Bulgaria from 28% to 23% of the EU average (MOUQUÉ 1999). Due to political and economic problems, real GDP fell by 10.1% (1996) in Bulgaria, and although there were already clear signs of economic recovery in the second half of 1997, it fell again by 7%. Since 1997, annual real growth rates between 2.5% and 3.5% have been achieved. In Romania, real GDP fell by 6.6% in 1997. During this period, production in the agricultural sector in both countries developed more strongly than in the industrial or service sector, and agricultural output, as a proportion of GDP, remained at virtually the same level as at the start of transition (KNOGLER 2000, TROSCHKE 2000, MOUQUÉ 1999).

Overall, agricultural employment in the majority of CEE countries has decreased, although it is still higher than in most EU Member States. Agricultural labour adjustments differ considerably in the transition countries because it is related to varying patterns of farm restructuring. One pattern is that of the Czech Republic and Hungary, where massive labour outflow coincides with a consolidation of large-scale farm structures, strong decline in output and increases in labour productivity. The second pattern is that of Bulgaria and Romania, where labour input in agriculture has decreased to a far lesser extent or even increased, coinciding with a much stronger increase in family farms and a smaller fall in output. Labour is a key source of income for many people in transition countries, and especially for the poor. Since the probability of being poor is 50% higher in rural than in urban areas, the focus here is on the impact of agricultural structure and labour reforms (MACOURS and SWINNEN 1998). By 1997, the percentage of persons employed in agriculture had risen to 39%[5] in Romania and 24.4% in Bulgaria. Of all ten EU accession candidates, these two countries thus have the highest percentage of persons employed in agriculture, above Lithuania and Poland (EC 1999a).

Agriculture suffered from sluggish privatization and land restitution until 1997. Thereafter, the timetable for the restitution of land and agricultural assets was accelerated, agricultural prices were largely liberalized and export taxes were lowered. This has been a very complex, time-consuming and costly process, as no proper records of the original boundaries of plots exist. Presently, about 2.2% of the farms are state-owned. The majority of agricultural enterprises are privately owned, including more than 66% by natural and about 3% by legal persons. The structural reform in agriculture has given rise to small farms with an average size of 3.9 ha. The average size of the nearly eight million parcels was 0.6 ha. in 1998 (KOPEVA, DOICHINOVA and MADJAROVA 2001). The share of agriculture in the economy is currently around 13% of GDP (KNOGLER 2000).

In Romania, between 1989 and 1990, former farm workers spontaneously dismantled agricultural co-operatives and a series of laws was then passed which legalized this "repossession" (DAVIS, BREITSCHOPF and BUCHENRIEDER 2001). Land Law No. 18/1991 regulates the restitution of land to its former owners. Landless rural households which used to work for co-operatives, or other landless rural inhabitants, were granted ownership rights to up to one-half of a hectare in Romania (CHIRCA and TESLIUC 1999). As early as 1993, 86% of land used for agricultural purposes had been returned to around 2.8 million private owners, with 60% of the agricultural land and 80% of arable land being owned by individual farms with an average area of around 2.2 ha. It was not until 1994 that Lease Law No. 16 permitted the reapportionment of land on a lease basis. Since 1997, the maximum limit for land leasing has been set at 500 hectares. In 1998, a decree was adopted which extended land restitution from 10 ha to 50 ha per person. Law No. 5/1998 now also permits the purchase and sale of land in private ownership and establishes a maximum limit of ownership of 200 hectares. Land Law No.1/2000 maintains the upper limit of ownership rights on restitution at 50 ha for agricultural land and 10 ha for forests (DAVIS, BREITSCHOPF and BUCHENRIEDER 2001). As a result, most of the land was restituted to the elderly, who accounted for 41% of the rural population and owned 65% of the land (WORLD BANK 2000a). By 1997, the structure of the agricultural sector was such that 12% of total agricultural land was still occupied by the former state-owned farms, 12% was held by agricultural associations, 8% by farmers' associations, and 59% in individual farms. On average, a private family farm cultivates about 2.2 ha. The restitution of land and the slow introduction of a legal framework for a land market resulted in almost 50 million parcels of agricultural land. The share of agriculture in GDP was about 19% in 1999 (TROSCHKE 2000).

There is growing evidence that in the Central and Eastern European countries (CEECs), rural households commonly depend on non-farm sources for 30-50% of their income (see DAVIS AND GABURICI 1999; GREIF, 1997), which is a similar proportion to those found by ELLIS (1999) in southern Africa (on average 40%) and in South Asia and Latin America, where rural households are around 60% dependent on non-farm income (LANJOUW 1999; REARDON ET AL., 1999). Kopeva, Doichinova and Madjarova (2001) estimate that the private farms in Bulgaria obtain about 40-42% of their family income from non-farm activities. On average, diversified family farms in Romania obtain incomes 25% higher than those based exclusively on agricultural activities (DAVIS 2001). The share of the agricultural population involved in non-farm activities varies quite widely, ranging from 13% in Hungary, 41% in Romania and 66% in Bulgaria (GREIF 1997, MACOURS and SWINNEN 1998). In the CEECs, the share of enterprises with supplementary activities is highest in regions with large-scale agriculture (15-20%). In general, in countries with scattered rural structures, the demand for additional employment is extremely high (e.g. Bulgaria, Poland, Romania and Macedonia); however, opportunities are less numerous.

Creating more opportunities for off-farm work in the Balkans has become a formidable task for policy-makers when the high levels of rural unemployed and depth of poverty in the Balkans is compared to that of Central Europe and the EU (MILANOVIC 1998). In transition countries, a significant proportion of the population still lives in rural areas.[6] Furthermore, there are signs that the agricultural sector is unable to generate sufficient income for the rural population, especially poor population groups. Demand for jobs in rural areas cannot be met productively through the agricultural sector, and poverty is increasing. Due to the poor mobility of factor labour and the limited absorption capacities of the urban centres, only the non-farm sector remains as a major source of potential demand for labour (BREITSCHOPF and SCHRIEDER 1999, DAVIS and ROBINSON 2000).

[6] In the CEEC-10 in 1997, for example, between 30 and 45% of the population still lived in rural areas: Bulgaria 31%, Czech Republic 34%, Hungary 34%, Poland 36%, Slovakia 40%, Slovenia 48%, Romania 43%, Estonia 26%, Latvia 27% and Lithuania 27% (WORLD BANK 1999).

4.2 Rural development and EU enlargement

In the EU-15, rural areas cover 80% of Community territory (EC 1999b). After EU enlargement, this figure is likely to increase. In the EU, rural development was given fresh political impetus in 1998 when the European Commission published its working document "Situation and Outlook - Rural Developments" (EC 1997). In the past, rural areas as a spatial category have often been equated with agriculture as the only sectoral activity (SARACENO 1994). As a result, the goal of "guaranteeing the future of rural areas and promoting the maintenance and creation of employment" (EC 1999b: 1) was pursued primarily through agricultural market and structural policy measures. With Agenda 2000, the need for a territorial and cross-sectoral approach to rural development was recognized politically, and it was acknowledged that not only the common agricultural policy (CAP) but also rural policy have an important role to play in the cohesion of EU territorial, economic and social policy (EC 1999b). In contrast to the sector-related policies of the 1990s, Agenda 2000 favours integrated development policy approaches for rural areas.

In the context of EU enlargement, the socio-economic imbalances between individual regions in the CEE have been recognized as one of the most intractable problems of transition (HAARBECK and BOGNER 1997). Alongside the classical problems faced by rural areas, which are all too familiar in the EU-15, the stagnation in rural development in the CEE is mainly caused directly or indirectly by the socialist legacy (GREIF 1997, JACKMAN 1995, JAKSCH *et al.* 1996, KÖSTER 1997):

- Large-scale release of surplus labour during transition, especially in heavy industry and agriculture: open unemployment in rural areas in the CEE transition countries amounts to 30% and above. Agriculture remains the most important source of income, but incomes here are below-average.
- No regional competence, as the creation of economic centres, housing, education services and social institutions was based on centralist decision-making.[7]
- Monostructured regions, i.e. strong concentration and vertical integration of specific economic sectors. Due to the lack of diversification of economic activities, no alternative job opportunities are available. This exacerbates the sluggish expansion of the private sector.
- High average age of persons working in agriculture due to the restitution of land to former owners.
- Neglect of rural infrastructure, especially social institutions. Restructuring of farms and the privatization of state-owned enterprises were often accompanied by the collapse of social institutions. Infrastructural deficiencies result in high market transaction costs for goods, services and production factors such as labour.
- Mobility restrictions on factor labour: the poor condition of the transport infrastructure and bottlenecks in the housing market limit labour mobility.
- An exceptionally high level of environmental pollution and damage.

During the first years of reform, the transition countries focussed primarily on achieving macroeconomic stability; available financial resources were thus concentrated on growth centres and growth sectors. There was also a view that market forces would help to achieve an acceptable balance in the distribution of economic activities around the regions. Once economic stability was achieved, development policy - especially at national and regional

[7] In Romania, centralization went so far that traditional village structures were destroyed through forced resettlement.

level - was given higher priority, and it was recognized at political level that the growing regional disparities had to be addressed. The prospect of EU accession and assistance from the EU Structural Funds (see Appendix 1) is a further strong incentive for the CEECs to create the necessary decentralized administrative capacities for effective regional policy. At present, only Hungary, Romania and Latvia have established a specific legal basis for regional policy. In Slovenia and Bulgaria, draft legislation is being debated in Parliament.

Bulgaria is currently adopting a raft of regional policies within a constitutional framework which aims to promote balanced regional development. Regional measures are now being drafted which form part of national development policy and will be implemented on a sectoral basis. For regions with structural problems, specific programmes have been designed to improve infrastructure and the environment. The draft regional development legislation will contain regional policy guidelines targeted towards less-developed industrial and rural areas. In Romania until 1998, regional policy was implemented within the framework of spatial planning. The Regional Development Law was then adopted on the basis of the joint Green Paper by the EU and the Government of Romania (1998). The Romanian Green Paper on regional development policy and analysis contains agricultural policy recommendations but also explicitly recommends that small and medium enterprises be set up in industry, the craft sector, trade and services as a rural development strategy. The Romanian Rural Development Law is intended to create a coherent legal and institutional framework for regional programmes. It also envisages the establishment of a National Rural Development Agency to be responsible for managing the assistance from the EU Structural Funds after accession (MOUQUÉ 1999).

In future, as in 1997-1999, the Phare programme (*Poland, Hungary Assistance for the Restructuring of the Economy*) will be the main channel through which EU assistance will flow to the CEECs. Through the EU's Agenda 2000, two further instruments are now available to prepare the CEEC structures for EU enlargement: ISPA (*Instrument for Structural Policies for Pre-Accession*) and SAPARD (*Special Accession Program for Agriculture and Rural Development*). [8]

The pre-accession instrument SAPARD contains a broad package of rural development measures which are intended to help associate countries prepare for participation in the CAP and the internal market. Another important aim of the programme is to equip the countries' administrations with the capacities to manage the EU Structural Funds effectively after accession. Out of all public financing for the programme, EU funding may reach a maximum of 75%. For revenue-generating investment, public funding may not exceed 50% of total costs; of this public sector element, EU finance may be up to 75% (see Figure 4.2). Table 4.2 lists agricultural and non-farm measures which are eligible for SAPARD funding (EC 1999a and 1999c; POPPINGA, FINK-KESSLER and LULEY 1998).

Within the SAPARD framework, each candidate country[9] draws up a *National Plan for Agricultural and Rural Development* (NPARD) covering the 2000-2006 period. The proposed measures should reflect national priorities and the development potential of rural areas. The strategy devised should contain clearly defined and quantifiable targets and identify the expected benefits. On the EU side, market efficiency and job creation in rural areas are seen

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[8] ISPA focusses on two areas, i.e. environment and trans-European networks and their expansion into Eastern Europe. With an annual budget of 1040 million euro for 2000-2006 (price basis 1999), ISPA will fund up to 85% of public expenditure. SAPARD is a structural assistance programme for agriculture and rural development. In particular, it will help the accession countries implement the *acquis communautaire* in matters of the CAP and related policies. The SAPARD annual budget amounts to 520 million euro for 2000-2006 (price basis 1999). Together, the two programmes provide more than 1500 million euro annually for 2000-2006 (price basis 1999). Total funding from Phare, SAPARD and ISPA amounts to 3 billion euro annually for 2000-2006.

[9] The candidate countries are Bulgaria, the Czech Republic, Estonia, Hungary, Lithuania, Latvia, Poland, Romania, Slovakia and Slovenia.

as particularly important. The plans must also take account of the EU's rural policy principles: a focus on disadvantaged regions, additionality, subsidiarity, partnership in policy-making and project implementation, and economic and ecological sustainability. Table 4.3 shows the allocation of the 520 million euro provided annually through SAPARD for the period 2000-2006 on a country-by-country basis.

Figure 4.2: SAPARD funding model

SAPARD Measures

Source of funding:	Private Investments		Public Investments
Private Sector:	50%		
Public Secotr:	12,5%	} 50%	20% - 25%
EU-SAPARD:	37,5%		75% - 80%

Table 4.2: SAPARD eligible measures

<table>
<tr><th>Agricultural sector</th><th>Non-farm sector</th></tr>
<tr><td>• Investments in agricultural holdings,
• Improving the processing and marketing of agricultural and fishery products,
• Improving the structures for quality, veterinary and plant-health controls, for the quality of foodstuffs and for consumer protection,
• Agricultural production methods designed to protect the environment and maintain the countryside,
• Setting up farm relief and farm management services,
• Setting up producer groups,
• Land improvement and reparcelling,
• Establishment and updating of land registers,
• Forestry, including afforestation of agricultural areas, investments in forest holdings owned by private forest owners and processing and marketing of forestry products ,</td><td>• Development and diversification of economic activities, providing for multiple activities and alternative income,
• Renovation and development of villages and the protection and conservation of the rural heritage,
• Improvement of vocational training.</td></tr>
<tr><td colspan="2">• Development and improvement of rural infrastructure,
• Agricultural water resources management,
• Technical assistance (including studies to assist with the preparation and monitoring of the programme, information and publicity campaigns).</td></tr>
</table>

Source: EC (1999c: 1)

To what extent the non-farm sector can help to reduce disguised and open unemployment (averaging 30%) in rural areas in transition countries is unclear (KÖSTER 1997). For Bulgaria, however, it has been shown that private agricultural enterprises earn around 40-42% of their family income outside agriculture, and diversified family farms in Romania have an income around 25% higher than purely agricultural enterprises. Although SAPARD's list of eligible measures does not make specific mention of the non-farm sector (cf. Table 4.2), it is explicitly referred to in the Green Paper by the EU and the Government of Romania (1998), which identifies setting up small and medium enterprises (SMEs) in industry, the crafts sector and services as a strategic goal. This view corresponds with URFF (1999), who even claims that it is the second and third sector and not the agricultural sector that will produce development incentives for rural areas. It is for this reason that the SME sector is of great interest of policy-makers and to private and public financial intermediaries (KLEIN 1996).

Table 4.3: SAPARD: Indicative annual allocation (in million euro at constant 1999 prices)

Poland	Romania	Bulgaria	Hungary	Lithuania	Czech Republic	Latvia	Slovakia	Estonia	Slovenia
168.683	150.636	52.124	38.054	29.829	22.063	21.848	18.289	12.137	6.337

Source: EC (1999c: 1)
NB: Indicative allocation of assistance to the CEE applicant countries based on the following objective criteria: (1) agricultural population, (2) land area used for agricultural purposes, (3) GDP per head purchasing power standard (PPS) and (4) the specific situation of individual areas.

5 Descriptive empirical analysis of rural economic development in Bulgaria and Romania

Against the background of EU enlargement, attention is increasingly focussing on rural development. The fundamental question which arises in the context of rural policy is whether an active economic balance between the regions is preferable to market economic assertion of regional competition principles. In theory, with fully liberalized and unregulated markets, regional disparities would be evened out through factor migration and an adjustment of factor wages. If the assumptions underlying the neo-classical model, i.e. perfect mobility and homogeneity of factors, are removed, achieving a regional balance via competition soon reaches its limits unless it is accompanied by targeted measures (WEISE 1995). Ultimately, the decision to promote a better national balance between economic options and social conditions is a political one (HAARBECK and BOGER 1997).

As part of the planned EU enlargement, the pre-accession instruments Phare, ISPA and SAPARD are intended to support candidate countries in overcoming structural challenges. ISPA is a regional policy instrument which focusses on promoting the environment and trans-European networks in the Eastern European accession countries, while SAPARD plays a key role in rural development. The applicant countries submit rural development plans to the STAR Committee (Committee on Agricultural Structures and Rural Development). The STAR Committee has now approved all ten programmes submitted by the applicant countries. Out of its annual allocation of more than 150.6 million euro from SAPARD, Romania has earmarked an average of 42.7% (64.32 million euro) for integrated rural development measures in its plan for 2000-2006. In Bulgaria, an average of 23.8% (12.4 million euro) out of a total of more than 52.1 million euro per year is being allocated to appropriate measures within the SAPARD programme. The strategic objectives pursued by Romania and Bulgaria include developing an efficient and sustainable agricultural production and food sector, as well as sustainable rural development. In both countries, this includes creating new jobs, diversifying economic activities, developing and renewing infrastructure, and improving vocational training for agricultural employees (EC 2000a and 2000b). Ultimately, both countries have opted to allocate only a small percentage of SAPARD funds specifically to the development and diversification of economic activities in rural areas: 6.2% in Bulgaria and 9.6% in Romania (annual average for 2000-2006). Funding for agricultural enterprises is given higher priority: 30.4% in Bulgaria and 14.5% in Romania (annual average for 2000-2006). It is precisely this policy of agricultural sector restructuring which, as a result of increased labour productivity with better access to capital and land, will result in the further release of surplus labour.

As early as 1997, a structured survey of 220 farm households showed that 41% of the sample had some RNFE full-time or secondary employment (farming as a primary and RNFE secondary activity 10% and RNFE only 31%) in 1998 (BUCHENRIEDER, HEINING and HEIDHUES 2000, DAVIS, BREITSCHOPF and BUCHENRIEDER 2001). As noted earlier, 72 rural MSMEs in the counties of Brasov and Dolj (in 1998) and 74 MSMEs in the county of Timis (in 1997) were interviewed using a structured questionnaire in 1997.[10] In Romania, small and medium sized enterprises (SMEs) are officially defined as those firms employing 50-250 persons). The number of employees in the enterprises in our sample was generally below 50, with an average of five. As one might expect, 83% (N=121) of the MSMEs were established between 1990 and the time of the survey in 1997. Yet 21 of the MSME operators stated that they had set up their enterprise before 1990; the oldest enterprise had been established in 1954. The MSME operators were asked for the reasons why they had established an non-farm enterprise. Multiple answers were allowed. The majority of operators felt that the non-farm enterprise would open up a new source of income to support their livelihood. This reason was given in 63% of all responses, i.e. by 111 operators. The second most important reason given was the positive economic development of the village, which would allow new activities. This response was given by 41 operators, corresponding to 23% of all answers given. The majority of the non-farm enterprises were in retail; some were in the wholesale business (43%, N=63). 27.5% of the MSME operators were employed in the service sector, mainly in repair shops and restaurants (N=40). Only 12 MSMEs were engaged in the processing of agricultural products (8%). A further 12% of the enterprises could be categorized as textile industries, construction business, metal industry and timber work (N=15)

Table 5.1 shows the non-farm enterprise operators' evaluation of the importance of different aspects of their location. If the percentage share of scores for ‘very important’ and ‘important’ are added together, the road network is the most important factor for location and thus for business success, according to the interviewees. This is followed by the qualifications of their employees. Almost 90% of all non-farm MSME operators felt that their workforce's qualifications were ‘very important’ or ‘important’. The third most important factor for a good business location is proximity to input markets (83% of the ‘very important’ and ‘important’ scores). It comes as no surprise that a large share of the business owners would be in favour of subsidized development programmes provided by the state or some other agency. In fact, merely on the basis of ‘very important’ scores, this aspect of business location ranks first with 55%.

The operators of the non-farm enterprises were asked to specify the constraints on their business development. Figure 5.1 shows the constraints on non-farm rural MSME development. The constraints are ranked. Unsurprisingly, the tax burden was mentioned as the enterprise's foremost constraint. While the output price structure was not perceived as a significant problem, the high input prices were mentioned in second place as constraining factors. Insufficient equity capital together with a lack of available credit feature prominently as problem areas for non-farm MSMEs. More than 40% of the entrepreneurs had no access to credit. Interestingly, the availability of sufficient employees and their motivation were not perceived as serious problems. The employees' qualifications also only posed a problem to enterprises in a few cases. On average, the non-farm entrepreneurs in the sample were better educated than the average person in the province. Obviously, a wide range of areas was mentioned as being problematical for enterprises. The sometimes difficult access to equipment and the lack of technical assistance and market information should be mentioned in this context. While strong market competition is certainly a problem for the individual enterprise, it creates benefits for customers.

[10] The survey of farm households in Romania was carried out under the EU-funded Ace-Phare programme P95-2170-R. The survey of Romanian non-farm MSMEs was given substantial support by the *Deutsche Gesellschaft für technische Zusammenarbeit* (GTZ).

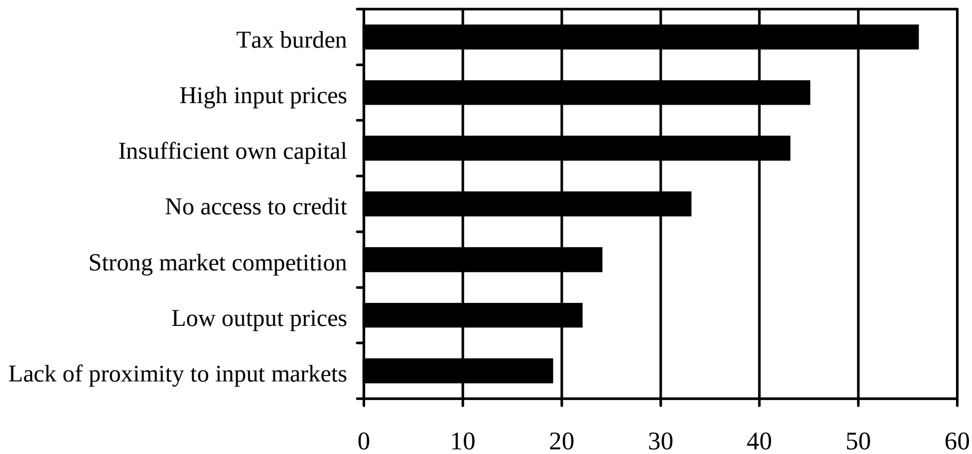
Table 5.1: Evaluation of location quality factors for non-farm enterprises in Romania, in %

	Assessment of importance		
	Very important	Important	Not important
Availability of land[1)]	18	41	41
Road network[2)]	47	36	8
Access to rail network[3)]	30	27	43
Workforce qualifications[4)]	35	52	13
Proximity to input markets[5)]	41	42	17
Proximity to output markets[6)]	29	37	35
Subsidized development programmes[7)]	55	25	20

Source: Survey of micro, small and medium enterprises (MSMEs) 1997/98; own data

NB: Figures may not add to 100, due to rounding.
1) N=23 no data; 2) N=11 no data; 3) N=16 no data;
4) N=13 no data; 5) N=13 no data; 6) N=22 no data;
7) N=12 no data.

Figure 5.1: Significant constraints on the development of non-farm enterprises in Romania, in %



Source: DAVIS, BREITSCHOPF and BUCHENRIEDER (2001)

The evaluation of the rural sector, especially the contribution made by non-farm enterprises to living standards in Bulgaria, is based on LSMS data (*Living Standard Measurement Survey*) carried out by the World Bank in 1995 (WORLD BANK 1995). While this survey reveals the importance of income diversification, no inferences can be drawn from the data about the constraints faced by non-farm SMEs. A structured survey on this issue is currently being carried out in Bulgaria under the Ace-Phare Project P98-1090-R. In the LSMS, 2468 households were surveyed. The majority of heads of households were in dependent employment (83%, N=2040). Of the positive answers (multiple answers were allowed) just 5% (N=125) stated that they ran a non-farm business. Less than 2% (N=39) had an agricultural enterprise, but around 5% of respondents over 16 years of age (N=3158) were employed in agriculture. However, more than 40% (N=1285) of family members over 16 years of age said that they had worked in agriculture during the twelve months prior to the survey. More than 15% (N=373) of heads of families were in temporary work. 12% of self-employed persons stated that they were looking for extra work, with this figure rising to 15% for farmers. Just 1.6% of respondents over 16 years of age (N=3158) had a second paid job (dependent employment). However a disproportionately large number of agricultural employees (N=154) had a second paid job (dependent employment), i.e. 4.5%. Furthermore, 4,4% (N=140) of respondents said that they had other self-employed work. Among farmers, the figure pursuing non-farm self-employment also stood at 4.5%. The fact that a very high proportion of the active population in the random sample had worked in agriculture during the past twelve months, that a relatively high number of households were engaged in secondary work, either on a dependent or self-employed basis, or were looking for such work, highlights the importance of a diversified employment structure in the agricultural sector in safeguarding livelihoods in Bulgaria too.

6 Summary and conclusions

The purpose of the Stability Pact for South Eastern Europe, which was launched in 1999 after an appeal by the EU, is to improve living conditions for people in the region. However, the prerequisite is fundamental structural reform, which has been very slow in starting in the South Eastern European transition countries. The WORLD BANK (2000a) identifies the tasks of combating poverty and tackling widening income inequalities as two of its reform priorities in South Eastern Europe. Poverty is especially acute in rural areas. Alongside rural development, fundamental reforms of the social security systems are also required.

Despite the substantial structural problems, most CEECs do not yet have coordinated regional policies, although a more pro-active approach to regional policy is now being pursued. However, the necessary decentralization of responsibilities is likely to be a lengthy process (MOUQUÉ 1999). Nonetheless, as part of the EU's pre-accession instrument SAPARD, all ten CEECs have submitted national plans on agricultural and rural development, which have now been approved by the European Commission's STAR Committee. Out of its annual allocation of 150.636 million euro from SAPARD for 2000-2006, Romania has earmarked an average of 43% to improving its rural infrastructure, promoting human resources in agriculture, and creating new and diversifying existing economic activities. In Bulgaria, 24% of SAPARD assistance (totalling 52.124 million euro per year) is allocated to similar measures. However, only a relatively small percentage of SAPARD funds is specifically earmarked for the development and diversification of economic activities in rural areas. Furthermore, 50% of financing for income-generating investments funded by SAPARD, both in agriculture and in other sectors, must be provided by investors themselves. Here, the situation regarding own and external funding for SMEs in Bulgaria and Romania continues to be difficult, which means that micro-enterprises have particular difficulty in competing for SAPARD funding.

Three pillars for employment creation were identified in the empirical analysis of non-farm MSMEs in Romania. (1) Almost 50% of Romanian operators regarded a lack of equity capital or poor access to credit as a key constraint on enterprise development. (2) The business environment, such as the road network and proximity to input markets, was also given high priority as a factor which makes a business location attractive. (3) On the other hand, there is still a lack of awareness among Romanian operators that advice and market information can strengthen competitive advantages. As mentioned above, a significant share of the funding within the SAPARD programme has to be mobilised by the investors themselves. In this context, the existence of an effective rural finance system is extremely important. Rural infrastructure projects fall within the scope of SAPARD or, indeed, ISPA. It is noteworthy that the SAPARD measures on economic diversification in rural areas for 2000-2006 are increasing as infrastructure development also makes advances. The debate about SAPARD as a pre-accession rural policy instrument modelled on the EU's Structural Funds, especially its potential to reduce poverty and create jobs, shows that SAPARD has the potential to reduce poverty by creating employment in rural areas. However, SAPARD is difficult to access for micro- and small enterprises (< 10 employees) which form the majority of rural SMEs in the CEE.

Yet the WORLD BANK (2000b) views SMEs as the major employment opportunity in the transition countries, especially in terms of creating jobs and diversifying economic activities in rural areas. In the EU as a whole in 1991, there were more jobs in businesses with ten or fewer employees than in businesses with 500 or more. This means that of the fourteen million or so enterprises in the EU, 99.9% were SMEs which accounted for 72% of the employed and 71% of the total turnover. If one draws the dividing line, in terms of employment, at fewer than 250 employees, as envisaged by the EU for practical SME policy purposes, one would still catch 66% of the employees and 63% of the total turnover in the EU (Klein, 1996). An effective strategy to promote SMEs must therefore be based on three pillars (WORLD BANK 2000b): (1) financing, (2) improving the business environment and (3) strengthening the SME support network.

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Appendix 1 The EU Structural Funds, regional policy and pre-accession instruments for rural development

The future structure of EU regional policy was set forth in the Official Journal of the European Communities on 16 June 1999. In this context, the Berlin European Council had reached agreement on Agenda 2000 in March 1999. The regional policy to be pursued within the framework of the Structural Funds in future was published in the Official Journal of the European Communities on 26 June 1999 (Council Directives 1257, 1260-1268/99). The European Community allocates an increasing percentage of the EU budget to structural policy measures. Whereas the figure was just 18.8% in 1989, the percentage had risen to 35.2% by 1999 (8535 million euro). Combined with an increase in the total budget, this represents almost a four-fold rise in the resources available for structural measures (Kunze 2000). The Structural Funds for the CAP and rural development focus primarily on Objective 1 and Objective 2 areas (and, on a transitional basis, the former Objective 5a and 5b areas). Objective 1 areas are regions whose development is lagging behind. This Objective also covers outermost regions and areas with a very low population density covered by Objective 6. Measures from the old Objective 5a for 1994-99 are supported within the framework of the Objective 1 programmes (EC 1999b, KUNZE 2000). The regions covered by Objective 1 are regions corresponding to level II of the Nomenclature of Territorial Statistical Units (NUTS level II) whose per capita GDP, calculated on the basis of Community figures for the last three years, is less than 75 % of the Community average (WINZEK 1997).[11] On average, the population in these areas earns less than two-thirds of the Community's per capita GDP. Objective 2 areas are areas facing structural difficulties. They may only cover those rural areas constituting less than 5 % of the population of the Community (EC 1999a: 12). Objective 2 draws together Objective 2 and Objective 5b from 1994-99 and, for the first time, also includes urban problem areas and areas dependent on the service sector (KUNZE 2000). The old Objective 5 covered rural areas. Objective 5a focussed on agricultural structural adjustment within the framework of CAP reform and structural actions in the fisheries sector. The purpose of Objective 5b was general development and structural adjustment in rural areas (HAARBECK and BOGER 1997). To be eligible for funding, rural areas must satisfy two of the following four criteria: either a population density of less than 100 people per km2, or a percentage share of agricultural employment in total employment which is equal to, or higher than, twice the Community average in any reference year; either an average unemployment rate above the Community average, or a decline in population (KUNZE 2000).

The Structural Funds support the EU Member States' regional economic policy in line with the principle of additionality, i.e. all Member States maintain their public structural expenditure at the level of the previous programming period. For 2000-2006, a total of 195 million euro are available (KUNZE 2000). This intended to strengthen the supplementary clause of the 1957 Treaty establishing the European Community which came into force on 1 July 1987and whose purpose is *reducing the differences existing between the various regions and the backwardness of the less-favoured regions.* The five Structural Funds are (1) the European Social Fund (ESF), (2) the European Agricultural Guidance and Guarantee Fund (EAGGF), (3) the European Regional Development Fund, (4) the Cohesion Fund and (5) the Financial Instrument for Fisheries Guidance (FIFG). In 1999, the Structural Funds' budget amounted to 0.46% of EU GDP (HAARBECK and BOGER 1997).

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[11] NUTS is an acronym for *Nomenclature of Territorial Units for Statistics*. The NUTS system was created as a single and coherent structure for regional statistics. Level 1 comprises the major regions of the European Community (e.g. the *Länder* in Germany). Level 2 covers the basic administrative units (e.g. the primary administrative divisions (*Regierungsbezirke*) in Germany). Level 3 covers the sub-divisions of these administrative units (e.g. counties). Levels 4 and 5 are communes and associations of communes in Germany (HAARBECK and BOGER 1997, KUNZE 2000).

(1) The European Social Fund (ESF) is the EU's most important instrument to improve the workings of the labour market and develop human resources.

(2) The European Agricultural Guidance and Guarantee Fund (EAGGF) *Guarantee* Section funds the four accompanying measures of the CAP: early retirement, agri-environment and afforestation, as well as the less-favoured areas scheme throughout the EU. These are supported in regions identified as most appropriate by the specific Member State, i.e. also regions not covered by Objective 1 (EC 1999a).

Other rural development measures are financed by the EAGGF *Guidance* Section in Objective 1 areas, and former Objective 5a and 5b areas, as well as projects under the LEADER+ Community Initiative (EC 1999). In the agricultural sector, measures focus on improving agricultural incomes and supporting farmers in less-favoured areas, e.g. mountain areas, improving the efficiency of production structures, and modernising, improving and diversifying productive activities and promoting product quality. Additional funding for rural development is provided in some regions.

(3) The European Regional Development Fund (ERDF) aims to promote economic and social cohesion by correcting the main regional imbalances. Measures focus primarily on productive investments to create and maintain long-term jobs and tap into the region's existing potential.

(4) The Cohesion Fund provides additional assistance to the four poorest EU Member States (Spain, Portugal, Greece and Ireland) whose per capita gross national product (GNP) is less than 90% of the Community average. These countries have been declared Objective 1 areas in their entirety (HAARBECK and BOGER 1997).

(5) The Financial Instrument for Fisheries Guidance (FIFG) supports structural measures in the fisheries sector.

The Structural Funds can be used to provide assistance to Objective areas. Since 1989, however, other horizontal Community Initiatives have also been funded through the Structural Funds. With the Community Initiatives, the European Commission wishes to address specific regional development problems.

The new Community Initiative for Rural Development, LEADER+, has a budget of 2020 million euro and will promote the introduction of integrated rural development strategies through the Community. There are four Community Initiatives in all: INTERREG (cross-border, cross-national and interregional cooperation, 4875 million euro), URBAN (economic and social regeneration of declining town, cities and run-down urban districts, 700 million euro) and EQUAL (combating all forms of discrimination and inequalities in the labour market, 2847 million euro). The four Community Initiatives have been allocated 5.35% of the budget (i.e. 10.442 billion euro) of the Structural Funds for 2000-2006 (EC 1999a, KUNZE 2000).

In terms of EU enlargement, structural policy is the major potential cost factor. The estimated costs of Objective 1 funding under present conditions would run to 33 billion euro for the CEFTA states (CEFTA: *Central European Free Trade Agreement*) and 56 billion euro for the ten CEECs. If a similar level of per capita funding were provided to the CEECs as for the cohesion countries on the basis of the current rules, the financial transfers would total around 10% of each country's GDP (Weise *et al*. 1997: 295). Apart from the development of a common structural policy in an enlarged EU, it is necessary to prepare the CEE candidates for accession. Originally, the Phare programme was created as a direct response to the structural challenges faced by the CEECs (Haarbeck and Boger 1997: 32f). There are now two further pre-accession instruments for rural and regional development, i.e. SAPARD and ISPA. These instruments are intended to enable the accession candidates to devise development plans under the EU programmes (e.g. SAPARD or the Structural Funds) and manage projects in line with EU criteria.