



# Policy Vision for Sustainable Rural Economies in an Enlarged Europe



# **Policy Vision for Sustainable Rural Economies in an Enlarged Europe**

**DATAR**

Délégation à l'Aménagement  
du Territoire et à l'Action  
Régionale



Akademie für Raumforschung  
und Landesplanung, ARL



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## Preface

By a joint initiative of the Akademie für Raumforschung und Landesplanung (Academy for Spatial Research and Planning, ARL) and the Délégation à l'Aménagement du Territoire et à l'Action Régionale (DATAR) a West-European Working Group was established in parallel with an East European Working Group and a Baltic Sea Working Group with the objective to have a closer look at territorial development in Europe. Within the framework of the West European Working Group a special group on the future of the CAP and its implications for rural Europe was established based on the particular interest of both ARL and DATAR in the development of rural areas. This interest had previously led to the establishment of an international working group, which dealt with the potential impact of the CAP reform of 1992 and the structural funds interventions envisaged for the financial period 1994-1999 on rural areas, and submitted its report on 1996.<sup>1</sup>

The present Working Group can be seen as a further effort to reflect on changes of the CAP which are necessary to achieve a greater positive impact on the development of rural Europe. It had the advantage of building on the work of a group of experts who in 1995/96, on the initiative of the European Commission, had formulated proposals to develop the CAP into what they called a "Common Agricultural and Rural Policy for Europe (CARPE)".<sup>2</sup> Some of the experts who had been involved in the CARPE proposal also participated in the Working Group.

Members of the Working Group were:

Giovanni Anania,	Arcavacata di Rende	Ewa Rabinowicz,	Lund
Jan C. Blom,	The Hague	Elena Saraceno,	Brussels
Allan Buckwell,	London	José M. Sumpsi Viñas,	Madrid
François Colson,	Angers	Winfried von Urff,	Bad Zwesten
Tomás García Azcarate,	Brussels	Jerzy Wilkin,	Warsaw

The Group was co-chaired by Winfried von Urff and François Colson. Evelyn Gustedt, Hannover, represented ARL and Elisabeth Osinski, Freising, was responsible for organisational matters.

All members of the Working Group served in their personal capacity.

The Group started its activities in December 2000. It held seven meetings at intervals of about four months. Papers on what the Group considered as major issues of the common agricultural and rural policy were prepared by members of the Group, distributed by e-mail, extensively discussed at the meetings and amended by the authors in the light of the discussion. These papers reflect a fairly large consensus achieved within the Group, although this does not mean that each member of the Group identifies himself or herself with every sentence. Unfortunately no funds were available for new research. All contributions were based on accumulated experience of the members of the Group. It was not possible to cover all relevant aspects on the common agricultural and rural policy. The Group had to decide to be selective.

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<sup>1</sup> Akademie für Raumforschung und Landesplanung (ARL): Regional Aspects of Common Agricultural Policy – New Roles for Rural Areas, Hannover 1996.

<sup>2</sup> European Commission, Directorate-General for Economic and Social Affairs: Toward a Common Agricultural and Rural Policy for Europe, European Economy, Reports and Studies No. 5, 1997.



When the Group started its deliberations it came soon to the conclusion that even after full implementation of the Agenda 2000 a further evolution of the CAP was required. Among the reasons, the Group identified the persisting and perhaps even increasing internal dissatisfaction with the present CAP resulting from consumers' concerns about food safety, and the widespread feeling that environmental aspects and issues of animal welfare were not adequately addressed. Economic distortions by setting wrong incentives were also seen as a reason for corrections. The Group opted for taking the functions the society wants to see agriculture and rural areas perform as point of departure and to identify the changes required to make sure that these functions will be performed more effectively and efficiently than in the past. The challenges resulting from eastward enlargement were also taken into account as well as those that may be expected from the WTO negotiations.

When the Group had reached a position that made it possible to define changes in the CAP which the Group considered important to better meet the requirements, the EU Commission published its Mid Term Review. The Commission's assessments of the need for changes in the CAP were, by and large, not much different from the Group's thinking. The Group did not consider it appropriate to comment at length on the Mid Term Review and the January 2003 reform proposals. It presents its views with some reference to the Mid Term Review in cases where similar views are expressed as well as in the rare cases where the Group comes to different conclusions.

In order to subject the thinking of the Group at a fairly advanced stage to a critical assessment and to collect additional ideas it was planned to conduct a workshop, which should bring together a larger group of experts from EU as well as Central and Eastern European Countries comprising a broad spectrum of professions and institutions. It was hoped that such a broader group would correct ideas that might not have gone into the right direction, comment on the objectives for future policy and on approaches that might have a better chance to achieve the objectives for the common agricultural and rural policy than the present policies or those proposed by the Group.

The workshop took place in Brussels on the 23<sup>rd</sup> of September 2002. It brought together about 40 participants from EU and candidate countries as well as from the EU Commission. Intensive discussions revealed that the views presented by the Group were to a very large extent shared by the participants. The Group was particularly grateful for comments focussing on specific aspects that deserved more emphasis than given to them in the presentations. Papers were amended in the light of the discussion and the gist of the discussion went also into the Group's "vision".

This publication contains the result of the Group's deliberations. It starts with a paper called "Policy Vision for Sustainable Rural Economies in an Enlarged Europe" that reflects the essence of the Group's thinking and was endorsed by the whole Group. For this paper the Group chose a time horizon of 25 years and decided to start with a vision for a desirable and sustainable agricultural and rural policy at the end of this period and to spell out in a second step in rather broad and general terms how it might be put in place.

This paper is not a scientific paper following academic rules. When the Group discussed a new common agricultural and rural policy many aspects entered into the discussion that had been discussed before by other authors. In many instances the Group built on proposals in line with its own thinking, in others – after extensive discussion - it decided for different options. It was not possible to make this process transparent by citing all the literature that directly or indirectly influenced the Group's thinking. Instead of detailed references a bibliography is presented at the end of the paper that gives

an overview of literature related to the various aspects of the subject and used by the Group.

The vision paper is followed by a series of individual papers dealing in more detail with specific issues of the common agricultural and rural policy, providing thus the background for the discussions that resulted in the Group's "vision".

The individual papers start with a reflection on the challenges and expectations related to a new CAP by WINFRIED VON URFF, followed by considerations on the directions of change by JAN C. BLOM. Specific considerations on the desirable balance between the pillars of the CAP for the promotion of a multifunctional European model of agriculture were contributed by FRANÇOIS COLSON AND JOËL MATHURIN. Obstacles to reforms were discussed by TOMÁS GARCÍA AZCARATE AND JOSÉ M. SUMPSI VIÑAS.

When the Group began its work it was assumed that the WTO negotiations would be a driving force for the EU to further reduce protection of its agricultural sector. GIOVANNI ANANIA looked into the matter and produced a paper assessing the extent of pressure on a change of the CAP to be expected from WTO in the light of the Ministerial Declaration of Doha.

Another driving force was seen in the eastward enlargement of the EU. JERZY WILKIN contributed a paper on the expectations of the Central and Eastern European Countries and their assessment of the then ongoing accession negotiations.

Consumers' concerns about the safety and quality of food are often mentioned among the most important reasons that call for a major change of the CAP. ALLAN BUCKWELL analysed the role of the CAP with regard to these aspects. From a producer's point of view income stabilisation may be seen as an essential element of the CAP, either in the form of price stabilisation or in the form of insurance or other safety net schemes introduced in some OECD countries. EWA RABINOWICZ had a critical look at issues related to stabilisation.

Environmental requirements are among the pressing needs to design a new agricultural and rural policy. The question how the CAP can be brought more in line with environmental requirements is addressed by ALLAN BUCKWELL AND JOSÉ M. SUMPSI VIÑAS.

Rural areas are not only the sites where agricultural production takes place and where natural and semi-natural habitats can be found, they are also sites where people live, work and seek recreation. How the second pillar of the CAP should be adapted to better cater for the needs of rural areas is dealt with by ELENA SARACENO.

The papers were completed in summer 2002 which implies that subsequent events like the Accession Agreement with the Central and Eastern European Countries of December 2002, the January 2003 reform proposals of the Commission (Proposals for Regulations by the Council), the EU proposals for the WTO negotiations, the Harbinson paper and the reform achieved by the European Minister Agriculture in June 2003 are not reflected in the texts that sometimes refer to earlier stages of the respective discussions and negotiations. Some attempts of updating have been made but in several papers the text would be different if they had been written today. This is, however, more a matter of presentation than of substance. The Group's aim was to analyse fundamental problems and to draw conclusions from basic facts and trends rather than to provide comprehensive and up-to-date information.

For reasons outlined above the report herewith presented could not deal with all aspects of the common agricultural and rural policy. The Group was not in a position to develop concepts for the future of specific Common Market Organisations that have not

yet undergone a major reform such as milk, sugar and olive oil. It was also not in a position to analyse the financial implications of different change scenarios, in particular redistribution effects between Member States and between different groups of producers. The Group is well aware of the limitations resulting from these shortcomings. Despite these limitations the Group hopes to have been able to make a contribution to the discussion on the further long run evolution of the CAP and to shed some light on its importance for rural Europe.

## Préface

Dans le cadre d'une initiative conjointe de l'Akademie für Raumforschung und Landesplanung (Académie pour la Recherche Territoriale, ARL) et de la Délégation à l'Aménagement du Territoire et à l'Action Régionale (DATAR), un groupe de travail Europe de l'Ouest a été mis en place, parallèlement à un groupe de travail Europe de l'Est et un groupe de travail Mer Baltique dont la mission est d'observer l'évolution territoriale en Europe. Dans le cadre du groupe de travail Europe de l'Ouest, un groupe spécial né de l'intérêt spécifique de la DATAR et de l'ARL pour le développement des zones rurales a été créé pour se charger de l'avenir de la PAC et de ses implications pour l'Europe rurale. Cet intérêt avait précédemment conduit à l'établissement d'un groupe de travail international qui s'était consacré à l'impact potentiel de la réforme de la PAC de 1992 et aux interventions du fonds structurel envisagées pour la période financière comprise entre 1994 et 1999 sur les zones rurales. Le groupe avait soumis un rapport en 1996.<sup>3</sup>

Le présent groupe de travail peut être considéré comme un effort supplémentaire de la réflexion sur les changements de la PAC, nécessaires pour obtenir un impact positif sur le développement de l'Europe rurale plus important encore. Il a eu l'avantage de pouvoir bénéficier des travaux réalisés par un groupe d'experts entre 1995/96 qui avait formulé des propositions pour faire évoluer la PAC vers ce qu'ils avaient appelé "Une politique agricole et rurale commune pour l'Europe (CARPE)".<sup>4</sup> Certains des experts ayant contribué aux propositions de la CARPE ont également participé au groupe de travail.

Les membres du groupe de travail étaient :

Giovanni Anania,	Arcavacata di Rende	Ewa Rabinowicz,	Lund
Jan C. Blom,	La Haye	Elena Saraceno,	Bruxelles
Allan Buckwell,	Londres	José M. Sumpsi Viñas,	Madrid
François Colson,	Angers	Winfried von Urff,	Bad Zwesten
Tomás García Azcarate,	Bruxelles	Jerzy Wilkin,	Varsovie

Le groupe a été co-présidé par Winfried von Urff et François Colson. Evelyn Gustedt, Hanovre, y représentait l'ARL et Elisabeth Osinski, Freising, était chargée de l'organisation.

Tous les membres du groupe de travail ont apporté leur capacité personnelle.

Le groupe a démarré ses activités en décembre 2000. Il s'est réuni 7 fois dans un intervalle de quatre mois. Des papiers ont été rédigés par certains membres du groupe sur les sujets considérés comme centraux de la politique agricole et rurale commune, ils ont été distribués par courrier, puis fait l'objet de discussions approfondies en réunion et ont été amendés par les auteurs à la lumière de la discussion. Ces papiers reflètent un assez large consensus obtenu au sein du groupe bien que cela ne signifie pas que chaque membre du groupe adhère à chaque phrase du document. Malheureusement, aucun fonds n'était disponible pour d'autres recherches. Toutes les contributions étaient basées sur le cumul de l'expérience des membres du groupe. Il ne fut pas possible de couvrir

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<sup>3</sup> Akademie für Raumforschung und Landesplanung (ARL): Aspects régionaux de la politique agricole commune – Rôles nouveaux des zones rurales, Hanovre 1996.

<sup>4</sup> Commission européenne, Direction Générale des Affaires Économiques et sociales : Vers une politique agricole et rurale commune pour l'Europe, Économie européenne, Rapport et Études n°5, 1997.

tous les aspects importants de la politique agricole et rurale commune. Le groupe a dû prendre la décision d'effectuer une sélection.

Lorsque le groupe a entamé ses délibérations, il en est rapidement venu à la conclusion que même après la mise en œuvre totale de l'agenda 2000, il était nécessaire de procéder à une nouvelle révision de la PAC. Parmi les raisons à cela, le groupe a mis en évidence l'insatisfaction interne persistante, voire croissante que suscite la PAC actuelle résultant de l'inquiétude des consommateurs relative à la sécurité des aliments et du sentiment répandu que les aspects environnementaux et ceux ayant trait au bien-être des animaux vivants n'ont pas été traités de manière adéquate. Les distorsions économiques résultant de la mise en place de mesures d'incitations impropres étaient considérées également comme une raison de procéder à des ajustements de la PAC. Le groupe a opté de prendre comme point de départ les fonctions que la société voit accomplies par les zones agricoles et rurales et d'identifier les changements requis pour assurer la mise en œuvre de ces fonctions de manière plus efficace et plus efficiente que de par le passé. Les défis liés à l'élargissement à l'Est ont également été pris en compte de même que ceux pouvant être attendus suite aux négociations de l'OMC.

Lorsque le groupe eut trouvé une position qui permit de définir les changements de la PAC, considérés comme importants par le groupe pour améliorer les critères, la Commission de l'UE publia sa révision à mi-parcours. Les évaluations de la commission du besoin de changement de la PAC n'étaient pas très éloignées des réflexions du groupe. Le groupe n'a pas considéré comme approprié de commenter dans les détails la révision à mi-parcours et les propositions de réforme de janvier 2003. Il présente ses vues en se référant à la révision à mi-parcours de l'agenda sur la PAC dans les cas où les opinions exprimées se rejoignent, de même que dans les rares cas où le groupe aboutit à des conclusions différentes de celle de la révision.

De manière à soumettre les réflexions du groupe à une évaluation critique à un niveau élevé et à rassembler des idées supplémentaires, il fut projeté de conduire un workshop rassemblant un groupe élargi d'experts de l'Union européenne mais aussi des pays de l'Europe de l'Est et de l'Europe Centrale regroupant un vaste spectre de professionnels et d'institutions. L'idée était qu'un groupe élargi pourrait corriger les propositions n'allant pas dans la bonne direction, commenter les objectifs de la politique future et les démarches plus à même d'atteindre les objectifs de la politique agricole et rurale commune que les politiques actuelles ou celles proposées par le groupe.

Le workshop a eu lieu à Bruxelles le 23 septembre 2002. Il a rassemblé une quarantaine de participants issus de l'UE, des pays candidats à l'adhésion de même que de la Commission Européenne. Des discussions intensives ont révélé que les vues présentées par le groupe étaient partagées par les participants dans une très large mesure. Le groupe fut en particulier reconnaissant de certains commentaires sur certains aspects spécifiques méritant davantage d'attention que celle leur ayant été consacrée au cours des présentations. Les papiers ont été amendés à la lumière de la discussion et le fond de la discussion a également été intégré dans la vision du groupe.

Cette publication contient un papier appelé "Vision politique pour des économies rurales durables dans une Europe élargie" qui reflète l'essence de la pensée du groupe et qui fut avalisé par l'ensemble du groupe. Pour ce document le groupe a choisi un horizon de 25 ans. Il a décidé de commencer par une vision pour une politique agricole et rurale désirable et durable à la fin de cette période et dans une deuxième étape d'expliquer clairement en termes vastes et généraux comment elle pourrait être mise en place.

Ce papier n'est pas un papier scientifique respectant des règles académiques. Lorsque le groupe a débattu en séance d'une nouvelle politique agricole et rurale commune, de nombreux aspects ont été pris en compte dans la discussion, qui avaient été exposés préalablement par d'autres auteurs. Dans de nombreux cas, le groupe s'est basé sur des propositions en accord avec sa propre opinion, dans d'autres cas, il a entériné une option différente suite à une discussion approfondie. Il n'a pas été possible de rendre ce processus transparent en citant toute la littérature qui a directement ou indirectement influencé la réflexion du groupe. Faute de références détaillées, une bibliographie donnant une vue d'ensemble de la littérature liée aux divers aspects du sujet et utilisée par le groupe est présentée à la fin du papier.

Dans un deuxième volume le papier sur la vision est suivi d'une série de différents papiers traitant de sujets spécifiques de la politique agricole et rurale commune de manière plus détaillée, fournissant ainsi la base des discussions qui ont abouti à une « vision » du groupe.

Les papiers individuels commencent par une réflexion sur les défis et les attentes liées à la nouvelle PAC de WINFRIED VON URFF, suivie de considérations sur les directions du changement de JAN C. BLOM. FRANÇOIS COLSON ET JOËL MATHURIN ont contribué à la réflexion en nous livrant leurs considérations spécifiques sur l'équilibre désirable entre les piliers de la PAC pour la promotion d'un modèle européen multifonctionnel de l'agriculture. Les obstacles aux réformes ont été traités par TOMÁS GARCÍA AZCARATE ET JOSÉ M. SUMPSI VIÑAS.

Lorsque le groupe a commencé ses travaux, on supposait que les négociations avec l'OMC constitueraient une force motrice pour l'Union Européenne qui contribuerait à réduire la protection de son secteur agricole. GIOVANNI ANANIA s'est penché sur la question et a produit un papier évaluant la portée des pressions sur un changement de la PAC à attendre de la part de l'OMC à la lumière de la déclaration ministérielle de Doha.

L'élargissement à l'Est de l'UE était également considéré comme une force motrice. JERZY WILKIN a élaboré un document sur les attentes des pays de l'Europe centrale et de l'Est et leur évaluation des négociations alors en cours concernant leur adhésion.

Les inquiétudes des consommateurs relatives à la sécurité et la qualité des aliments sont souvent mentionnées parmi les raisons les plus importantes plaidant en faveur d'une révision de la PAC. ALLAN BUCKWELL a analysé le rôle de la PAC en prenant ces aspects en considération. Du point de vue des producteurs, la stabilisation des revenus peu être considérée comme un élément essentiel de la PAC, soit sous la forme d'une stabilisation des prix, soit sous la forme d'une assurance ou d'un programme mesures de sécurité introduites dans certains pays de l'OCDE. EWA RABINOWICZ avait un regard critique quant aux sujets relatifs à la stabilisation.

Les critères environnementaux font partie des besoins les plus urgents dans la conception de la nouvelle politique agricole et rurale. La question de savoir comment rendre la PAC plus compatible avec les exigences environnementales a été traitée par ALLAN BUCKWELL ET JOSÉ M. SUMPSI VIÑAS

Les zones rurales ne sont pas uniquement des sites où a lieu la production agricole et où l'on peut trouver un habitat naturel et semi-naturel, ce sont également des sites où des gens vivent, travaillent et se détendent. ELENA SARACENO s'est attaché aux ajustements nécessaires du deuxième pilier de la PAC en vue de mieux répondre aux besoins des régions rurales.

Les papiers ont été élaborés au cours de l'été 2002 ce qui implique que certains événements importants tels que le Traité d'Adhésion conclu avec les pays d'Europe Cen-

trale et de l'Est en décembre 2002, les propositions de réforme de la Commission en janvier 2003 (projets de règlements de la part du conseil), les propositions de l'UE pour les négociations avec l'OMC, le papier de Harbinson et la réforme achevée par les Minist de l'Agriculture en Juin 2003 ne sont pas pris en compte dans les textes qui se réfèrent parfois à des stades antérieurs des discussions respectives et des négociations. Certaines tentatives de mise à jour ont été effectuées mais le texte de nombreux papiers serait différent s'il avait été rédigé aujourd'hui. Toutefois, il s'agit là davantage d'une question de présentation que de contenu. L'objectif du groupe était davantage d'analyser les problèmes fondamentaux et de tirer des conclusions à partir des faits et tendances essentiels que de fournir des informations exhaustives et actualisées.

Pour les raisons décrites ci-dessus, le rapport présenté en annexe n'a pas pu traiter tous les aspects de la politique agricole et rurale commune. Le groupe n'était pas en position de développer des concepts pour l'avenir des Organisations Communes de Marché (OCM) n'ayant pas encore subi de réforme majeure comme le lait, le sucre et l'huile d'olive. Il n'a pas non plus été en mesure d'analyser les conséquences financières des différents scénarios de réforme, en particulier les effets de la redistribution entre les États-membres et entre différents groupes de producteurs. Le groupe est conscient des limites résultant de ces imperfections. En dépit de ces limites, le groupe espère avoir été en mesure d'avoir apporté une contribution à la discussion sur la suite de l'évolution à long terme de la PAC et d'avoir mis en évidence son importance pour l'Europe rurale.

## Executive Summary

### Background Assumptions and Challenges

The approach followed in this paper is to start with a vision for a desirable and sustainable agricultural and rural policy for an enlarged Europe in about 25 years from now and in a second step to spell out in broad terms how it might be put in place. In this way the logic of the reform process is driven by what one wants to achieve rather than by what exists.

Within this time frame one may assume a further expansion of the EU to the East. Economic development in the large countries of Asia, and at least some progress in lifting poverty in the poorest parts of the world, may result in some recovery in world agricultural commodity prices from their levels in the last 5 years. Globalisation will imply further trade liberalisation. Volatility of international markets may increase. Border restrictions and domestic agricultural and rural policies will still create some tensions in international trade because of different degrees of concern about, and different values of citizens with respect to, food safety, the environment and animal welfare.

In Europe farm business enlargement will continue. Growth in productivity will result in a further concentration of production. On the other hand many small farmers will find themselves unable to follow this route and either remain in subsistence form or develop 'solutions' based on pluri-activity. The food processing and distribution industries will become more concentrated. Farming will increasingly become a supplier of agricultural raw materials but there will be an equally important counter-trend towards differentiation and higher quality often linked to regionally, or locally produced, food.

The challenge for a future Common Agricultural and Rural Policy is to address the following tasks:

- To implement a single European market for agricultural food products with respect to prices and safety standards in a way that is compatible with international competitiveness and commitments under the WTO;
- To stimulate the competitiveness of the agricultural sector in such a way that the quality of product is improved and the production process meets the required standards with respect to the environment and animal welfare;
- To promote an effective rural development program for the rural population;
- To develop effective instruments to guarantee the sustainable use of natural resources in agriculture in order to protect and develop the natural environment and to preserve rural cultural heritage;
- To create the institutional framework to implement these policies in an efficient and effective way.

The Common Agricultural and Rural Policy has a *sectoral* function for food and agriculture and a *territorial* function for rural regions. Both functions should be seen as parts of an integrated Policy.



## Policy Vision for Sustainable Rural Development

### The changing role of agriculture and agricultural policies

The main objectives and thus tasks of agricultural and food policies are to assist and, in some cases, ensure:

- productivity growth;
- competitiveness;
- price and income stability;
- food safety;
- food quality and good animal welfare;
- rural environment and cultural landscape quality.

The traditional objectives

- supporting farm incomes;
- maintaining the farming population;
- food security

have to be reconsidered.

Agricultural and food policy just as policy for any other economic sector has to stimulate sustainable **productivity growth**. Given the combination of farmer immobility and the inelasticity of demand for food, technical progress is no guarantee that relative incomes will rise, but without technical progress they can not rise.

European food and agriculture has to increase its international **competitiveness**. Border measures which nullify this objective such as export subsidies, import quotas, and high import tariffs, and domestic support measures, such as production quotas and other commodity market related instruments will also have to be progressively reduced over time.

However, agricultural and food policy will also have to secure a certain degree of **stability**. Risk is an inherent part of any business activity, but risk in farming has specific characteristics. The present CAP contributes substantially to stability of prices and incomes mainly as a by-product of policies that aim at income support. In future, stabilisation of some prices could be achieved by relying on existing CAP instruments but using them only as “safety nets”. Income insurance schemes, at present not used in European agriculture, could play a role. The EU could facilitate re-insurance of risk by providing an appropriate legal framework and also facilitate development of futures markets.

All food must be **safe** to eat. There is a duty for Member State and EU authorities to ensure that there is in place the necessary: information, training, public infrastructure, farm inputs licensing, food product and process licensing, food safety monitoring, inspection and regulation, and sanctions for non-compliance. However, these are not roles for market policy and direct payments, neither should they be. Of course, any market management measure should not encourage practices which in any way compromise food safety.

The strongest force for ensuring **food quality** must be the market, but there are some important roles for public policy, such as providing the institutional regulatory framework for consumer protection and information. These roles already exist. Instead of

militating against raising food quality as market regimes did in the past, a future policy should help farmers to focus on improving quality and to better coordinate and integrate within the food chain.

Some of the same considerations arise in respect of **animal welfare** standards. Beyond a certain point, welfare standards can be considered as a quality attribute to which consumers will attach their own value. The public role is, first, that of agreeing the welfare standards below which no production can drop. The second is to validate the accuracy of consumer information and to monitor the accreditation of the production systems which deliver higher standards.

Wealthier societies place both more pressure and higher value on the **quality of the rural environment and cultural landscapes**. The countryside management role of farmers and land managers has assumed more importance, and there is a stronger role for policy, too. Incentives to environmentally damaging intensification of land use should be diminished by reducing price supports and separating direct payments from production. Environmental conditions should be attached to remaining market support measures, including aids to investment and direct payments,

A prime, and persistent, objective of the CAP has been to **raise the incomes per capita of those engaged in agriculture**. However, most analyses have shown the efficiency of price supports in raising farm incomes to be very low. Also the benefits of the CAP have been very unevenly distributed as between commodities, regions and farmers. Neither price supports, nor direct payments calibrated on those price supports, are efficient instruments for dealing with low farming incomes

Another justification for broad market support or direct payments has been to **maintain farming activity**, where it would not otherwise exist. For traded commodities the argument that natural disadvantages of some areas resulting in higher costs should be compensated by subsidies is economically unacceptable. A plausible reason for assistance to such areas can be that there are some other public goods or services supplied by farming. If this is the justification, then the basis of the support should be payments targeted directly to the production of these public goods.

**Food security** is no longer a prime objective of European food and agricultural policy. There is no credible threat to the availability of the basic ingredients of human nutrition from domestic and foreign sources. If there is a food security threat it is the possible disruption of supplies by natural disasters or catastrophic terrorist action. The main response necessary for such possibilities is the appropriate contingency planning and co-ordination between the Commission and Member States.

### **Policy for ensuring the viability of rural areas**

Rural areas are an integral part of European Society. More than 80% of European land territory is rural, and 25% of the European Union's population lives in rural areas. Viable rural areas are essential for a balanced spatial development. They are also important for the development of the natural and cultural heritage, contributing to the formation of its own identity and feeling of belonging.

Rural areas in Europe are quite diverse. Some of them successfully assimilated structural change and economic diversification. This is increasingly attributable to factors such as the quality of the natural and cultural heritage, the existence of networks and partnerships and the direct involvement of all the main stake holders in decision making. On the other hand, a number of rural areas have not yet managed to achieve structural change. The structural weaknesses of these areas may be caused by extremely

low population density, inaccessibility, peripheral location, climatic disadvantages, poor infrastructure, outdated industrial structures and outdated production conditions.

In rural areas where structural change has not yet occurred or is in an early stage, agriculture as a source of income is often still important. However, economic viability can not be brought about by agriculture alone. Agriculture has to contribute to make rural areas attractive by maintaining and developing the natural and cultural heritage.

Rural areas are not in general less competitive than urban areas in attracting resources. They should not be imagined as homogeneously “backward” in relation to urban economies and requiring symmetrically homogeneous policy measures in order to catch up (in the most optimistic scenario) or to be indefinitely compensated for the hypothetical handicap of being rural (in the most pessimistic one).

Rural areas must rely on economies of diversification rather than on the economies of scale and agglomeration. Each area should combine its own mix of resources in its special way, trying to find its specific competitive advantage through a locally agreed overall strategy and relevant actions. The valorisation of typical products through rural tourism, of natural heritage or landscape through certain farming practices, of crafts and small enterprises with ad hoc training and research, are some of the many examples already deployed with success.

In order to achieve viable rural areas the most important policy task is to induce the diversification of their economies, where diversification has not occurred spontaneously. The promotion of activities in different sectors should not discriminate on the basis of size or origin. Small-scale initiatives are more likely to be generated endogenously and have shown a higher degree of stability in the face of crisis. External investment may stimulate growth and innovation at the local level, but may show a greater propensity to leave the area more easily when the initial cost advantages decline. Where population and enterprise densities are low, specialisation implies the risk of a downturn for the whole area as result of a sectoral crisis. A mix of economic sectors and enterprises of different size makes rural areas less vulnerable.

A policy for the diversification of the rural economy should consider:

- Promotion of an articulated human and social resource base,
- Maintaining the diversity between rural areas as a European asset,
- Supporting rural economies and societies to establish meaningful links and exchange with the external world,
- Integrating environmental concerns in relation to the non-farm sectors and to modern living standards.

Another key policy task, in order to achieve viable and sustainable rural economies, is to integrate the sectoral and the territorial components of a Common Agricultural and Rural Policy. This should imply that current policy measures are reformulated. The agricultural sector orientation, with farmers as the main direct beneficiaries, will remain as an important part of the policy, but much broader thinking is required about all actions in the framework of expected rural needs. Such new needs include both specific agricultural sector needs as well as wider rural economy objectives, such as:

- facilitating the adjustment of farms to changing markets, including increasing food quality and differentiation,
- promoting a stronger horizontal integration of farm activities into the wider rural economy,

- supporting farm pluri-activity,
- integrating environmental concerns into the new framework of agricultural policy.

Policy actions should provide an approach to achieve the objectives rather than providing a recipe or a list of specific measures to be followed. There is no need to establish a menu of eligible measures. A list of non-eligible actions and instruments may be the only constraint as well as limits on the levels of aid. This method is based on a decentralised institutional set-up with strong participation of private and public stakeholders following the principle of subsidiarity. Partnerships of rural interests, with Regional Administrations, should be responsible for the preparation of pluri-annual programmes and the allocation of financial resources. Programme preparation should start with an in-depth analysis of each rural area, focussing on specific opportunities and constraints, strengths and weaknesses. One or more alternative strategies should be established and submitted for consultation and approval before being transformed into a pluri-annual programme. There are two major references to guide the implementation of this vision: the experience of the reformed Structural Funds and the experience of the LEADER programme.

There are three reasons for intervening at European level in such decentralised rural policies. The first reason is that the pluri-annual programmes approach must be coordinated with other EU policies such as regional policy (Structural and Cohesion Funds), environmental regulations and consumer policies. The second reason is that the transfer of resources between Member States is legitimated as a redistribution policy aimed at territorial cohesion and based on the principle of solidarity. This is even truer in the framework of enlargement. The third reason is not related so much to financial transfers as to the wide “market” of exchange of policy practices and experience that is generated through the transfer of knowledge and lessons learned through transnational cooperation and networking.

## **Getting to the New Policy Vision**

### **The inadequacy of reform efforts to date**

The CAP has been continually adapting since the first market regulations were agreed and put in place during the mid-1960s. The MACSHARRY reform started the process of partially decoupling support to farmers by switching price support to direct income payments for important sectors. At the same time the process of assembling the elements of rural development policy commenced. The Agenda 2000 reform took this process further. An innovation of Agenda 2000 was to consolidate the accompanying measures plus those for the less favoured areas, schemes for the modernisation of farms, processing and marketing, and rural development, in a new Rural Development Regulation.

Upon close inspection, certain limitations of this so-called “second pillar” became apparent. From the outset of the Rural Development Regulation, there were no real additional resources made available for its measures. Member States exercised little imagination in using what scope it gave for a wider and more innovative approach. Most of them continued with their existing schemes. The option offered to Member States to voluntarily, and unilaterally, cut direct payments and to switch the funds into Rural Development plans, was hardly used because it requires the Member States to provide additional match-funding and to put their farmers at a competitive disadvantage.

The July 2002 Mid-Term Review and the reform proposals of January 2003 comprise a further set of changes, some even quite radical, but all within the logic of a common *agricultural* policy seen as capable of serving a wider rural development role. The decoupling of (most but not all) payments will diminish the incentive both to push out the margin of cultivation to fragile land and to intensify production simply to collect more subsidies. This will tend to reduce output of some commodities and to reduce the trade distorting effects of the CAP. Although these would be worthy achievements these alone do not define a sustainable policy. Such a policy must have agreed, positive, social objectives and measures which are specifically chosen, appropriately balanced and resourced to deliver them.

### **From a sectoral to a territorial approach**

What is needed is a shift from a mostly sectoral to a mostly territorial approach. Such a policy would reverse the logic of the approach of conceiving rural policy as a set of accompanying measures for farmers. This has important institutional implications. At present there is no institutional set-up at EU level which could serve as a framework for the reconciliation of competing interests. The organisation of the appropriate institutional framework has to come first. Restructured institutions are likely to adopt more easily the new vision than the existing structures based heavily on the agricultural sector approach. Experience shows the strong tendency to “adapt” innovative measures within the logic of existing procedures. At Member State level the problem is exacerbated by an understandable interest to maintain the financial envelopes redistributed through the CAP.

The transition to the new rural development policy could follow a sequence of steps. Having established an appropriate institutional set-up first, the following steps could consist of applying the new approach to the policy task of: (1) **diversifying the economic activities in rural areas**, i.e. defining a strategy and the corresponding measures, having the possibility of leaving the other components of the policy unchanged; and (2) **integrating agricultural and rural policy**, i.e. a shift from the “menu” of standard measures currently available to self-defined strategies. Each of these two steps could coincide with a programming period (5 to 7 years). The EU could offer Member States the possibility to choose between more or less accelerated implementation of the transition, and Member States, in turn, could allow the same flexibility to Regions. Accession countries should be allowed to immediately adopt the new vision (if they wish so) without having to go through the adoption of the existing measures, when it is already known that they will need to be reformed anyway.

The financing of a Common Agricultural and Rural Policy should be determined on its own merits and should not have any permanent or automatic character. Funds will be allocated to Member States as sort of “national envelopes” limited to a specific period of time. They will not be extended automatically but have to be renegotiated periodically on the basis of emerging needs and impact assessment. This gives Member States higher margins of discretion to use these funds according to their priorities, and to explore preferred “transition” paths, which may stir up a certain competition between “best ways” of addressing rural development in all its dimensions. Waiving, or reducing temporarily, the need for national co-financing of rural development measures could greatly facilitate the willingness for eliminating the present distinctions in the financing procedures of Pillar 1 and Pillar 2.

## Steps required to change Pillar 1 and Pillar 2 measures

There will be a significant contraction in the magnitude of existing public support provided at present under Pillar 1 measures. However, this is subject to two strong qualifications. The first is to recognise that it is necessary to give **time** for the farmers as well as the other sectoral actors to adjust (for instance the time horizon for large capital investments, say 15 years), and **to assist** with the adjustment process by giving producers flexibility to use supports as these are phased out. The second qualification is the necessity to counteract the reduction of Pillar 1 production support by an appropriate expansion of the measures in the Rural Development Programmes.

The process of reducing intervention prices to an agreed level below world market prices should continue. Increased volatility makes it desirable to retain genuine safety-net interventions. Border protection will be considerably lowered but not eliminated. Residual tariffs will provide a continuing, but much smaller, degree of community preference, to offset (partially) higher EU environmental and other standards; their existence will offer the possibility of applying special safeguard tariffs in the event of an unusual collapse in prices. Direct payments will be reduced. For any remaining payments, the key is to agree a schedule of reductions given the assurance that there will be a significant shifting of support to pay for services required by society and the assurance that some degree of collective assistance for stabilisation will be provided.

The first-best solution to arrange the delivery of public environmental and cultural landscape services is that agro-environment schemes are integrated into Rural Development measures. Agro-environmental goals and willingness to pay for these services will be different across regions. However, administrative problems and political realities, especially the additional co-financing required if funds are switched from first to second pillar, may prevent this solution. The January 2003 reform proposals to decouple direct payments and to link them to some degree of eco-conditionality cannot be an enduring solution, because these payments are based on previous agricultural production and not on society's current demand for the environmental services. Alternative ways out of this conundrum are either systematically to reformulate and target the decoupled payments to make them genuinely more 'environmental green' over time within Pillar 1, or to relax the Member State co-financing element of funds switched to Pillar 2 to set up broad application of environmental schemes in that pillar.

The most challenging aspect of the adaptation of present Pillar 2 measures is strengthening the complementarities between the agricultural sector and the overall rural economy by conceiving and implementing the integration of the sectoral and the territorial elements of a Common Agricultural and Rural Policy. The long-established pattern of having a fixed list of measures to choose from makes it difficult to adopt a more "entrepreneurial" attitude in identifying self-defined strategies. The transition phase should allow for a significant degree of flexibility between Member States, not referring to the general goal, but to the ways in which the new vision is extended to different domains of the present policy. Allowing diversity without abandoning the unity of having common regulations makes it coherent with the peculiar nature of the construction of the European Union and is also appropriate for dealing with the problems posed by enlargement.

During the transition phase the experiences with the Community Initiatives (LEADER in particular) provide a good reference. They have proved to be effective in stimulating rural economies. Their characteristic features are well codified. The approach is area-based, bottom-up and participatory. They embrace the partnership principle, integration and the multisectoral nature of actions, based on networking, trans-

national cooperation, programming and co-financing. The regular programmes of the Structural Funds have also been successfully operating on some of these principles. One of the most important lessons is the interplay between the partnership principle (both horizontal, between local actors, and vertical, between institutions at different levels) on the one hand and the integrated, multisectoral approach on the other.

The most difficult aspect is the “merging” of the present standardised and top down approach of the agriculture structural measures with the more self-defined, mostly “one off” measures of the territorial approach. Incentives to make the merging attractive could improve the willingness to adopt the new approach. The sooner the present rigid distinction, within the Rural Development Regulation, between the measures for farmers and the measures for the rest of the rural population disappear, the better for accelerating the transition. A single European Structural Fund, to be used for all types of measures, would greatly simplify an integrated approach toward the development of rural economies.

## Récapitulatif

### Hypothèses générales et défis

La méthode employée dans ce papier consiste à décrire d'abord une vision de la politique agricole et rurale durable et désirable pour une Europe élargie à un horizon de 25 ans environ et ensuite de décrire dans les grandes lignes comment elle devra être mise en place. De cette manière la logique du processus de réforme est guidée par la vision d'une situation souhaitable et non pas par la situation existante.

On peut supposer que l'UE connaîtra une autre expansion vers l'Est. L'évolution économique dans les grands pays d'Asie, de même que certains progrès réalisés concernant le recul de la pauvreté dans les régions les plus pauvres du monde, pourrait se traduire par une reprise des prix mondiaux des matières premières agricoles par rapport à leur bas niveau les 5 dernières années. La globalisation entraînera d'autres libéralisations commerciales. Il se pourrait que la volatilité des marchés internationaux augmente. Les restrictions frontalières et les politiques agricoles et rurales nationales continueront de créer des tensions dans le domaine du commerce international en raison des différents degrés d'inquiétudes et des différentes valeurs des citoyens à l'égard de la sécurité des aliments, de l'environnement et du bien-être des animaux vivants.

En Europe, l'élargissement du commerce agricole se poursuivra. La croissance de la productivité se traduira par la poursuite de la concentration de la production. D'un autre côté, nombreuses seront les petites exploitations agricoles qui se verront dans l'incapacité de suivre cette voie, et qui, soit se maintiendront à un niveau de subsistance, soit développeront des solutions basées sur la diversification de leur activité. L'industrie de la transformation et de la distribution alimentaire se concentrera davantage. Les agriculteurs deviendront de plus en plus des fournisseurs de matières premières agricoles mais l'on connaîtra une contre-tendance tout aussi importante vers la différenciation et la qualité supérieure, souvent liée aux aliments de production locale ou régionale.

Les défis que la politique agricole et rurale commune aura à relever sont les suivants :

- Mise en place d'un marché européen unique pour les produits alimentaires agricoles en ce qui concerne les normes de prix et de sécurité en conformité avec la concurrence et les engagements internationaux dans le cadre de l'OMC.
- Stimulation de la concurrence du secteur agricole tout en améliorant la qualité du produit et en veillant à observer les normes requises en ce qui concerne les processus de production, dans le respect de l'environnement et du bien-être des animaux vivants.
- Promotion d'un programme de développement rural efficace pour la population rurale.
- Développement d'instruments efficaces pour garantir l'utilisation durable des ressources naturelles dans l'agriculture de manière à protéger et à développer l'environnement naturel et à préserver l'héritage culturel rural.
- Création d'un cadre institutionnel pour mettre en œuvre ces politiques d'une manière efficace et efficiente.

La politique agricole et rurale commune revêt une fonction sectorale pour l'alimentation et l'agriculture et une fonction *territoriale* pour les régions rurales. Ces deux fonctions sont considérées comme parties de la politique intégrée.



## Vision d'une politique pour le développement rural durable

### L'évolution du rôle de l'agriculture et des politiques agricoles

L'objectif primordial et par la même les tâches des politiques agricoles et alimentaires consiste à assister, voire dans certains cas assurer :

- la croissance de la productivité
- la compétitivité
- la stabilité des prix et des revenus
- la sécurité alimentaire
- la qualité alimentaire et le bien-être des animaux vivants
- l'environnement rural et la qualité du paysage culturel.

Les objectifs traditionnels comme

- le soutien des revenus agricoles
- le maintien de la population agricole
- la sécurité alimentaire

doivent être revus.

La politique agricole et alimentaire doit, à l'instar de toute politique de tout secteur économique, stimuler la croissance **durable de la productivité**. En raison de la combinaison de l'immobilité des agriculteurs et du manque d'élasticité de la demande alimentaire, le progrès technique ne constitue pas une garantie d'accroissement des revenus relatifs, mais sans le progrès technique la croissance de ces revenus est impossible.

L'alimentation et l'agriculture européenne doit accroître sa **compétitivité** internationale. Les mesures douanières qui invalident cet objectif, comme les subventions à l'exportation, les quotas d'importation, les tarifs douaniers élevés à l'importation, ainsi que les mesures nationales de soutien, tels que les quotas de production et autres instruments liés au marché des matières premières devront également être réduits progressivement au cours du temps.

Toutefois, la politique agricole et alimentaire devra assurer également un certain degré de **stabilité**. Le risque est inhérent à toute activité commerciale, mais le risque dans le domaine de l'agriculture revêt des aspects caractéristiques spécifiques. La PAC actuelle contribue substantiellement à la stabilité des prix et des revenus, principalement comme un produit annexe des politiques visant le soutien des revenus. À l'avenir, la stabilisation de certains prix pourrait être atteinte en se fondant sur les instruments de la PAC existant mais en les utilisant uniquement comme "filets de sécurité". Les programmes d'assurance du revenu non pratiqués actuellement dans l'agriculture européenne pourraient jouer un rôle. L'UE pourrait faciliter la réassurance du risque en fournissant un cadre légal adéquat et faciliter également le développement des marchés futurs.

Tout aliment doit être **sain** à la consommation. Les États-membres et les autorités de l'UE ont la responsabilité de garantir que les conditions nécessaires soient réunies : information, formation, infrastructure publique, agréments concernant les moyens de production agricoles, agréments concernant les processus et les produits alimentaires, contrôle de la sécurité alimentaire, inspection et règlement, et sanctions en cas de non-

conformité. Toutefois, il n'incombe ni à la politique de marché, ni aux paiements directs de remplir ce rôle, et tel doit être le cas. Il va de soi qu'aucune mesure de gestion du marché ne devrait encourager des pratiques compromettant de quelque façon que ce soit la sécurité alimentaire.

La force la plus puissante pour assurer la **qualité des aliments** doit être le marché, mais la politique publique a également un rôle important à jouer, comme fournir un cadre réglementaire institutionnel pour la protection et l'information du consommateur. Ces rôles existent déjà. Plutôt que de militer contre l'augmentation de la qualité alimentaire comme l'ont fait les régimes de marché dans le passé, la politique future devrait aider les agriculteurs à se concentrer sur l'amélioration de la qualité et à améliorer la coordination et l'intégration au sein de la chaîne alimentaire.

Certaines de ces mêmes considérations s'appliquent également aux normes de **bien-être des animaux vivants**. Au-delà d'un certain point, les normes de bien-être des animaux vivants peuvent être considérées comme un critère de qualité auquel les consommateurs attacheront leur propre valeur. Le rôle public est tout d'abord celui d'agréer des normes de bien-être des animaux vivants, en deçà desquelles aucune production ne peut aller. Le second consiste en la validation de la précision de l'information du consommateur et le contrôle de l'accréditation des systèmes de production, ce qui permettra d'obtenir des normes plus élevées.

Les sociétés plus opulentes mettent à la fois davantage de pression et accordent une valeur plus importante à la qualité de **l'environnement rural et aux paysages culturels**. Le rôle des agriculteurs et des gestionnaires de l'occupation du sol de gérer la campagne a pris de l'importance de même que celui de la politique. Les mesures d'incitation à une utilisation intensive des terres dévastatrice pour l'environnement devraient être réfrénées en réduisant le soutien des prix et en découplant les paiements directs de la production. Les conditions environnementales devraient s'attacher à rester des mesures de soutien du marché, y compris les aides à l'investissement et les paiements directs.

L'un des objectifs primordial et continu de la PAC est d'**augmenter les revenus par tête des personnes travaillant dans le domaine de l'agriculture**. Cependant, la plupart des analyses ont montré que l'efficacité du soutien des prix par l'augmentation des revenus agricoles était très faible. Aussi les bénéfices de la PAC sont-ils répartis très inégalement entre les matières premières, les régions et les agriculteurs. Ni le soutien des prix, ni les paiements directs calibrés sur ces soutiens de prix, ne sont des instruments efficaces pour traiter le problème du bas niveau des revenus agricoles.

Ce vaste soutien du marché et les paiements directs sont justifiés également par le **maintien de l'activité agricole** dans des régions où elle aurait disparue autrement. Concernant les matières premières commercialisées, l'argument selon lequel les désavantages naturels de certaines régions entraînant des coûts plus élevés devraient être compensés par des subventions, est économiquement irrecevable. Une raison plausible à l'assistance de telles régions pourrait être que l'agriculture est le fournisseur d'autres biens et services publics. Si cela est la justification, alors la base du soutien pourrait être des paiements ciblés sur la production de ces biens publics.

**La sécurité alimentaire** n'est plus un objectif primordial de la politique agricole et alimentaire européenne. Il n'existe pas de menace crédible quant à la disponibilité des ingrédients de base de la nutrition humaine en provenance de sources nationales et étrangères. S'il existe une menace de la sécurité alimentaire, elle concerne la destruction possible des réserves par une catastrophe naturelle ou une action terroriste catastrophique.

que. La principale réponse nécessaire à une telle menace est la mise sur pieds de plans d'urgence appropriés et la coordination entre la commission et les États-membres.

### **Politique de garantie de la viabilité des zones rurales**

Les zones rurales font partie intégrante de la société européenne. Plus de 80% du territoire européen est rural et 25% de la population de l'Union européenne vit en zones rurales. Les régions rurales viables sont essentielles pour un développement territorial équilibré. Elles sont importantes aussi pour le développement de l'héritage culturel et naturel car elles contribuent à la formation de sa propre identité et du sentiment d'appartenance.

Les régions rurales d'Europe sont tout à fait diverses. Certaines d'entre elles ont assimilé avec succès les changements structurels et la diversification économique. Ceci est de plus en plus attribuable aux facteurs tels que la qualité de l'héritage naturel et culturel, l'existence de réseaux et de partenariats et l'implication directe des décideurs principaux. De l'autre côté, un certain nombre de zones rurales ne sont pas encore parvenues à réaliser les changements structurels. Les faiblesses structurelles de ces régions pourraient être dues à une densité de population extrêmement faible, un manque d'accès, une localisation en périphérie, un désavantage climatique, une infrastructure déplorable, des structures industrielles vétustes et des conditions de production dépassées.

Dans les régions rurales où les changements structurels n'ont pas encore eu lieu, ou en sont à un stade plus précoce, l'agriculture est encore souvent une source importante de revenus. Toutefois, la viabilité économique ne peut pas être générée par l'agriculture seule. L'agriculture doit contribuer à rendre les régions rurales attrayantes en maintenant et en développant l'héritage naturel et culturel.

Les zones rurales ne sont en général pas moins compétitives que les régions urbaines pour ce qui est d'attirer des ressources. Il ne faut pas les imaginer comme étant "en retard" de façon homogène par rapport aux économies urbaines et nécessitant des mesures politiques symétriquement homogènes pour rattraper (dans le scénario le plus optimiste) ou étant indéfiniment indemnisées pour un handicap hypothétique du fait qu'elles sont rurales (dans le scénario le plus pessimiste).

Les zones rurales doivent fonder leurs économies sur la diversification davantage que sur les économies d'échelle et l'agglomération. Chaque région doit combiner son propre mélange de ressources lui étant spécifique en essayant de trouver son avantage particulier par rapport à la concurrence à travers une stratégie globale agréée localement et par des actions correspondantes. La mise en valeur de produits typiques par le biais du tourisme rural, de l'héritage et du paysage naturel par le biais de certaines pratiques agricoles, l'artisanat et les petites entreprises avec la formation et la recherche ad hoc constituent quelques exemples de stratégies mises en œuvre avec succès.

Pour obtenir des zones rurales viables, la tâche la plus importante de la politique consiste à induire la diversification de l'économie dans les zones où elle ne s'est pas réalisée spontanément. La promotion d'activités de différents secteurs ne devrait pas être discriminante en fonction de la taille ou de l'origine. Les initiatives à petite échelle sont générées avec une plus grande probabilité de manière endogène et elles se sont montrées très stables en période de crise. Les investissements externes peuvent stimuler la croissance et l'innovation au niveau local mais ils peuvent montrer une propension plus grande à quitter la région plus facilement si les avantages initiaux au niveau des coûts diminuent. Dans les zones où la densité de population et d'entreprise est basse, la spécialisation implique le risque d'un ralentissement pour toute la région suite à la crise

d'un secteur. La vulnérabilité des régions rurales est moins évidente lorsque plusieurs entreprises et secteurs économiques de différentes tailles y sont représentés.

Une politique de la diversification de l'économie rurale doit considérer :

- la promotion d'une base de ressource humaine et sociale articulée,
- le maintien de la diversité entre les zones rurales comme un atout européen,
- le support des économies et des sociétés rurales pour établir des liens et des échanges significatifs avec le monde extérieur,
- les soucis environnementaux d'intégration en relation avec les secteurs non agricoles et les standards de vie modernes.

Un autre rôle clé de la politique pour créer des économies rurales durables et viables réside dans l'intégration des composantes sectorale et territoriale de la politique rurale agricole commune. Ceci devrait impliquer que les mesures de politique actuelles soient reformulées. L'orientation du secteur agricole avec les agriculteurs comme principaux bénéficiaires directs continuera de constituer une part importante de la politique mais il conviendra d'élargir la réflexion concernant toutes les actions dans le cadre des besoins ruraux attendus. Ces nouveaux besoins incluent à la fois les besoins spécifiques du secteur agricole que les objectifs de l'économie rurale plus large tels que :

- faciliter l'adaptation des exploitations aux marchés en évolution, y compris l'accroissement de la qualité et de la différenciation alimentaire,
- la promotion d'une intégration horizontale plus forte des activités agricoles dans une économie rurale plus large,
- le soutien de la diversification de l'activité agricole,
- l'intégration des soucis environnementaux dans le nouveau cadre de la politique agricole.

Les actions de la politique devraient fournir une approche pour atteindre les objectifs plutôt que de fournir une recette ou une liste de mesures spécifiques à suivre. Il n'est pas utile d'établir un menu des mesures éligibles. Une liste d'actions et d'instruments non éligibles pourrait être la seule contrainte de même que les limites concernant les niveaux de l'aide. Cette méthode est basée sur une décentralisation des institutions avec la participation active des parties prenantes publiques et privées suivant le principe de la subsidiarité. Les partenariats d'intérêts ruraux avec les gouvernements régionaux devraient être responsables de la préparation de programmes pluriannuels et de l'attribution des ressources financières. La préparation des programmes devrait commencer par une analyse approfondie de chaque zone rurale, axée sur les opportunités et les contraintes spécifiques, les points forts et les points faibles. Une ou plusieurs stratégies alternatives devraient être établies et soumises pour consultation et approbation avant d'être transformées en un programme pluriannuel. Il existe deux références majeures pour guider la mise en œuvre de cette vision : l'expérience du fonds structurel réformé et l'expérience du programme LEADER.

Il existe trois raisons justifiant une intervention au niveau européen dans de telles politiques rurales décentralisées. La première raison est que l'approche des programmes pluriannuels doit être coordonnée avec les autres politiques de l'UE comme la politique régionale (fonds structurel et fonds de cohésion), les règlements environnementaux et les politiques de la consommation. La seconde raison est que le transfert des ressources entre les États-membre est légitimé au titre d'une politique de redistribution visant la cohésion territoriale et basée sur le principe de la solidarité. Ceci s'avère encore davan-

tage dans le cadre de l'élargissement. La troisième raison n'est pas tant liée aux transferts financiers qu'au large « marché » d'échange de pratiques et d'expérience politique qui est généré par le transfert des connaissances et des leçons apprises par le biais de la coopération transnationale et du tissage d'un réseau.

## **En marche vers une nouvelle vision politique**

### **L'inadéquation des efforts de réforme jusqu'à présent**

La PAC s'est constamment adaptée depuis que les premières réglementations du marché ont été entérinées et mises en place au milieu des années 60. La réforme MACSHARRY a entamé le processus de découplage partiel du soutien aux agriculteurs en remplaçant le soutien des prix par des paiements de revenus directs pour les secteurs importants. Parallèlement a commencé le processus de l'assemblage des éléments de la politique de développement rural. La réforme de l'agenda 2000 a accentué ce processus. L'une des innovations de l'agenda 2000 fut la consolidation, dans le cadre d'un nouveau règlement du développement rural, des mesures accompagnatrices ainsi que des mesures destinées aux zones moins favorisées, des programmes de modernisation des exploitations, des processus et du marketing, et du développement rural.

Suite à une inspection approfondie, certaines limites du dit "second pilier" sont devenues apparentes. Dès le début du règlement du développement rural, aucunes ressources réelles supplémentaires n'ont été débloquées pour ces mesures. Les États-membres ont déployé peu d'imagination pour utiliser la marge de manœuvre que leur conférait ce règlement pour mettre en place une approche plus vaste et plus innovatrice. La plupart d'entre eux ont poursuivi les programmes existant. L'option offerte aux États-membres de supprimer volontairement et unilatéralement les paiements directs et de transformer les fonds en des plans de développement ruraux a à peine été utilisée car elle obligeait les États-membres à fournir les fonds équivalents et à placer leurs agriculteurs dans une situation désavantageuse par rapport à la concurrence.

La révision à mi-parcours de juillet 2002 et les propositions de réforme de janvier 2003 comprennent un ensemble supplémentaire de changements, dont certains même totalement radicaux, mais tous inscrits dans la logique d'une politique agricole commune considérée comme capable de remplir un rôle de développement plus vaste. Le découplage des paiements (de la plupart mais pas tous) diminuera la motivation à la fois de repousser la limite des cultures jusqu'à des terres fragiles et d'intensifier la production uniquement pour percevoir davantage de subventions. Ceci tendra à réduire la production de certaines matières premières et à réduire les effets de distorsion commerciaux de la PAC. Bien que ces mesures soient valables, elles ne suffiraient pas à elles seules à définir une politique durable. Une telle politique doit comporter des mesures et des objectifs sociaux, positifs, agréés et des mesures sélectionnées spécifiquement, équilibrées et ressourcées pour les atteindre.

### **Le passage de l'approche sectorale à l'approche territoriale**

Il est nécessaire de passer de l'approche sectorale à une approche principalement territoriale. Une telle politique inverserait la logique de l'approche de concevoir une politique rurale comme un ensemble de mesures accompagnatrices pour l'agriculteur. Ceci a des implications importantes sur les institutions. Actuellement il n'existe pas d'institution au niveau de l'UE qui pourrait servir de cadre pour la réconciliation d'intérêts en concurrence. Il convient en premier lieu de s'occuper de l'organisation du cadre institutionnel approprié. Des institutions restructurées adopteront probablement plus facile-

ment la nouvelle vision que les structures existantes basées largement sur l'approche sectorale de l'agriculture. L'expérience montre la forte tendance à "adapter" les mesures innovatrices au sein de la logique des procédures existantes. Au niveau des États-membres le problème est exacerbé par un intérêt incompréhensible de maintenir les enveloppes financières redistribuées par le biais de la PAC.

La transition vers une nouvelle politique de développement rural pourrait se faire par étapes. Suite à la mise en place d'une institution appropriée dans une première étape, les étapes suivantes pourraient consister en l'application de la nouvelle approche à la mission politique de : (1) la **diversification de l'activité économique dans les zones rurales**, par exemple la définition d'une stratégie et des mesures correspondantes, en se réservant la possibilité de laisser inchangées les autres composantes de la politique et (2) **l'intégration de la politique agricole et rurale**, par exemple un passage du "menu" des mesures standard existant actuellement vers des stratégies auto-définies. Chacune de ses deux étapes pourrait coïncider avec un programme sur une période (5 à 7 ans). L'UE pourrait offrir aux États-membres la possibilité de choisir d'effectuer la transition plus ou moins rapidement et les États-membres, quant à eux, pourraient accorder la même flexibilité aux régions. Les pays candidats à l'adhésion devraient être autorisés d'adopter immédiatement la nouvelle vision (s'ils le souhaitent) sans avoir à passer par l'adoption des mesures existantes, lorsque l'on sait déjà qu'ils devront être réformés quoiqu'il en soit.

Le financement d'une politique agricole et rurale commune devrait être déterminé sur ses propres mérites et ne devrait pas avoir un caractère permanent et automatique. Les fonds seront attribués aux États-membres comme des "enveloppes nationales" limités pour une certaine période de temps spécifique. Ils ne seront pas prolongés automatiquement mais ils devront être renégociés périodiquement sur la base des besoins apparaissant et de l'évaluation de l'impact. Cela confère aux États-membres des marges importantes d'utilisation des fonds en fonction de leurs priorités et d'explorer les voies "transitoires" privilégiées, ce qui pourrait susciter une certaine compétition entre les "meilleures manières" de traiter le développement rural dans toutes ses dimensions. Abolir ou réduire temporairement le besoin des co-financements nationaux des mesures de développement rural pourrait faciliter énormément la volonté d'éliminer les distinctions actuelles dans les procédures de financement du pilier 1 et du pilier 2.

### **Étapes requises pour modifier le pilier 1 et le pilier 2**

On assistera à une contraction significative de l'ampleur du soutien public existant fourni actuellement dans le cadre des mesures de pilier 1. Toutefois, ceci est subordonné à deux critères qu'il est important de souligner. Le premier est de reconnaître qu'il est nécessaire de donner du **temps** aux agriculteurs autant qu'aux autres acteurs sectoraux pour s'adapter (par exemple calendrier des investissements de capitaux importants, disons 15 ans), et **de les assister** dans le processus d'adaptation en accordant aux producteurs la flexibilité d'utiliser les soutiens lors d'une période au cours de laquelle ils diminueraient progressivement. Le second critère est la nécessité de compenser la réduction du soutien à la production du pilier 1 par une expansion appropriée des mesures des programmes de développement rural.

Le processus de réduction des prix d'intervention à un niveau agréé en deçà des prix du marché mondial devrait se poursuivre. La volatilité accrue nécessite de maintenir de véritables interventions de sauvegarde. La protection des frontières sera considérablement réduite mais pas totalement éliminée. Le maintien de droits de douane résiduels entraînera la persistance d'un degré de préférence communautaire continu mais bien inférieur pour compenser (partiellement) les normes environnementales et autres plus

élevées de l'UE ; leur existence donnera la possibilité d'appliquer des droits de douane de sauvegarde spéciaux suite à une chute inhabituelle des prix. Les paiements directs seront réduits. Pour tous les autres paiements, la solution est de se mettre d'accord sur un calendrier de réduction, sous réserve de l'assurance qu'il y aura un transfert important du soutien à payer pour les services requis par la société et de l'assurance qu'un certain degré de support collectif sera fourni pour la stabilisation.

La meilleure solution pour organiser la fourniture de services relatifs au paysage culturel et environnemental public est l'intégration de programmes agro-environnementaux dans les mesures de développement rural. Les objectifs et la volonté agro-environnementaux de payer pour ces services seront différents d'une région à l'autre. Toutefois les problèmes administratifs et les réalités politiques, en particulier les co-financements supplémentaires nécessaires dans le cas où les fonds seraient transférés du pilier 1 au pilier 2, pourraient compromettre cette solution. Les propositions de réformes de janvier 2003 de découpler les paiements directs et de les associer à certains degrés d'éco-conditionnalité ne peut pas être une solution durable car ces paiements sont basés sur la production agricole passée et non pas sur la demande actuelle de la société en services environnementaux. Les solutions alternatives hormis ce casse-tête peuvent être soit reformulées systématiquement et briguer les paiements découplés de la production de manière à les rendre plus 'vert environnemental' au cours du temps dans le cadre du pilier 1, ou de retirer l'élément du co-financement des États-membres des fonds transférés au pilier 2 pour instaurer une large application des programmes environnementaux dans ce pilier.

L'aspect le plus difficile de l'adaptation des mesures du pilier 2 actuel est le renforcement des complémentarités entre le secteur agricole et l'économie rurale en général en concevant et en mettant en œuvre l'intégration des éléments sectoraux et territoriaux de la politique rurale et agricole commune. Le modèle établi depuis longtemps d'avoir une liste fixe de mesures à sélectionner rend difficile l'adoption d'une attitude plus "entrepreneuse" dans l'identification des stratégies auto-définies. La phase de transition devrait permettre un degré significatif de flexibilité entre les États-membres ne se référant pas à l'objectif général, mais aux manières dont la nouvelle vision est étendue aux différents domaines de la politique actuelle. Permettre la diversité sans abandonner l'unité des règlements communs assure la cohérence avec la nature particulière de la construction de l'Union européenne et est également approprié au traitement des problèmes posés par l'élargissement.

Lors de la phase de transition, les expériences réalisées avec les initiatives communautaires (LEADER en particulier) constituent un bon référentiel. Elles se sont avérées efficaces dans la stimulation des économies rurales. Leurs caractéristiques spécifiques sont bien codifiées. L'approche est basée sur la zone, du bas vers le haut et avec participation. Elles comportent le principe du partenariat, l'intégration et la nature multisectorale des actions basées sur le réseau, la coopération transnationale, la mise en place de programmes et le co-financement. Les programmes réguliers du fonds structurel ont été opérés avec succès en suivant certains de ces principes. L'une des leçons les plus importantes est l'interaction entre le principe du partenariat (à la fois horizontal, entre les acteurs locaux, et vertical, entre les institutions à différents niveaux) d'un côté et l'approche multisectorale intégrée de l'autre côté.

L'aspect le plus délicat est la "fusion" de l'approche actuelle standardisée du haut vers le bas des mesures structurelles de l'agriculture avec les mesures davantage auto-définies, généralement exceptionnelles de l'approche territoriale. Les mesures d'incitation pour rendre la fusion attrayante pourraient améliorer la volonté d'adopter la nouvelle approche. Plus la distinction actuelle rigide dans le cadre du règlement du dé-

veloppement rural entre les mesures pour les agriculteurs et les mesures destinées au reste de la population rurale disparaîtront rapidement, plus il sera facile d'accélérer la transition. Un fonds structurel européen unique à utiliser pour tous les autres types de mesures simplifierait grandement une approche intégrée en vue du développement des économies rurales.





**Part I**

**Policy Vision**

**for Sustainable Rural Economies**

**in an Enlarged Europe**



# **1. Background Assumptions and Challenges**

## **1.1 Rural areas and agriculture - a changing paradigm**

Rural areas are relevant in many ways for European society. They hold all the agricultural land and a quarter of the total population. They supply the varied food needs that consumers demand today. They keep the memory of our recent past and cultural heritage. They are a showcase of the variety of European landscapes. They offer leisure, amenities and different lifestyles to urban people. For the future, they hold the promise of an environmentally friendly and more sustainable modern way of living and working. The functions of rural areas have been increasing in recent decades. Maintaining and developing the viability and diversity of rural Europe is a vital task not just for the farmers and the rural population but also for society as a whole. To accomplish such a task is a major challenge. It requires a substantial change in the present rural policy vision.

Forty years ago farmers, policymakers and experts coincided in imagining the future of rural areas as agriculturally based. Medium and large farms, well equipped, technologically advanced, highly productive, in mostly family holdings, with a skilled and efficient labour force and producing for the rapidly growing industrial urban markets would become the key economic actors of rural areas. This sectoral vision implied that part of the rural population would have to leave in order to make a living. Consequently, policies were conceived to facilitate and soften such a transformation, offering protection both to those displaced and to farmers, not yet ready to face international competition. This was a coherent and attractive policy design, with an economic, social and political legitimacy, which few questioned. To achieve these objectives, an agricultural policy was all that was considered required. In fact, the initial design of the Common Agricultural Policy did not envision any need for a distinct rural policy.

Both the imagined future of rural areas and the sectoral policy designed to realise it, turned out to be partial representations of the observed course of events in the last forty years. Already at an early stage the question was raised, whether a modernised agriculture was able to operate under the natural conditions of available agricultural land, its soil quality, and climate, and economic conditions of farm structure, factor prices, and commodity markets without significant levels of public support. No definitive answer has yet been given. However, this question has been answered indirectly, by the large convergence in realisation that the problem of public support for agriculture is not related to a transition phase in the development process but appears to be a structural one. The CAP has therefore been subject to a continuous adaptation, extending its interventions over time.

In relation to the initial policy vision, farm modernisation and the rural exodus did in fact take place as expected, especially in the early stages of the policy implementation. However it became also clear that small farms often found through multiple job-holding, or pluriactivity, their own peculiar form of modernisation and development. This enabled many farm families to maintain their living standards apace with the rest of society, whilst maintaining their place in farming. Furthermore, after an initial rush, the rural exodus subsided and in some regions, especially in the last two decades, reversed. In this way, many rural areas have been able to retain a growing portion of the non-farming population and even attracting new residents and economic activities. This unexpected outcome may be explained by the fact that rural areas have become attractive, in relative terms, not only to farmers but also to other social actors which want to live, work, establish economic activities or simply enjoy rural areas. As a

consequence, the weight of farming families in the rural population has been declining, while non-agricultural activities have been expanding. The economic viability of rural areas is not only insured by farming. Such an outcome should be considered as a desirable one, to be supported and encouraged by a new policy vision. It is clear that agricultural policy alone does not address the new functions that rural areas have developed both for the rural population and for society as a whole. A new policy vision would also provide a positive and appropriate reference for the new Member States and future enlargements.

## **1.2 Assumptions about future trends**

The time horizon of the new policy vision we are describing here is of about a quarter of a century. Its adoption will require a change of mentality and a longer time framework than it would be required for a reform of an unchanged vision. It is the understanding of the ongoing processes and their policy requirements that must change. However, the relevance of the current policy vision, its entrenched character, and the difficulty of the reform attempts so far, all tell us that a shorter horizon would be unrealistic if we want to achieve a change of perspective. On the other hand, a longer time framework would be of little value and credibility.

In this period, we would expect that the EU itself may have expanded further to the East. This in turn may have meant a further enlargement embracing the remaining part of the Balkans, decisions on Turkish membership, and clarification of relations with Moldova, Ukraine, Belarus and Russia. Merely mentioning these possibilities is suggestive of the breadth of considerations the policy must embrace in the time period under consideration.

This longer vision is premised on continued rapid economic development in the large countries of Asia (China, India and Indonesia), and on at least some progress in lifting poverty in the poorest parts of the world. These assumptions imply some recovery in world agricultural commodity prices from their levels in the last 5 years. This is because we expect demand growth in these regions, despite technological improvements, to exceed capacity to expand production given limitations of arable land area and water. But it would be wise also to assume that because of the uncertainties about these developments, volatility of international markets will continue and may even increase.

It is expected that the process of globalisation – i.e. greater international economic, social and environmental interaction – will continue. This will be accompanied by, and indeed be stimulated by, continued progress in world trade liberalisation including agricultural trade. This is likely to mean that agricultural exports are treated no differently than any other exports from the point of view of subsidisation. It will mean that tariff barriers on agricultural products are significantly lower than now, but not eliminated. Domestic agricultural support related directly to agricultural production will also be much reduced (ANANIA, ARL 2003).

However, border restrictions and domestic agricultural and rural policies will still create tensions in international trade. This is because of the quite different extent of the integration of agriculture in rural society, rural environment and cultural landscape within and between the new and old worlds. It also stems from the fact that different levels of economic development are associated both with different degrees of environmental impact of economic activities, and different degrees of concern about, and different values of citizens with respect to food safety, the environment and animal welfare. The food and farming related issues high on the trade agenda will be food safety, environment and competition policy. The competition issues will concern

intellectual property rights, and issues surrounding the appropriate regulation of large multi-national corporations which supply farm inputs, including seeds, and process and distribute farm produce.

Narrowing down to Europe itself, the major trends in food, farming and in rural society will continue. These patterns and trends observed in most of Western Europe will, generally, be adopted in the new Member states. Because the starting points are so different, there will remain significant differences in most of these aspects for the period under consideration.

Farming will continue to lose labour. The rates of loss may accelerate in some countries, especially the new member states. Farm business enlargement will continue by a number of mechanisms: farms growing larger in area; land renting; share cropping; contract farming; company farming; and various other forms of horizontal and vertical integration. Growth in productivity will continue. This generally means that labour and, to a lesser extent, land, will continue to be substituted by capital. This takes the form of mechanisation, agro-chemical use, genetic developments (whether through traditional or modern biotechnological methods), more sophisticated control systems, and more knowledge-intensive management. These processes are enabled by technical change and driven by the economic forces of changes in wages and capital costs, and a product-price squeeze driven by the liberalisation of markets. The result will be a further concentration of production of the bulk of the output by a smaller number of businesses. These businesses will themselves integrate further with the food chain and some will engage in significant processing and value-adding.

At the same time, a numerically much larger number of current 'farms' will find themselves unable to follow the above route. They have too small a land base from which to derive a 21<sup>st</sup> Century living standard for a family based on farming alone. In some regions these farms may not develop, but remain in subsistence form with little engagement with the rest of the economy, creating a continuing social challenge. In many others, they will develop one or several of a range of 'solutions' based on pluri-activity and part-time farming. These will include focusing on raising value-added of their products through specialist processes, breeds, or varieties; engaging in downstream processing or retailing; or engaging in other non-farming activities whether land-based or not. These are part time or pluri-active farmers, and their activities can span a wide range from week-end or hobby farmers, through seasonal farmers, to specialist producers and distributors of high quality, high value, food products.

Many of the changes in farming systems and structures will be driven by the ever-closer integration with the rest of the food chain. This chain itself is under continual pressure for change driven by technical, economic, social and regulatory factors, by increased international competition and by structural changes in the retail sector. Demographic and social trends lead towards more, but smaller, households which increasingly consume more processed foods, prepared meals, convenience foods and food eaten out of the home. This simultaneously drives commoditisation and differentiation of the food chain. There is no contradiction here.

The mass, and reliable, production of many food products, from ketchup to chicken breasts, requires a consistency of supply (in quality and in time, through the season). This pushes the primary producer to be a raw material supplier to exacting standards of consistency and product definition. The industries processing and distributing these products become more concentrated and systematised. The demands for higher standards of food safety and occupational safety in the food chain, and for higher standards of environmental protection and animal welfare all imply more regulation.

This comes with associated costs and drives further concentration and the need for more information to flow up and down the chain with the products. An important aspect of this is product traceability. Farming increasingly becomes a supplier of agricultural raw materials for the food industry, and, depending on the fiscal regime, for the bio-fuels industry too.

At the same time as this continued commoditisation there is an equally important counter-trend towards differentiation, higher quality and value-added. Higher income levels and greater disconnection of consumers from farming and rural roots increases the demand for differentiated, higher-value, often regionally, or locally, linked foods. These premium products also build on special and traditional breeds of plants and animals, on traditional production or processing methods or on organic production. The shares of such 'specialist' foods, individually, will be small. If they get beyond a certain share they become commoditised themselves. However, collectively, there is scope for considerable expansion in this sector both for domestic EU consumption and export.

Another major element of the future for agriculture and land management more broadly is the supply of environmental and cultural landscape services. The technical and structural changes in agriculture have enabled the large out-migration of farm labour and a corresponding rise in productivity and thus living standards of remaining farmers and their workers. These changes have also facilitated the food chain developments described above. But these developments have come at some environmental costs. Both the market and policy signals to the increasingly commercialised farmers have often pushed them towards farming systems which have depleted bio-diversity, degraded landscapes, and caused damage to natural resources in the form of air and water pollution and soil erosion and damage. These are the so-called negative externalities of agriculture. They have increased. At the same time the 'supply' of positive externalities of cultural landscape and bio-diversity has diminished. This contraction in supply has coincided with increased demand for these services as society has become wealthier, more mobile, better informed, more detached from rural values and inclined to value them more highly.

Taken together, what is being described is a continuation of the major trends of the last half-Century. They culminate in a remorseless decline in the share of agriculture in Gross Domestic Product, and in a continual decline in the farm gate share of the consumers' Euro spent on food and drink. The share of the food chain beyond primary production rises as a proportion of consumer food and drink expenditure. In Western European countries, the GDP share of the total food chain itself declines, but in the new Member States it may rise for a time – although much of the up and down-stream value-adding activity is not located in rural areas. Correspondingly, agriculture, and its ancillary industries and service sectors up and down stream, shrink relatively in the national economy. They shrink too in their relative importance in the *rural* economy. In many regions of Europe within, say, 75 Km of cities, the very boundaries of rural and non-rural are becoming less distinct and the flows between them of people, labour, capital, goods and services increase and become more important. Rurality is defined in terms of relatively low population density and absence. That is, absence of farming in the non-rural areas, and absence of large-scale manufacturing in the rural areas. Apart from this, the economic composition of rural areas, apart from the most remote areas, becomes almost indistinguishable from the non-rural areas dominated by private and public service activity.

### 1.3 Challenges for a reformed agricultural and rural policy

The challenge is to design an effective and successful new policy addressing the following tasks:

- To implement a single European market for agricultural food products with respect to prices and safety standards in a way that is compatible with international competitiveness and commitments under the WTO;
- To stimulate the competitiveness of the agricultural sector in such a way that the quality of product is improved and the production process meets the required standards with respect to the environment and animal welfare;
- To promote an effective rural development program for the rural population;
- To develop effective instruments to guarantee the sustainable use of natural resources in agriculture in order to protect and develop the natural environment and to preserve the rural cultural heritage;
- To create the institutional framework to implement these policies in an effective and efficient way.

Such a new policy should effectively cope with the broadly felt dissatisfaction with the current CAP. This stems from a lack of coherence between the CAP and other European policies on trade, international cooperation and environment. More specific complaints come from consumers, citizens, farmers, taxpayers and economists. Consumers have concerns about food safety and food quality. Citizens question the effects of the CAP on the environment and animal welfare. Farmers complain about their unsatisfactory incomes and the weight of regulation. Taxpayers question the high expenditures on agriculture and economists criticise the misallocation of resources and trade distortions caused by the CAP (see the contribution of VON URFF in this volume).

A single European market with uniform safety standards addresses the problem of a misallocation of resources and the consumers concern about the food safety. An open market for agricultural products in the enlarged EU should provide a level playing field for farmers in Europe. The *sine qua non* for such a market is a unified standards and implementation mechanisms for food safety measures.

An effective and mature rural development policy is necessary to create other economic opportunities for farmers and their families. Agriculture plays only a partial role in the economic development of rural areas. Other sectors such as tourism, industry and services play a more important role nowadays in these areas.

Until now agricultural is mainly remunerated by selling products to market: cereals, milk, beef and so on. More recently price support has been substituted in some sectors by direct payments. Agriculture provides society with public services: an attractive landscape, high nature values and cultural heritage, i.e. the so-called positive externalities. For most of these services farmers are not yet directly paid. On the other hand intensification of production and a further substitution of labour by capital, stimulated by more open competition from international and European markets may increase the possible negative impact of agricultural production on the environment (negative externalities). Therefore the challenge is to design instruments that take care of these positive and negative externalities (see the contribution of COLSON; MATHURIN in this volume).

A new CAP should create an incentive structure to safeguard the provision of these services. The current CAP has well-developed institutions to transfer money from the



taxpayer to the individual farmer. A new CAP, or as will be argued, Agricultural and Rural policy, requires different institutions that will create an efficient and optimal interaction between those who provide the services and those who take advantage of the services. Where the execution of the current CAP is highly centralised, the new policy should be characterised by a design, based on local needs, within the framework of an EU policy. This new policy will respect the public function of agriculture and will need more decentralised implementation (see the contribution of BLOM in this volume).

As ten new member states join the Union, this gives greater urgency to getting the conceptual framework right and finding a more coherent instrument set. This more effective agricultural and rural policy should therefore both refocus the CAP for the EU-15 and provide a useful tool for the economic development of new Member States. For example, once it is acknowledged that the rural and the agricultural policies should be differentiated in their objectives, instruments and beneficiaries, and then the adaptations needed in the EU-15 might be different from those needed for the accession countries. It seems more effective to achieve convergence to a common policy by different routes rather than asking CEEC countries to adopt first all the distorting instruments only in order to change them afterwards because they are out of focus with reality.

With these considerations in mind, the conclusion is that the existing basis for agricultural policy must change. A different policy is required to achieve the goal of sustainable rural economies. This policy is necessary to address the new needs in a more efficient and less costly way. The context of rural policy has changed. The new policy must suit the enlarged and more diverse Union, in a world of more liberalised trade, with the focus of food consumers on quality food production methods rather than quantity, and with the diminished economic, but heightened environmental role of farming in the rural areas. It is clear that markets will not solve all the problems of these areas, but it is equally clear that a policy based on agriculture alone will not either (see the contribution of SARACENO in this volume).

The purpose of the paper is to attempt two things. In chapter 2 we spell out our vision for the main elements of the policy required for agriculture itself and for the broader development of rural economies. We make the case that a sectoral policy for agriculture alone is insufficient; this must be accompanied by a much stronger and wider territorial policy for the rural areas. The remaining roles for what remains of agricultural policy are spelled out in section 2.2, and the tasks of the twin-track rural policy are outlined in section 2.3. Chapter 3 then discusses how progress can be made to move from the present, Agenda 2000 CAP towards this vision.

## **2. Policy Vision for Sustainable Rural Economies**

### **2.1 Why is a European Agricultural and Rural Policy required?**

The reason for intervening at European level with decentralised (local) rural policies is mainly that in a single European market, more so after enlargement, all policies need at least to be coordinated and have common rules of the game, even if designed and implemented at national or regional levels.

The second reason for EU intervention is that the transfer of resources between Members States is legitimised as a redistribution policy aimed at territorial cohesion and based on the principle of solidarity, which animates the actions of the European Union. This is even truer in the framework of enlargement, where disparities in income and wellbeing will increase.

The third reason that justifies European intervention in rural areas is not related so much to financial transfers as to the wide “market” of exchanges of policy practices and lessons learned that is generated through the transfer of experience, transnational cooperation, networking that takes place in the course of designing and implementing programmes. These forms of cooperation are unique to the European Union, have proved a positive influence on development and should be included among the added value of EU intervention.

A fourth reason is that there are important environmental spillovers concerning water, air and ecology, between Member States which justify a trans-boundary approach to environmental and some other issues. In any case, the CAP exists, it has its basis in European Treaty, and there are strong inertial forces in European decision making. There is no point in imagining a clean sheet of paper to devise an ideal framework for European agriculture and rural areas, this is not practical.

Given the adjustments to the treaties, and the modern concerns with food, agriculture and rurality, the future Common Agricultural and Rural Policy must have economic, social and environmental aspects. The core purpose of the policy is to seek the sustainability of Europe’s rural economy and regions. A policy with this over-riding objective, and starting where it does, will have sectoral functions for food and agriculture and territorial functions for the rural regions. The bulk of the sectoral functions is and will continue to be dealt with by measures that are at present in Pillar 1. Territorial functions are mainly addressed by measures of Pillar 2. Because environmental issues are deeply integrated with agricultural production and other land management activities, measures addressing these concerns will be found in both sectoral and territorial parts of the policy; at present they are addressed by measures of both Pillars. Section 2.2 focuses on the sectoral matters; Section 2.3 turns to territorial matters.

## **2.2 The changing role of agriculture and agricultural policies**

Whilst Article 39 of the Treaty of Rome defining the objectives of the CAP remains part of the Treaties of the European Union, it is necessary still to be concerned with those objectives. However, objectives for agricultural policy today must take account of the progress in achieving these earlier objectives. It must also note the additional objectives added to the Treaties, particularly the necessity for all policies to contribute to sustainable development. And, of course, objectives for the future must recognise the technical, economic and political changes since the late 1950s. It is suggested that a better reflection of objectives for the agricultural and food policy part of a future Common Agricultural and Rural Policy should be as follows.

The main objectives and thus tasks of agricultural and food policy are to assist and, in some cases, ensure:

- productivity growth;
- competitiveness;
- price and income Stability;
- food safety;
- food quality and good animal welfare;
- rural environment and cultural landscape quality.

Each of these will be considered in turn, before considering some traditional objectives which it is argued have to be reconsidered, namely:

- supporting farm incomes;
- maintaining the farming population;
- food security.

### **Sustainable productivity growth and competitiveness**

An important role of policy for any economic sector must always be to stimulate productivity growth in that sector. Fundamentally, it is by improving productivity that workers in any industry raise their incomes and therefore their living standards. It has long been recognised in the agricultural sector that the combination of constraints to the occupational flexibility of farmers and the inelasticity of demand for food mean that technical change in agriculture results in falls in real food prices and little improvement in returns to farmers. This is often referred to as the result of the technological 'treadmill'. In addition, the structural feature in which farmers are wedged between highly oligopolistic input suppliers upstream and equally concentrated processors and purchasers downstream, ensures that farmers are unable to retain much of the benefit of farm productivity gain. These features cannot excuse farmers from constantly seeking to improve their productivity, but they explain that productivity gain *per se* is not a sufficient condition for improvement in their relative income position.

Improving productivity, in the sense of both total factor productivity and labour productivity, has been, and remains, a prime goal of agricultural policy in Europe. The accession of countries with low levels of farm productivity and income ensures that this remains high on the policy agenda. Raising productivity by raising the skills level of people engaged in the industry and by increasing the quantum and quality of capital and technology with which they work, does not guarantee their relative income levels will rise. However, without such improvement, their relative incomes will surely fall. The role of policy should therefore be to stimulate training and skills acquisition, to assist research, development and technology transfer, and to create the conditions for capital investment in the industry.

Thus the objective of productivity development remains important for the agricultural policy, but the means for achieving it are mostly outside the classic instruments of Pillar 1. The instruments available are through the provision of research, technology development and transfer, through advisory services and training. Much of this effort is the competence of the Member States although there are also significant EU budgets for these activities. Most of these measures for agriculture and the rural areas are within the agricultural sector components of Pillar 2 Rural Development programmes. In addition, the focus of productivity improvement must embrace quality and variety and not solely the sheer quantity of output. Research and development have also a strong role to play in supplying more efficiently the public good aspects of food and production processes. In particular, environmental impacts of agriculture must be an integral part of the public research and extension agenda.

An important objective of the new Common Agricultural and Rural Policy must be to assist European food and agriculture to be internationally competitive. This refers to the ability of the European food and farming sector to survive a more liberalised international trade regime. To do this it must match the competitiveness of the food systems of other countries. Competition is the main method for driving productivity improvement, more efficient use of scarce resources, including environmental assets, and for stimulating innovation. As a part of the world which has been the cradle of inventiveness, innovation and high quality in agricultural and food products, European producers should not fear competition. In addition, given its population size and relative

wealth, and given its largely temperate climate, good supply of fertile arable soils, its farming technology and management, it is likely that the bulk of temperate-zone agricultural products can be competitively produced in Europe. Furthermore, as the importance of food transport inefficiencies and externalities grow (e.g. road congestion and emissions from road and air transport), and as the taste for higher food quality grows, closeness to market may become an even more important factor. It is also the case that as Europe reduces subsidisation of exports, the balance of competitiveness between agricultural and horticultural, and other unsupported crops, will change.

Despite this, there are many who suggest that Europe can never be competitive and that we should not seek this goal. This is most often argued from the perspective that the combination of high population density of relatively wealthy citizens leads to land values and labour costs which ensure that European farm produce can never compete with supplies from parts of the world where these conditions do not apply. We reject this argument. It is based on absolute advantage, whereas since Ricardo, it has been accepted that comparative advantage is the relevant concept. Farmers' organisations often build on these arguments suggesting that Europe has higher food and occupational safety requirements, and higher environmental and animal welfare standards all of which add costs and render European output fundamentally uncompetitive. This is essentially an empirical matter. That Europe has high standards under these headings is true, and higher standards are continually sought. However, this is also true in the rest of the developed world. It is not a sufficient answer to say that the citizens responsible for the higher standards will show their support by only buying produce which satisfy these standards. There is simply insufficient information – especially in processed foods and food consumed out of the home – for this to be satisfactorily resolved by information alone.

Subscribing to competitiveness implies strong lessons for agricultural policy. It means that there is continuing pressure to reduce, if not eliminate, border measures which nullify incentives to pursue this objective such as export subsidies, import quotas, and high import tariffs. The corresponding domestic support measures, production quotas and other commodity market related instruments will also have to be much reduced. However, even in the long period envisaged, import tariffs and some domestic direct payments will and, we are suggesting, should, not disappear entirely. That is, some degree of Community preference will, and should, remain. It has taken over four decades to achieve the goal of reducing such measures to minimal levels for industrial products. The complexity and political and environmental sensitivity of food safety, and rural land management, are complicating factors which slow, and prevent, full trade liberalisation in food and agriculture. What remains of the border and domestic protection in the better adapted policy is justified for reasons of stabilisation (see below) and as a partial recognition of the higher regulatory standards. This latter will not be satisfactory for purists. It is a manifestation of the unwillingness in Europe to allow the principle of freer trade to win over the argument that it is for European citizens to decide their production standards and to make their own assessment of the risks associated with new technologies of production.

### **Price and income stability**

It is likely that the risk exposure agriculture is facing will increase in the future. The liberalisation advocated above, and underway in the Doha Round of WTO is expected to increase price variability in the European Union. Further restrictions on the acceptable methods of production, e.g. bans or taxes on certain pesticides, may result in higher yield variability. Climate change will have an impact on production risk as well

since volatility of weather and ensuing crop failures may increase. In addition, increased trade flows in animal products and growing mobility of people and movement of animals can result in an increased spreading of plant and animal diseases across national borders. Structural change in agriculture contributes also to an increased risk exposure. Specialisation in European agriculture is increasing which raises both producers' production and price risks.

Risk is an inherent part of any business activity and agricultural enterprises face many risks that are common to all businesses (health, personal accidents, macroeconomic situation, and financial environment). However, risk in farming has specific characteristics due to dependence on climate and biological processes, which are more difficult to control than mechanical processes. Production risks occur as result of plant or animal disease, natural damage (drought, floods, frost, hail or storms), ecological risk caused by climatic change, and pollution. Inelasticity of supply and demand contributes to wider fluctuation in commodity prices. It is also the case that the small scale of operation of most farm businesses limits their capacity to understand and manage these risks.

In theory, farmers could cope with uncertainty by relying on contingency markets to neutralise risks. In reality contingency markets are not always available and they have a cost. If uncertainty affects farmers' decisions regarding production and use of resources, and leads them to produce below profit maximising level of output and to avoid production of riskier commodities, social welfare will decrease. Market failures related to the risk management in agriculture include, on the demand side, a lack of knowledge on behalf of farmers about how to use risk management tools and cognitive failures which mean that low probability, high-magnitude, risks tend to be underestimated. On the supply side, insurance may not be supplied, as a result of violations of the conditions for insurability (the existence of a large number of independent exposure units, no catastrophic losses, and sufficient statistical information to establish the extent and frequency of damages). It may also be argued that justification of governmental assistance comes from the scale of these market failures in agricultural risk management in relation to the size of the business involved and producers' capacity to act (see the contribution of RABINOWICZ in this volume).

The present CAP contributes substantially to stability of prices and incomes. This is achieved mainly as a by-product of policies that aim at income support. The CAP contributes to price stability, but there are considerable differences between commodities. Some sectors operate already almost in free market conditions. Direct payments, by being independent of current prices and quantities, also increase income stability, but at present they cover only some commodities. With exception of epizootic diseases, the CAP does not include insurance schemes against crop failures or other perils. Such insurance is, to varying degree and under different institutional arrangements, provided by Member States. Also the degree of subsidisation of such schemes varies noticeably. Existing rules allow Member States to introduce such schemes at the national level. Revenue, or income, insurance schemes have not been used in European agriculture.

It is doubtful whether crop or income insurance should be a part of a common agricultural policy. The advantage would be that the bigger the pool, the easier it is to reduce variability and spread the risks. However, these types of measures are very demanding as regard information requirements, and administrative provisions. Risk for fraud seems considerable. Significant investment in monitoring and acquiring information must occur to prevent moral hazard and adverse selection. In case of income insurance, additional problems arise because of questions of compatibility with

existing national social security systems and co-ordination of taxation policy since some income insurance schemes are based on tax concessions. However, the EU should play a role when production risk is to large extent systemic. In such cases no insurance is available as it is not commercially viable due to high costs. The EU could facilitate re-insurance of risk by providing an appropriate legal framework. Re-insurance should, however, not imply pooling all risk and subsidising high-risk areas. The EU should also facilitate development of futures markets.

With respect to the role of risk management tools in the future, when the CAP has been liberalised, it should be noted that the measures that are presently included in the CAP are designed to support farm income. By pursuing this objective, some degree of income stabilisation is achieved as a by-product. Risk management tools cannot reverse long income trends and hence accomplish this dual objective. Removal of market regimes is likely to increase variability and hence price risks. Removal of market regulation could also stimulate development of futures markets, which are at present hampered by existing regimes. However, even when such instruments are well developed, farmers are reluctant to use them. Stabilisation of prices could be achieved by relying on existing CAP instruments and using them only as last resort “safety nets”. This could imply keeping the level of border protection at a level implying zero protection at an average or trend value of world market prices – or at a margin above world market prices that is justified by higher environmental and animal welfare standards - and to be activated when the price falls below the trend level. An alternative method would be the use of safeguard measures. Such measures are already available in the Uruguay Round Agreement on Agriculture and allow increasing tariffs if domestic prices fall too much or import volumes increase too much according to agreed formulas.

Income insurance schemes are at present not used in European agriculture. Such schemes could play an important role in the future agricultural policy, especially for specialised farmers. However, insurance schemes may be difficult to apply at EU level. The Member States seem more equipped to deal with this type of policy. Price stabilisation and income insurance schemes do not exclude each other and could even be used as complements (see the contribution of RABINOWICZ in this volume).

### **Food safety and quality and animal welfare**

**Food safety** implies that all food must be safe to eat. This must be an explicit objective of agricultural policy. There is a duty for Member States and EU authorities to ensure that there is in place the necessary: information, training, public infrastructure, farm inputs licensing, food product and process licensing, food safety monitoring, inspection and regulation, and effective sanctions for non-compliance. There is also a duty of care on all those in the food chain to ensure the safety of the food they produce. However, these are not roles for market policy and direct payments, neither should they be. Of course, any market management measures should not encourage practices which in any way compromise food safety. Indeed, it is preferable they encourage best food safety practice where this is practicable. For example, any remaining payments to livestock producers could incorporate mechanisms of animal identification, movement recording and traceability which can help provide information necessary for consumer food safety protection (see the contribution of BUCKWELL in this volume).

**Food quality** refers to the combination of attributes possessed by food ingredients or products. It is a very wide term and there is a strong subjective element as to what constitutes high quality. It embraces: biological definition, trueness to type, chemical and physical composition and degree of contaminants. These are mostly what the food industry considers when defining quality. For final consumers, food quality refers to the

shape, colour, smell, provenance, production methods, cooking characteristics, and, of course, tastes of food. There is enormous variety in the combination of these attributes in foods and an equally, enormous variety in the tastes and preferences of individuals for them. These preferences themselves are not static, they change across time, cultures, age and gender and are capable of being changed by social trends and manipulated by commercial interests and fashion. For these very reasons the strongest force for developing and delivering quality must be the market (see the contribution of BUCKWELL in this volume).

That said, there are some important roles for public policy. The fundamental role is to provide the institutional regulatory framework for consumer protection and information to ensure consumers that products are what they say they are. Regulations for product trade descriptions (to ensure products are what they claim to be), label protection (to ensure minimal information and accuracy on labels), and weights and measures monitoring are all part of this framework. As for the case of food safety, these roles already exist and are mostly in the competence of the Member States. The EU role becomes stronger in harmonising or ensuring mutual recognition of standards, to enforce the rules of the single market, and to be eternally vigilant for misapplication of state aid rules.

There is very little role for traditional CAP market management instruments, or direct payments, in dealing with these issues. Indeed it is most often argued that some of the market regimes of the CAP have militated against raising food quality because they encourage production for intervention, and in order to qualify for subsidies, rather than to satisfy consumers. It is argued instead that the role of agricultural policy is to help farmers better connect with the food chain and consumers. This means stimulating farmers to focus on improving quality and adding-value.

It also means better marketing. A traditional way of doing this has been through the development of Geographical Indications, traditionally most frequently used in wine and cheeses. Domestic and international regulatory frameworks are necessary to protect such indications. There is considerably more scope to better establish the connection between foods and the environment and cultural landscape in which they are produced, by encouraging more attention to be paid to local and regional product labels, traditional crops and breeds, and production methods. Steps have been taken to develop some of these ideas through schemes to encourage extensification of livestock production. This is an important part of the process, but active marketing of the superior characteristics from such production systems requires considerably more attention to consumer demands for quality attributes and how they can be supplied. Assistance for these quality-enhancing activities comes under the headings of helping improve marketing and processing, and assisting farmers to work together. This latter may be achieved by encouraging marketing co-operatives or other farmer-controlled business structures with professional management, operative skills and sufficient scale to invest in the necessary storage, grading, processing and promotional capacity.

These desirable actions are goals of agricultural development which may require training and skills acquisition, information, institutional development and some investments. However these are generally the instruments of the sectoral aspect of rural development programmes and therefore would not normally be found in the first pillar.<sup>1</sup> Indeed the January 2003 reform proposals included ideas to stimulate quality in additional Pillar 2 measures. There are also dangers of taking public action too far in

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<sup>1</sup> The fact that some of these functions, e.g. assistance for setting up producer groups, have been part of the commodity regimes is political accident rather than inherent policy logic.

trying to stimulate quality through public policy measures. For example many groups advocate the policy of setting specific market shares for certain quality output, e.g. for organic production. The danger of such politically, and centrally, determined targets is that the quality products will find themselves in the same position of oversupply as emerged for undifferentiated commodity markets.

The prime role for public policy as far as food quality is concerned is thus stimulation, facilitation, and provision of public infrastructure. Because of the particular characteristics of rural areas – population sparsity, long distances and lack of concentration and scale – there can be a case for continued public support of certain aspects of the food processing infrastructure. For example, if society wishes to support local and regional identity in foods and if simultaneously there is a desire to maintain local skills and employment, and to reduce the distance that live animals are transported; this necessitates a larger network of smaller abattoirs than market economics alone would dictate. Specifically, with the post-BSE regulations for meat hygiene and disposal of abattoir waste, if full costs were to be recovered from these small and medium sized enterprises, they would be driven out of business.

It is not a sufficient answer to say that the consumer can and will pay for the higher quality, and costs, of these products. These markets do not always work with textbook perfection. There is imperfect information. Free-riding is a problem. If they can, some people will avoid paying for higher quality produce which take better care of the environment, and yet still deplore the lack of care for the environment. There is a fuzzy line between marketable quality attributes in products, and social and environmental aspects of some production systems. These market failures therefore necessitate, and justify, some collective regulatory action or public support. Such support is not however the traditional kind offered by CAP commodity regimes. Some of it is currently provided by Member States, and probably labelled as food safety expenditure; some of it is implicitly bound up in the direct payments given to producers of some products (see the contribution of BUCKWELL in this volume).

Some of the same considerations arise in respect of **animal welfare** standards, although these are primarily a matter of citizens' concerns to define appropriate standards for the ethical treatment of animals. European citizens are demanding ever-higher standards of treatment of animals including those farmed or reared for slaughter, for food. Beyond a certain point, welfare standards can be considered as a quality attribute to which consumers will attach their own value. Thus it has been for individual consumers to decide if they wish to pay the additional price for free-range eggs, and it is still for consumers to decide if they wish to pay the additional price of products from out-door raised pigs. These distinctions in production systems are capable of being handled by the market. The public role is, first, that of agreeing the welfare standards below which no production can drop. Second it is to validate the accuracy of consumer information (free range eggs must be produced from uncaged hens) and monitoring the accreditation of the production systems which deliver higher standards.

There is a tendency, over time, for society to raise the legislative standards for animal welfare. For example the decision has been taken to rule out battery cage production of eggs and poultry meat in the EU by 2012. This will not be enforceable on poultry producers outside the EU. There remains the question of the appropriate treatment of imports of poultry products – many of which will be ingredients in processed foods and ready meals in which there is no possibility of providing information of provenance and production system on food labels. Likewise this will be difficult or impossible on menus in canteens and restaurants. With no further action the effect is to import both more poultry production and poorer welfare standards with it. Such examples can be found



for other livestock products. Thus consumers of prime cuts of meat may well wish to exercise their choice to purchase the meat which has been produced in a ‘welfare friendly’, or ‘extensively grazed’ system. However, the consumers of sausages or meat pies will often be more interested in the price, or the recipe of the product, than the farming system of the animal. The outcome will be the same as the poultry example; price will drive the purchasing decision of the food processor irrespective of the welfare of the farmed animals. This cannot be in the interests of animal welfare. The resolution is likely to involve either border measures or some compensating payments to domestic producers – pointing to a continued role for some Pillar 1 type supports. This will be a difficult issue to resolve in the WTO, not least because developing countries, understandably, find it difficult to give a high priority to animal welfare when they have stark problems of human poverty and malnutrition (see the contribution of BUCKWELL in this volume).

## **Rural Environment**

Modern farming structures and technology give farmers the capacity to have a big impact on the environment and cultural landscapes of the countryside. Wealthier societies with more leisure time and mobility place both more pressure and higher value on these landscape qualities. It is therefore clear that the countryside management role of farmers and land managers assumes more importance, and there is a stronger role for policy too. It is a difficult choice whether to broaden the concept of agriculture and *agricultural* policy to embrace the management of land for its biodiversity, resource protection and cultural landscape maintenance roles, or whether these functions and the incentives required for their delivery should be described under the rubric of *rural* policy. Because, the principal positive instruments for ensuring the delivery of environmental and cultural landscape services will be in the territorially defined, programming based programmes of rural development policy they are dealt with in the next section.

What role, if any, should agricultural policy play in dealing with these issues? First, it is generally believed those price supports, and the payments which have partly replaced them, have stimulated more land to be in production and a more intensive use of that land, both of which have contributed to environmental damage. Therefore, reducing the price supports and separating direct payments from production (i.e. decoupling) should diminish these effects. Second, it should be ensured that any remaining market support instruments and direct payments do not provide direct or indirect inducements to environmental damage. Examples of such effects have been subsidies to forage maize production, encouragement of damaging irrigation and encouragement of over-grazing by the headage-based sheep regime. A third approach is to attach environmental conditions to remaining market support measures, including aids to investment, and direct payments, where this is practical. The logic of this approach is policy coherence. If public funds are used in agro-environment schemes explicitly to pay for the output of environmental services, then other parts of the policy should not undermine these goals. This is the concept of cross compliance. Determining the correct level of the compliance conditions is not straightforward. Simplicity, and the avoidance of confusion between environmental conditions applied to instruments which have some other prime justification and direct Agro-environmental measures, suggests that the base compliance level should be respect for the prevailing body of environmental law (see the contribution of BUCKWELL, SUMPSI VIÑAS in this volume)

## Supporting farm incomes

A prime and persistent objective of the CAP has been to raise the incomes per capita of those engaged in agriculture. To what extent this goal has been achieved is an empirical question for which a straightforward answer cannot be given. Undoubtedly the outflow of labour from agriculture, the increase in productivity and diversification of activities of those who have remained, have resulted in an increase of farm income and enabled a substantial part of them – with variation from region to region – to earn an income on par with comparable incomes outside farming. However, most analyses have shown the efficiency of price supports in raising farm incomes to be very low (OECD 2002). It is well known that much of the economic effect of price supports and direct payments is capitalised into land values. Also the benefits of the CAP have been very unevenly distributed as between commodities, regions and farmers. To illustrate the latter point, the commodity price support systems and the direct payments which replaced them, naturally rewarded least the smallest producers of those commodities. For the EU as a whole in 2000, the smallest producers who comprise 71% of total direct payment recipients received 17% of the payments. Therefore, although the support arrangements of Pillar 1 have indeed had a positive effect on farming incomes, it has not been in a pattern that was, *ex ante* designed, nor is it *ex post* defensible. In particular, CAP market supports and payments have had little effect on the smallest and poorest farmers. Those with very small amounts of land received a very small proportion of the support benefits of the CAP. There has never been any mechanism objectively to relate CAP supports to the income of the farmer or his family. In any case, such social policy is a Member State competence, and social benefits schemes in Member States are arranged for all families irrespective of sector of occupation.

The major lesson is that agricultural policy based on production supports is an inefficient and inequitable way of dealing with the income problem. This approach focuses on just one, relatively small, occupational group (farmers) and uses a distribution mechanism based on the production of a narrow range of crops and animals. However, politically, it is very difficult to reduce or remove payments and supports that have been in place a long time. These supports provide little help in raising farming income of recipients in the long run. But to cut them, certainly causes significant short-run pain because land rents and land prices are sticky downwards. Also, because of the concentration of the benefits of the support and payments on the largest farms the pain of support reductions is correspondingly concentrated. Therefore there are highly-focussed interest groups defending these supports if they are threatened.

Because the distribution of beneficiaries of CAP price supports and direct payments is not well based, there have been proposals to redistribute the support.<sup>2</sup> These have mostly taken the form of proposals to reduce the support to the largest recipients. However, this alone gives nothing extra to low income farmers. Such ideas offer only a small scope to affect the distribution of support.

In short, neither price supports, nor direct payments calibrated on those price supports, are efficient instruments for dealing with low farming incomes and even less efficient for dealing with any broader rural poverty. It is not merely that they are blunt instruments. It is because they are linked to current or past levels of production of crops and certain classes of farm livestock, that they are completely misdirected. These instruments are already criticised as encouraging misallocation of resources, distorting trade and stimulating some environmental damage, if they have little objective basis in

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<sup>2</sup> 'Modulation' of support payments was part of the MACSHARRY, Agenda 2000 and Mid Term Review proposals for CAP reform. To date, such modulation has often been diluted in the political decision process.

income support either, then they cannot have a long-run role in future agricultural policy.

### **Maintaining farming activity**

Another pervasive, but equally misguided, justification for broad market support or direct payments is to maintain farming activity, and thus a farming population, where it would not otherwise exist. This is often expressed as the policy objective of keeping all (current) farming land in cultivation. Such a policy ignores the fact that the current farmed area has not always been so. It also begs the question why a patently uneconomic activity should be supported by the rest of society in perpetuity. An economically *un*acceptable answer is that natural disadvantage (poor soils and climate and distance from markets), means that costs are higher in such areas and therefore prices or subsidy payments are necessary to maintain production. However, for traded goods in the context of a policy of international competitiveness, this is an irrational policy. A plausible answer for support such areas can be that there are some other public goods or services supplied by farming, or farming populations in these regions which justify support. The main such services are environmental and the preservation of the cultural landscape. If this is the justification for assisting these farmers, then the basis of the support should be targeted to the production of these public goods. The evolution of Less Favoured Area payments for livestock has moved in this direction, the shift in payment basis away from compensation for permanent natural disadvantage should be completed. These are either environmental and cultural landscape payments, or they are unjustified.

Another key aspect of this problem is that there are often few alternative activities in these areas which are generally remote from centres of population. The solution here is broader rural development action aimed at removing obstacles to the diversification of those economies. In short, the appropriate approach to the policy desire to avoid further exodus from farming in the peripheral and marginal areas is to focus on the instrument set of rural development policy rather than unfocussed market support or production-linked direct payments.

### **Food security**

It is argued that food security is no longer a prime objective of European food and agricultural policy. Any threat to food security in Europe does not concern the sheer availability of the basic ingredients of human nutrition: carbohydrates, fats, proteins, fibre, vitamins and vital minerals. There is no credible threat to the continuity of supply of these from domestic and foreign sources which would imperil the health of the European population in the time period considered by this paper. The larger threat for many decades has been over-supply and the accompanying problem of over-eating and obesity. If there is a food security threat it is not the quantum of domestic production and import availability, but possible disruption of supplies by natural disaster or catastrophic terrorist action. This latter could come about by widespread contamination of crops, food stocks or introduction of virulent animal disease. The main response necessary for such possibilities is the appropriate contingency planning and co-ordination between the Commission and Member States. The alarming Foot and Mouth Disease epidemic of 2001 showed that the EU and its Member States were not well prepared for such an eventuality. The conclusion for the future of market support and direct payments is that there is no argument for such support to farmers on food security grounds. Continually over-supplying domestic consumption now is no protection for prospective shortage later. Indeed it may even imperil future domestic food availability if soil fertility and water are depleted in the meantime.

## 2.3 A policy for ensuring the viability of rural areas

### The future of rural areas, how do we imagine it?

Economically active people in rural areas have expanded their activities beyond agricultural production and may be expected to continue this trend in the future. The relevant stakeholders in this process have been farmers as well as other social actors, like new residents, leisure seekers, investors, service providers, environmentalists, small and medium enterprises, artisans, institutions, both within and outside the rural areas.

Rural areas are likely to become complex, differentiated systems, both in the mix of resources that make them viable, as well as in the exchanges –or lack of them- they establish with other rural or non-rural areas. Accessibility, communication and services will become increasingly differentiated and sophisticated. Commuting residents and incoming visitors, mixing with local actors are likely to provide new income and employment opportunities, innovative ideas and initiatives combining traditional contextual knowledge with more general forms of know-how, multiplying the occasions for social and cultural exchange. Such diversity and complexity is likely to create increasing and specific problems of environmental sustainability, requiring policy attention, both from a sectoral perspective and for dealing with the cumulative effects of multiple activities (see the contribution of SARACENO of this volume).

While the pursuit of economies of scale should not be discarded *a priori*, the opportunities offered by economies of diversification should be easier to achieve. Competition between alternative land uses is likely to increase while traditional demographic pressures on agricultural land will decline. The combination of different resources in traditional (typical products and tourism) and innovative ways (quality and organic food, health and fitness resorts) provide examples of the benefits that could be obtained from the integration between agriculture and other sectors, without losing the advantages of sectoral modernisation. The best practices and the relevant know-how for developing attractive rural areas still need to be developed and codified.

Complementarities between sectors usually imply cooperation between social actors and the pulling together of capabilities. This should strengthen the human and social capital of rural areas, its cohesion and democratic participation. A partnership approach based on negotiation between different interest groups should provide a useful framework for conflict resolution as well as an effective system of checks and balances.

The balance between tradition and innovation in rural areas is a very sensitive one, and difficult to achieve. Two points can be made in this respect. A purely defensive strategy based on the conservation of the inherited traditions alone may seduce visitors but is likely to become an obstacle for the modern quality of rural life. On the other hand, the haste in throwing away no longer useful technologies and habits may eliminate interesting developing opportunities and generate a false opposition between tradition and modernity. Research and experimentation have important roles to play in this area. Cooperation between local actors and expertise may produce tailored solutions and adapted innovations for specific problems and situations.

Rural diversity applies to farming systems and to the way these are integrated in the rest of the rural economy, contributing to their evolution. This is relevant for rural architecture, for product innovation, for the modernisation of traditional practices, for marketing, to name just a few (see the contribution of SARACENO in this volume).

These points are particularly relevant and useful for the enlargement process that will take place in the years to come. The paths that accession countries choose to follow to arrive at viable rural economies do not need to follow the example of Member States,

nor arrive at similar situations. This flexibility is positive and necessary, since it allows maximum flexibility and responsibility in the use of policy support. What maintains a European unity within the support for diversity are establishment of common rules of the game, such as the levels and instruments of state aid, minimum environmental regulation, food safety standards, and non-eligible actions.

Within these complex and interconnected territorial systems, agriculture is likely to remain an important - but not the sole - component. The diversification of activities has had a relevant effect on land use, the character of human settlements (towns and villages), the mobility of people, goods and services, farm turnover and the quality of rural life.

Overall, this evolution has been perceived by European citizens as positive. It has reduced the gap between rural and urban areas; it has increased their social and economic sustainability while at the same time maintaining some of their specific features and distinct identity. Farmers have also reacted favourably to this evolution since it has increased their opportunities, without damaging their influential role in rural society. In reality, we could say that farmers in diversified rural areas are already quite well integrated in the social fabric.

### **Why are rural policies required?**

The experience of rural diversification over the last few decades should become the reference and example for a newly formulated policy vision. It should promote and consolidate this transformation in rural areas.

To do this we have to reconsider the current agricultural policy vision along the lines indicated in the previous section. The existing instruments and measures did not aim at diversifying the rural areas. In the current debate on reforms, the point that agricultural policies need to become an integral part of the new rural vision is often missed. The phasing out of the majority of undifferentiated instruments does not imply the disappearance of agricultural policy but rather its reconceptualisation within a changed rural context. Environmental, quality and safety issues, food chains, which are strategic for the valorisation of agricultural products in modern societies, cannot be dealt with in a generalised and abstract way. Their relevance will vary with the vocation and resources of a particular area and need to be adapted to the changes in consumption patterns over time, space and culture, responding and respecting the diversity of existing situations.

The new territorially integrated rural policies should not be based on a competition between sectors for support, neither in their separation. Complementarities and synergies should be considered as a potential source of additional opportunities. In the future, these kind of policies will be able to achieve viability in a more effective and cost efficient way (see the contribution of SARACENO of this volume)

The recent evolution of rural areas towards diversification has been attributed to wider processes in the economy and society, such as urban congestion, increasing living costs, a more diffused location of economic activities in relation to the past, changing consumption patterns and lifestyles. These drivers of change have acted spontaneously. Therefore, we could say that the observed evolution of rural areas has only in part been the result of explicit policies in general or of rural policies in particular.

It is therefore fair to ask why we need policies for rural economies if real processes seem to be working on their own and in a desirable way. Our answer is that:

- not all rural areas have experienced such spontaneous diversification,

- environmental problems tend to increase with the recent evolution and are not solved by market forces alone, and
- we are convinced that rural policies are necessary to manage and guide these processes towards collectively shared preferences within a common regulation framework, given the existence of a single European market.

Given these complex and differentiated rural systems in the making, which requires a new policy vision in relation to the existing one, what should be the link between rural and agricultural policies? This is a key political issue that must be addressed explicitly given the inertia in the current policy framework. We are arguing that the new agricultural policy should be based less on market supports and direct payments and more on a thoroughly revised rural development policy, designed and implemented at a decentralised level.

This implies first a shift from a sectoral to a territorial approach for everything but genuine safety net stabilisation measures and some residual protection discussed in section 2.1 above. Second, it implies that the “other” needs of the agricultural sector, which are spatially differentiated, will be best served if they are fully integrated with those of the rural economy at regional level. Such a policy reverses the logic of the present approach that conceives rural policy as a set of accompanying measures for farmers.

It also implies that environmental concerns are included in the territorial policy vision and integrated with agricultural activities and policies as well as with any other land management activities. Sustainability objectives and policy support for addressing such concerns have a legitimacy of their own, and should be distinguished clearly from income support needs, which respond to different objectives (equally legitimate) and may refer to different social groups within the rural population. Ideally, environmental goods and services should be considered a source of competitive advantage for rural areas, particularly within an integrated strategy that includes farming activities, cultural heritage, landscape conservation, and rural amenities which mutually reinforce one another. Furthermore, in those specific areas and conditions where market failures are evident, it should be possible also to pay for such services (see the contribution of SARACENO in this volume)

### **The assumptions and tasks of the new rural policy**

Agricultural policy and rural policy do not coincide and they should not be considered as interchangeable with each other. However, this should not lead to the opposite position, as if the two are unrelated policy areas, implemented side by side and ignoring each other. We believe that agricultural policies have much to gain from being integrated with the rural policies of the same area.

Rural areas should not be considered as structurally less competitive than urban areas in attracting resources. Rural areas have demonstrated in their real processes that they are not homogeneously “backward”. Consequently, rural areas do not need to be indefinitely “compensated” by policies for abstract disadvantages, but rather assisted to overcome specific and well defined constraints that may be transformed into opportunities with the right mix of measures and appropriate strategies. Within the need for adapted policy measures we should consider with particular attention those areas in which the diversification process has been weak or slow, in order to promote agricultural production factors as well as other activities and linkages with other areas, in order to develop the specific competitive advantage of the area in question.

Economies of diversification strengthen the capacity of rural areas to remain viable. This happens because diversification reduces risk at times of sectoral crisis and helps to develop competitive advantages, not easily subject to imitation by other areas which do not have the same mix of resources and strategy. Rural areas should not all try to follow the path of the most “advanced” areas but should find their own way to sustainability.

Public support for rural areas should be based on a development rationale rather than on a compensation for disadvantages principle. Success should be measured in terms of well-being, sustainability and growth. The elaboration of *ad hoc* strategies is aimed at overcoming constraints, not at perpetuating the need for assistance.

All rural areas should be eligible for policy interventions. Their territorial and integrated character should not exclude their horizontal application. The problems of rural areas are not limited only to an initial “take-off” phase through diversification. This is no guarantee of indefinite viability. Rural areas have experienced before urban areas the consequences of ageing and financially unsustainable services, low growth, lack of entrepreneurship and innovation, environmental damage, which now afflict wider regions and areas formerly characterised as “advanced”. It would therefore be desirable to allow for the possibility of designing policies to address changing structural problems, within well-defined common rules. The intensity of aid could be differentiated according to the difficulty and complexity of the problems to be faced, exploring whether they should be implemented on the basis of a “universal” eligibility or not. In certain cases, a competition between areas on the basis of the projects’ excellence could be an efficient way for allocating increasingly scarce resources.

There are two major tasks for rural policies: the first is to promote the diversification of rural economies, the second is the integration of agricultural and rural policies. The two tasks are not conceptually of the same nature. The first one identifies the main means or strategy to achieve viability. The second task is necessary to correct or establish coherence between agricultural and rural policy. If the two would be conceived *ex novo* today, this coherence would come naturally. It is because the Common Agricultural Policy has been a separate and different policy, that we now need this task.

### **The first policy task: Diversification of the rural economy**

In order to achieve viability of rural areas the most important task is to diversify their economy. Development of economic activities in different sectors should be based on economies of diversification and be respectful of sustainability criteria. The more the various sectors are connected by backward and forward linkages and the more the income generated will be spent within the region, the stronger will be the growth of the rural economy.

The promotion of activities in different sectors should not discriminate on the basis of size or origin. Small-scale initiatives are more likely to be generated endogenously and policies should support their establishment through grants and credit, tutoring services, promoting cooperation and links between initiatives. Endogenous initiatives are likely to be small but have shown a higher degree of stability in the face of crisis. On the other hand external investment may indeed stimulate growth and innovation at the local level, but may show a greater propensity to leave the area more easily when the initial cost advantages decline.

This implies that specialisation or concentration in a single sector or exclusively on large scale activities may become a weakness rather than strength in the rural context. In rural areas characterised by a low population and enterprise density specialisation

implies the risk of a downturn for the whole area as result of a sectoral crisis. A mix of economic sectors and enterprises of different size makes rural areas less vulnerable.

Diversification with small-scale activities favours cooperation and exchanges between enterprises of different sectors, for example promoting a recognisable and consistent image for the entire production of an area. It also has a counterbalancing effect on competition within the same activity, which increases economic sustainability.

In rural areas whose economy is still largely based on agriculture, diversification in the initial stage of the modernisation process may consist of diversifying from the traditional agricultural base into other activities through farm pluri-activity. At later stages of development, when alternative activities are present in the same area, professional specialisation is likely to become more frequent, while exchange of services and contracting out different phases of the production process substitute multiple job holding. Policies should support such developments since they strengthen economies of diversification.

Every rural area may achieve viability in its own way, combining its resources in a unique way and thus achieve a competitive advantage in relation to other rural areas and also in relation to urban areas. Such an approach reduces the distance and the difficulties of “catching up” for latecomers in the development process. “Backward” rural areas should not be expected to imitate the path followed by “advanced” rural areas. On the contrary, they should study and evaluate this experience, use this know-how selectively for the valorisation of their own specific assets. For this reason it is important that rural policies be designed and implemented at the regional/local level. This principle should be particularly relevant for the enlargement process and the new member states (see the contribution of WILKIN in this volume).

A policy for the diversification of the rural economy must also consider:

- Promotion of an articulated *human and social resource base*, capable of representing different interest groups, elaborating strategies, interpreting needs and expectations, organising participation and cooperation, arguing for accessibility to key services such as housing, health, communications, welfare benefits and education and training, adapted to local needs. These services may be provided in different ways due to the low density of population but they must be accessible to all. Investments in human and social capital and services whose rationale is to expand growth opportunities may be expected to pay off in the medium term with the improved capacity to attract population and resources from outside, thus reducing the need for subsidies.
- Supporting rural economies and societies to *establish meaningful links and exchanges with the external world* (through accessibility, infrastructures, services, research, networking and credit). Commuters in and out of rural areas may make important contributions in facilitating exchange. More recently, networking practices have been useful in reducing the isolation from which some rural areas (peripheral areas in particular) suffer and facilitating the circulation of information and experience.
- *Encouraging innovation in using rural know-how*, combining different sources of knowledge in original ways, building specific competitive advantages which will be typical of the area and may reproduce its distinctive character over time.
- *Integrating environmental concerns in relation to the non-farm sectors and to modern living standards*. Diversification may conflict with fragile environmental systems adding the pressures of modern life to any existing negative externalities of



agriculture. The nature of the concerns may vary greatly according to the type and intensity of the other economic activities that have already developed or are likely to be developed. Pressure on the environment may also increase with improved accessibility and mobility in and out of rural areas. The instruments to be used in addressing such concerns include information and advice, and when this does not work, control, regulation and sanctions for negative externalities as well as the possibility to remunerate providers of environmental services and public goods.

### **The second policy task: Integrating agricultural policy and rural policy**

The second policy task, in order to have sustainable rural economies is to integrate agricultural policy and rural policy in a coherent territorial approach, with the exception of the residual parts of a sectoral policy, in particular safety net measures. This task acquires particular relevance due to the present impact of the CAP, which is largely sectoral. Because these two policies have today different visions of rural development, it is necessary to adapt one of the two to the other in order to make them coherent and able to interact in a mutually reinforcing way. From what has been already discussed so far, it follows that farming activities need to be considered and treated as a component of rural economies, within a territorial strategy, adapted to the specific area.

Until now, rural policy has been mainly focused on agriculture. Policy measures facilitating the integration of agricultural policy with the rest of the rural economy have been of minor importance or non-existent. Sectoral and territorial policies have been designed and implemented separately and not as part of a fully integrated policy. They were considered an added and optional feature. We believe that this is not an effective approach either for farming or the other activities. The complementarities between the two must be fully exploited rather than be discarded or made difficult by policies.

Strengthening the complementarities and synergies between the agricultural sector and the overall rural economy should imply that current policy measures are reformulated *ex novo*, maintaining its sectoral orientation and farmers as the sole beneficiaries, but rethinking all actions in the framework of expected needs, in a realistic and coherent design which assumes the presence of a diversified economy as its context. These include both specific agricultural sector needs as well as the integration in the wider rural economy objectives.

*Facilitating the adjustment of farms to changing markets.* It has been mentioned already that modern consumers are expressing a preference for a wider variety of products than in the past, of varying quantity and quality, including the environmental goods expected from rural areas. These new consumption patterns are related to higher levels of affluence, to choice between alternative lifestyles and to higher levels of health and safety requirements. These patterns express a more segmented demand for goods than in the past, which reduces the market for undifferentiated products in general and for food in particular. This trend is likely to increase in the future and should provide the guiding rationale for reorienting current production and support for farmers. The association of an image of quality should be helpful to a successful integration of agricultural policy in the wider rural policy. Quality products are often identified with a particular area of origin and traditions, which the territorial approach to rural development is likely to address more effectively than a sectoral and undifferentiated approach.

Some of the instruments for supporting this orientation to new consumption patterns, such as certifications of quality, codification of production standards, regulation of areas of origin and geographical denominations, associations of producers and collective

forms of marketing, are all area specific and may be associated with other activities realised in the same area (such as a particular landscape, a form of rural accommodation). Investments, guidance and training required to implement these measures should be included in rural development programmes.

*Strengthening horizontal integration of farm activities into the wider rural economy.* The integration of farm activities into the wider rural economy responds to the same principle that has been mentioned above about economies of diversification, and refers to farmers as actors and entrepreneurs. A diversified rural economy opens new opportunities for all the rural population including farmers, creates the conditions for fulfilling their needs for a modern quality of life, provides better incomes through the market, expands job opportunities within the area, decreases the dependency on any one sector and reduces the need for public transfers and subsidies. For farmers specifically, it eases the pressure on farm land, widens the opportunities for farms' turnover, creates a more articulated structure of labour supply and demand, facilitates transfers of technology and innovation from other sectors, increases the demand for local products, and expands marketing circuits.

This would be a highly innovative policy area, for which there is little experience, since the practice of addressing farmers' needs and other rural population's needs separately has been quite rigid. Both an approach and specific programmes have to be defined and experimented with. The principles of such integration need not be different from those for other integrated programs: joint partnerships, collection and organisation of needs through consultation and mobilisation of actors, local management, definition of adapted projects and actions, networking, diffusion of good practices.

*Supporting farm pluri-activity.* Multiple job holding farm households should be considered as one of the many arrangements that farming may take, due to insufficient size, choice, risk diversification, position in the life and income cycle. No prejudgement on the competitiveness of these farms should be made for policy purposes. The possibility for opting between economies of scale or diversification should be left to the decision of farmers and not directed by policies, since pluriactivity is positive for rural development, and high standards of environmental management, just as professional farming is. Other activities may use the resource base of the farms, as in the case of offering accommodation or food, or they may use off-farm job opportunities, either on other farms or in manufacturing enterprises or services. Joint ventures among farmers to provide services to other farmers (equipment, subcontracting of specific operations) should be encouraged not only because they provide additional income but also because they make a more efficient use of available resources and reduce the need for small farmers to make capital investments.

*Integrating environmental concerns into the new framework of agricultural and rural development policy.* A new agricultural and rural policy must embrace the contribution farming and other land management activities can make to the environment and cultural landscape in rural areas. It is now accepted that there are very widespread market failures concerning rural land management and agriculture leading to an over-production of environmental bads, or negative externalities. The principal examples are: pollution of soil, by heavy metals and other substances from sewage sludge; pollution of air by methane, ammonia and nitrous oxides from animal production units and certain crops; pollution of water by fertilisers (mineral and organic), crop protection chemicals and by soil erosion. It also shows as the under-production of many environmental goods, positive externalities – such as provision of habitat, for example, flower rich grazing meadows or water meadows, and landscape features such as stone walls, species rich hedgerows or farm ponds. There are cases where farmers and land

managers also provide care for many rural archaeological, architectural and heritage features. The two categories of negative and positive externalities are interrelated. Actions which increase the production of positive externalities often reduce the production of negative externalities and vice versa. The dividing line between them is the historically and politically determined definition of property rights in land use.

These externalities occur in situations where there has been no market mechanism to ensure that the full, social, costs of production are met by farmers, or where the farmer is not rewarded by the market for the true social benefit of the environmental goods he provides. Furthermore, because these environmental goods and bads are multi-dimensional, complex, interrelated and generally diffuse in their occurrence, with long time lags between pollution and harm showing up, it is difficult to devise specific instruments for each individual aspect to ensure the right level of supply. The general conclusion has been that a broad approach will be necessary to deal with these market failures.

There are both problems of compliance with common regulations that need to be incorporated in farming activities as well as special provisions for farmers who, in their capacity as land managers with a wider scope than farming, may undertake, on a voluntary basis, to provide services that the society is willing to pay for as public goods. In both cases, farmers are responding to the wider functions that society expects from rural areas.

In the case of negative externalities, the common regulatory environmental framework concerning the use of land, water, waste and chemicals, should not require any specific form of support since the general principle that the polluter pays should be applicable to farming as to any other activity. For the negative externalities, the presumption is that the property rights to clean air and water belong to the public. Therefore land managers must respect these rights. The practical way of bringing this about will include a mix of information, advice, eco-conditionality on any remaining payments to farmers and on supports under other regimes. In some circumstances command and control regulation or pollution taxes may be the most effective policy. The nature of the negative externality and its causes, and the most cost-effective way of internalising it, will determine the appropriate mix of these instruments. Whilst 'polluter pays' may be the determining principle, in practice the costs of dealing with diffuse pollution may dictate a broader range of instruments including providing assistance for producers to change production technology. In this case, investments or services needed in order to comply with such common regulations may be supported through farm structures' adjustment measures. What matters is the cost-effective achievement of the outcome of lower pollution.

A second policy area included among environmental concerns refers to support for production methods better adapted to the environment, such as integrated farm management, organic farming, extensive grazing and afforestation. The adoption of such systems is voluntary, responding to emerging consumers' needs. In such cases, a start-up support could be envisaged for the investments needed, the association of producers, the diffusion of good practices that result in a lower intensity of production as well as compliance controls. As in the case of quality products, the market is expected to remunerate adequately the higher costs of production.

A third policy area included among environmental concerns is related to the positive externalities, the production of "public goods and services". The approach in this case is that the property rights in land management are with the farmers and land owners. They may manage their land as they wish, subject to the law, and thus to induce the output of

the public environmental and cultural landscape services there should be incentives or payments for these services.

A further consideration is that the actions which are necessary to increase the supply of environmental goods – for example wider field margins, buffer strips alongside water courses and areas of non-cropped habitat on every farm - will also have the potential to reduce the negative externalities. Also it has to be noted that there are usually long time lags between change of agricultural practices, or implementation of environmental actions, and measurable environmental effects showing up.

Other forms of land use such as forests, parks, mountains, coastal areas, or abandoned land should attract a similar approach, since they involve similar land management concerns, even though for different combinations of positive and negative externalities.

### **The methodology of the new rural policy**

Some of the specific instruments characteristic for the new policy vision has been indicated while describing each of the two major tasks and the single components that articulate them. In general, policy actions to promote diversification should seek to provide an approach to achieve the objectives rather than a recipe or specific measures to be followed. This has to be the case because we advocate a decentralised institutional approach further described below. It must be based on an analysis, for each rural area as an integrated whole, of its own specific opportunities and constraints, strengths and weaknesses. Such an analysis should lead to the establishment of one or more alternative strategies to be followed, that is submitted for consultation and approval to the social and economic partners, both public and private. The next step is the definition of a pluri-annual programme, with the definition of objectives and expected results, projects and measures to be realised, and a quantification of the funds needed.

There is no need to establish a menu of eligible measures. Each area should be free to develop its own strategy and measures, either choosing its references from the existing policy supply in Member States or elaborating innovative actions. A list of non-eligible actions and instruments may be the only constraint to such flexibility as well as limits on the levels of aid. The reason for this is that differentiated development paths and unique combinations of resources cannot be realised with a top down approach, simply because the “top” can only have a standardised vision of what needs to be done. Monitoring and evaluation, not only as control practices but to get a feedback on the efficiency and effectiveness of the strategies being implemented should be required.

There are two major references to guide the implementation of this vision, although these should not be seen as the only possible approaches. The first is the experience of the reformed Structural Funds, including the Community Initiatives which have experimented with innovative approaches in different sectors. The second is the experience of the LEADER programme, now in its third generation which is specific to rural development and provides examples of the innovative strategies that rural areas are capable of, when left free to design and implement their self-defined strategies (see the contribution of SARACENO in this volume).

### **Institutional approaches to rural development**

The two major rural policy tasks briefly described will need to be implemented in a decentralised institutional approach. If the diversity of rural contexts is expected to remain as an European asset even with change and modernisation, and future development programmes are expected to remain differentiated and based on a unique combination of resources and territorial strategies, then the only possible way to realise

efficiently such programmes is to design and implement them at a decentralised level. The rural areas within a region might be the most appropriate level of decentralisation.

A further reason for a decentralised approach is that experience so far shows that the complexity of rural systems can only be managed effectively and democratically if different actors know each other and share a sense of belonging to the same community. This enables the assessment of how sectors and interests are interrelated, and the resolution of conflicts of interest within the communities.

Consultation and participation of private and public stakeholders (the partnership principle) has generally worked well in the past and should be used as an instrument of governance and empowerment, which spontaneously provides checks and balances to dominant interests and improves the effectiveness of actions. These partnerships of rural interests, with Regional Administrations, should be responsible for the preparation of pluriannual programmes (rather than individual projects or measures) and the allocation of financial resources to different measures.

The decentralised approach is respectful of the principle of subsidiarity and should follow a similar approach to that which has been tried out since the reform of the Structural Funds, in the early 1990s. In general all rural areas should be eligible, defined on an agreed level of population density.

This institutional approach to rural development should be coordinated with other EU policies such as regional policy (Structural and Cohesion Funds), environmental regulations and consumer policies. Ideally a clear “division of labour” must be established between the actions that can be included in rural development programmes and those included in other policy instruments. There should not be any constraint for closer coordination between public service provision (such as health, education, transportation and housing policies) even if not an EU responsibility, with rural development programmes, in order to increase positive interactions, efficiency and effectiveness.

## **2.4 Summarising the Vision**

Our vision is for a two-pronged agricultural and rural policy for the enlarged Europe in which the agricultural and food policy components are horizontal and centralised, and the rural territorial component is decentralised.

### **The future role of agricultural and food policy**

The agricultural and food components of a new policy must in future focus on productivity growth, competitiveness, price and income stability, food safety, food quality and animal welfare. None of these justify high levels of market protection, nor indefinite annual payments to farmers. Therefore, market supports and direct payments linked to production or derived from production at a historical base period must be steadily, and significantly, reduced. Remaining Pillar 1 supports will be concerned with the public contribution to safety net stabilisation measures – whether through exceptional commodity intervention mechanisms or income insurance schemes – with residual protection and compensation for higher EU internal regulatory standards and with correction of market failures surrounding rural land management. Any such measures will have due regard not to conflict with high standards of environmental land management delivered through programmes under rural policy which will be scaled-up in parallel with scaling-down the agricultural and food components of the new policy (see Chapter 3).

In this vision, for a considerably scaled-down Pillar 1 in the longer-run Common Agricultural and Rural policy for the enlarged Europe, there is little scope for measures to deal with food safety and quality, with occupational safety in agriculture and with animal welfare beyond the specification and control of standards below no production can drop. There is certainly a requirement for actions to strengthen the infrastructure and regulatory framework to stimulate and promote higher quality, and regionally and locally defined foods. There are market failures and missing markets which obstruct the full development of these sectors. The proper place for the necessary public actions on these are in a variety of consumer, other non-agricultural and rural European policies, appropriately co-ordinated Member State policies, and through measures in the Rural Development Programmes in each region. At this strategic level, there is little point in incorporating policy measures targeted at these (long run) issues into Pillar 1 market support and payment regulations which are in any case expected to be significantly reduced. This is the fundamentally the same argument used to stress that it is unwise to use cross-compliance and set-aside as principal vehicles for delivering environmental services. If the prime purpose of the payment to which conditions are attached, and the set aside areas, is about to evaporate, then it makes no sense to tie long run environmental objectives to such instruments.

### **The future role of rural policies**

The future role of rural policies is to contribute in making rural areas economically and socially viable, environmentally sustainable, with an integrated development strategy with respect to the role of agriculture. The key assumption of these policies is that the diversification of economic activities and the integration between all relevant sectors will be able to promote their viability and sustainability in a more effective and efficient way than has been the case with a nearly exclusive emphasis on agricultural policies. The major tasks of rural policies are substantially along two axes: the promotion of diversified activities on the one hand and the strengthening of complementarities between the agricultural sector and the overall rural economy on the other. Environmental concerns are key dimensions of both tasks: with the diversification of activities environmental problems are likely to become more complex and interrelated.

Rural policies should leave to the local actors the decision to choose a strategy and identify priority actions to implement such a strategy. This requires that rural development policies be designed and implemented at a decentralised level. It will imply that each programme may be different from another. This should increase the efficiency and effectiveness of actions, as well as the responsibility of the local actors. It should also guarantee that the asset of European rural diversity may evolve according to the wishes of local constituencies. Even though highly decentralised, rural policies should continue to be coordinated at European and national level. This coordination is required because of the need to establish common rules of the game for all members, to implement the principles of solidarity and cohesion with enlargement and to make available to new Member States the experience accumulated by rural policies in the European area.

## **3 Getting to the New Policy Vision**

### **3.1 The incompleteness of reform efforts to date**

The CAP has never been a static policy. It has been continually adapting since the first market regulations were agreed and put in place during the mid-1960s. The changing technological and economic circumstances in Europe and outside, the expanding

membership, and the changing scope of the European Union and its budget, have all brought with them important developments in the CAP. Until the mid-1990s the essence of the CAP was a set of highly developed market intervention arrangements, including supply controls, which maintained high and stable prices in the EU, and provided strong protection from world markets in the form of variable import levies and export subsidies.

The MACSHARRY reforms started the process of decoupling support to farmers by switching price support to direct income payments for important sectors. At the same time the process of assembling the elements of rural development policy was started in the form of the introduction of accompanying measures for forestry, early retirement and agro-environment.

The Agenda 2000 reform took this process further. It signalled further moves to more market oriented agriculture. The reforms included: reductions in prices for cereals and oilseeds, and unified payment rates for these crops; reduced support prices for beef; introduction of reduced support prices for dairy produce to start in 2005, with compensating direct payments for all these price cuts. An innovation of Agenda 2000 was to consolidate the accompanying measures plus the less favoured areas scheme, farm modernisation, modernisation of processing and marketing, and a number of rural development measures which had been operated under the Objective 5b structural programme in a new Rural Development Regulation (RDR). The actions available under this regulation in principle could be applied over the whole rural territory. They were put together in multi-annual, menu-driven, regionally-based, and co-financed rural development plans. These were significant steps towards the more integrated rural policy called for by the Cork Conference and the CARPE report, amongst others.

The Commission was pleased to refer to this RDR as the second Pillar of the CAP. However, upon close inspection and with the experience of seeing it in action for three years, certain limitations have become apparent. These are principally inadequate resources; a mechanism for fund switching that could not work except for marginal changes; and a focus which was locked in the logic of agricultural development rather than rural development.

From the outset of the RDR, there were no real additional resources made available for its measures. This in turn meant that Member States exercised little imagination in using what scope it gave for a wider and more innovative approach to rural development. As there were no extra funds available most Member States had little choice but to continue with their existing 'accompanying measures'. The mechanism offered to switch funds between Pillars (Article 4 of the Horizontal Regulation 1259/99)<sup>3</sup> was that Member States could voluntarily and unilaterally cut direct payments and switch the funds into their Rural Development plans. However, not only did this put their farmers at a competitive disadvantage, but it required the Member State to provide additional match-funding necessary in order to co-finance the Pillar 2 measures. The result is that only one Member State has persisted with the use of this, voluntary, fund-switching mechanism. A third and more fundamental problem is that

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<sup>3</sup> This mechanism to allow cuts in direct payments and for the funds so saved to be switched within that Member State into measures under the RDR has unfortunately come to be called 'Modulation'. This is because the Commission wished not only to encourage fund switching but also a redistribution of expenditures between farms of different sizes. The word modulation is correctly used to describe the idea of varied rates of payment cuts for different sized farms. Paradoxically the only Member State to make significant use of this mechanism, the UK, decided not to modulate the payment cuts, but to apply a simple flat-rate cut to all payments. The result is a tortured and confusing use of the word Modulation which sometimes refers to fund switching between Pillars and sometimes to differentiated payment cuts.

the scope of the RDR is overwhelmingly focussed on the sectoral dimension of rural development, which as argued in section 2.2 above is simply inadequate to achieve rural development goals.

The result is that the CAP of 2003 can still be characterised as a system of support for agriculture. Successive enlargements have, if anything increased the inefficiencies of the policy. New measures, even desirable ones, have compounded the complexity of the CAP because very few old measures have been removed altogether. The support mechanism of direct payments is accepted as less distorting of resource allocation than the market price support it replaced. But the policy is still accused of stultifying innovation, distorting trade, and being resistant to changes in society. Despite the resources devoted to it, the policy still does not solve the original problems it set out to deal with, notably low incomes of many farmers, but neither does it deal with the newer challenges society has posed for its food production and land management sector. Thus the current CAP remains an obstacle to the achievement of the vision articulated above.

### **3.2 The reform discussions around the Mid Term Review are not enough**

The July 2002 Mid Term Review, and the January 2003 reform proposals comprise a further set of changes, some quite radical, but all within the logic of a common *agricultural* policy which is trying to serve a wider rural development role. Without a more fundamental change of vision and approach, we continue to bump up against the limits of what an agricultural policy can do to assist wider rural development. The decoupling of (most but not all) payments will indeed reduce some of the negative effects of the CAP. It would encourage farmers to focus their attention on their customers. This would, in turn, encourage them to think more about raising quality, adding value, and improve their marketing. Decoupled payments would diminish the incentive both to push out the margin of cultivation to fragile and sensitive land, and to intensify production simply to collect more subsidies. It is bound to be the case that this would tend to reduce output of some commodities and to reduce the trade distorting effects of the CAP. These are all very worthwhile objectives in themselves. The reduction of negative effects of the CAP would be a worthy achievement. However these alone cannot define a mature, and to use the Commission's own word, sustainable, policy.

A sustainable policy can only exist for positive reasons, with measures which are specifically chosen, appropriately balanced and resourced to deliver agreed social objectives. If the CAP reform 2003 proposals are accepted, the distribution of financial resources between Pillar 1, then largely decoupled payments, and pillar 2, in a decade's time will still be preponderantly in Pillar 1. This might occupy 80% of the budget rather than its 86% today. This is likely to remain the EU's largest policy in budgetary terms. Agriculture will still be much more heavily supported than in most other countries in the world, and more supported than any other sector of the European economy. The principal instrument of the policy will be the decoupled payments – on the Commission's figures these will account for 90% of the Pillar I expenditures in 2013, that is, about 70% of the total CAP expenditure. These payments will be linked to the respect of existing common basic standards of environmental protection, plant and animal health, animal welfare and occupational safety standards on farms but do not induce any progress. It is reasonable to provide assistance to farmers to enable them to know about these standards, and to find ways of adapting their production systems to meet them. Indeed this was the core idea in the CARPE proposals to redefine direct payments as Transitional Adjustment Assistance to help farmers make the transition to a more open, competitive food system, but to provide this help at a progressively



declining rate, for a time-limited period. However, the proposed reductions in decoupled payments, the link to meeting ‘required management standards’ and ‘good agricultural conditions’, and the farm advisory system stop well short of Transitional Adjustment Assistance. It is regrettable to mislead EU farmers and citizens into thinking that the proposed, decoupled, single payment system defines a key part of a sustainable policy.

### **3.3 Putting the Vision in place**

Given the lack of a convincing and renovated long-term policy perspective, in both previous and current reform attempts, as well as the inadequacy and rigidity of the “*acquis communautaire*” proposed to the accession countries for the years to come, we believe that a more courageous effort should be made to imagine what kind of policy we would like to have, to meet the diversity of situations and problems that European agriculture and rural areas will have to face.

We have deliberately chosen to illustrate *first* the vision we have in mind for a desirable and sustainable agricultural and rural policy for an enlarged Europe, in about 25 years from now. In this way we make sure that the policies to support such a vision are inspired and conceived looking forward rather than backwards. It also helps to think about the general design and the required instruments rather than getting immediately into a discussion of the reform of the present measures without challenging the persistence of the old vision that is taken for granted. This approach should prove useful to freely imagine the components of the vision, in response to perceived emerging trends and needs. However, it makes necessary a *second step*, spelling out how the vision might be put in place, even in very broad and general terms, starting from the present policy situation and taking us to the desired one. In this way the logic of the reform process is driven by what we want to achieve rather than by what we fear to lose.

In the following paragraphs we give a few, tentative ideas about the transition that would be required, first in more general terms for both agriculture and rural policy, and then with a more specific description of the changes that appear necessary in order to adapt both Pillar 1 and Pillar 2 to this vision.

#### **From a sectoral to a territorial approach: institutional implications**

To date, both the design of the CAP and its subsequent reforms have been conceived and managed within a sectoral perspective. This has implied that agricultural ministries (and regional administrations in certain Member States) as well as relevant agencies have been the key actors in implementing the measures and, when a choice was foreseen, in choosing from the fixed “menu” of measures defined at EU level. This institutional organisation, of a vertical and top down character, has implied an organisation of interests at the local, regional, national and European level along a consistent sectoral rationale.

The sectoral approach, common to other sectors of the economy, has been considered as the most appropriate and efficient way to support change towards a shared policy goal. This institutional approach is less adequate for the present reform needs: the pressures for reform are coming mostly –so to speak- from “outside” the sector, the interests involved appear different from the traditional ones associated with the current policy. Pressures come from non-European farmers and international organisations, from consumers, from the food industry, from environmentalists, from the rural population at large, from other social groups in difficulty “competing” for financial resources and also in the process of negotiating scaled-down support (pension systems,

employment benefits, health and education). In such circumstances, the sectoral organisation of interests (both public and private) tends to act in a defensive and corporate way and this has made reform slower and more inefficient.

There is no institutional set-up at EU level which could serve as a framework for the expression of, and negotiation among, competing interests. Therefore, the reform process, especially in the transition phase, must have an appropriate institutional framework that allows the voices of all relevant partners, from the public and private spheres to be heard. At Member State level the same problem exists, with the added feature of an understandable interest, on the part of the public administration, for maintaining the financial envelopes redistributed through the CAP. This tends to reinforce the rigidities of the system.

We suggest that the organisation of an appropriate institutional framework has to come first over any of the other aspects of the reform. Restructured services are likely to adopt more easily the new vision than the existing ones, breaking away from habitual practice. Experience with the implementation of innovative programmes which are administered by unchanged structures with different operating rationales indicates that public administrations tend to “adapt” innovative measures within the logic of existing procedures rather than the opposite.

Another dimension that must be considered is the changing institutional architecture of the European Union as a whole. This is currently being discussed in the Convention. A more explicitly political Europe is likely to be the result of this work, with less rigid budget allocations and a lower need to rely on a technocratic approach. The special and rigid nature of the CAP budget is likely to become less constraining and subject to the Parliament’s scrutiny. This will imply a less automatic expenditure and the need to renovate the arguments in favour of an agricultural and rural policy and convince society of its absolute and comparative advantages. The recent changes in different Council formations also indicate a move towards a more multisectoral arrangement in the policy decision-making at EU level. This could provide a more appropriate institutional set-up to manage the reform process, with a broader representation of interests.

Within the institutional architecture emerging from the Convention, all policy areas may be subject to reform. This arises both because they are no longer perceived as responding to the needs of society, and because the economic stagnation and rising inequalities between social groups and countries (or regions), enhanced by enlargement, make the need to choose between alternative destinations of public resources more urgent than before.

The shift from a sectoral to a territorial approach will also require that the national and regional level reorganise the administration of the policy through the sectoral agencies, intervening by type of support available both in the first and in the second pillar. Their mode of operation will have to be restructured in order to allow decisions to be taken at a territorially decentralised level concerning both the elaboration of programmes and their implementation. This is an institutional set-up very different from that existing today for the Rural Development Programmes being implemented under the Regulation 1257/99.

Different rural interest groups will have to be consulted and participate in the design and implementation of the rural strategy, in the adjustments required by the reform process, and in the desired actions and measures. The articulation of different concerns (the environmental, the social, and the economic) may take different forms at different institutional levels. It is certainly better if it is multisectoral and adapted to the specific

area at local and regional level (where a large representative base is involved) but it may be more aggregate and standardised, involving the same key interest groups, at national or European level.

Regional authorities will have to set up the appropriate administrative framework for dealing both with the transition phase as well as with the reformed policy when the new policy vision will be in place.

The tasks of restructured rural services would consist of: the identification of the relevant actors and stakeholders to be involved in the decision making about the reform process, the preliminary work necessary for the elaboration of the rural strategy for the area, deciding how the margins of freedom allowed in the reform process are going to be used, the elaboration of a territorial rural development programme for the area, its implementation, monitoring and evaluation. National and regional authorities will have to define the areas, within each administrative region, that qualify as rural areas and whose population may be eligible for interventions with the rural development programs.

These administrative tasks are broadly similar to the ones that have been established in the past decade in order to deal with the operation of the Structural Funds. Since the territorial approach which the rural policy follows is the same as that of regional policy, one possibility in the transition phase could be to use these administrative structures as reference for initiating the reform process. The same could already be done for in the new Member States, starting after 2006. The new partnership and consultation arrangements could get started on that occasion, even if the measures remain unchanged and are modified gradually afterwards. The disadvantage of this option is that the integration between agricultural and rural policies would be weakened and it would be extremely difficult to implement from a political point of view as farmers and agricultural administrations are unlikely to regard these changes favourably. (see the contribution of SARACENO in this volume).

### **The transition to new rural development plans**

The transition to the new rural development plans should allow some margin of freedom to the relevant administrations to adapt the weight of each major task and its components to the particular rural context as well as to respond differently to political preferences and pressures in the progress towards a reformed policy. It could therefore follow a sequence of steps, setting key milestones in the realisation of the reform during the transition process. Having established an appropriate institutional set-up first, the following steps could comprise:

- Applying the new approach proposed to the policy task of *diversifying the economic activities in the rural areas*, defining a strategy and the required measures to implement it, having the possibility of leaving the other components of the policy unchanged as they will be changed with the new financial perspectives;
- Applying the new approach to the policy task of *integrating agricultural and policy and rural policy*. The problem here is more difficult because it is necessary to shift from the current “menu” of standard measures currently available (horizontal measures) to self defined strategies and measures which help the adjustment of farm structures but also integrate them in the actions of the rural program. Of course it should be possible to decide to adopt the current menu of measures if this is already well adapted to the specific rural context in question.

Each of these steps could coincide with a programming period (of 5 to 7 years). Any regional administration, in agreement with the national level, could decide to anticipate

any of the subsequent steps at any time, but it would not be possible to delay beyond the established sequence. Such a gradual transition, should allow putting in place first the “easier” but also the most innovative parts of the new vision, while giving more time to think and address the implementation of the most “difficult” parts. This procedure should create a “pull effect” towards the new vision while reducing the resistance to change.

The EU could offer Member States the possibility to choose between more or less accelerated implementations of the transition, and Member States in their turn could allow the same flexibility to Regions. A further advantage of this procedure is that it allows accession countries to immediately adopt the new vision (if they wish so) without having to go through the adoption of the existing measures, when it is already known that they have important limitations in their effectiveness and will need to be reformed anyway.

During the transition phase there will be heterogeneous progress made by different stakeholders towards the new vision. The “disorder” and lack of “level playing field” that this implies from a regulatory EU perspective could be compensated by the positive aspects that the package offers: the improved approach to rural viability, the more efficient integration of environmental concerns, the empowering of rural areas in the definition of policies, the adaptation of the new vision to the diversity of situations in Europe, the solution that this vision offers to new Member States, the freedom to innovate that it generates, the replacement of a defensive, rigid and assisted approach with a development oriented, flexible and adapted approach, the lower costs for European consumers and taxpayers, the higher quality of food they will get.

The transition between the old and the new vision may be facilitated by allowing stakeholders to negotiate the speed of the reform with relevant actors at regional level according to their “rapports de force” on the one hand, while establishing, at EU level, common and clearly defined milestones for the latest date at which any one step or phase will have to be completed.

For example, Member States and Regions could be left free to decide how to replace existing horizontal measures for farmers (structural adjustment) – all of them, some of them, leaving them as they are - after 2006. In the subsequent period however, all measures should be self-defined. This includes the possibility to choose to maintain or adapt some of the present schemes to suit particular needs and preferences. This flexible procedure could be applied to present sectoral measures (for farm structures and farmers), mixed sectoral and territorial measures (agro-environment schemes, forestry, environment, landscape conservation) and to territorial measures (basic services to the rural population, renovation of villages and rural heritage, diversification of rural activities, tourism and crafts).

The possibility to design new measures at the same time that the old ones are adapted or reformed should act as an incentive to speed up the transition process. This is achieved by shifting the responsibility for the design and mix of actions to regional public and private actors, negotiating among themselves, with commonly EU agreed rules of the game.

It should be possible to include, in any programming period, additional innovative measures within the key components of each task (as outlined in section 2.2). The responsible administrations may also want to introduce such measures on an experimental basis for a period of time, and only afterwards, when its demonstrative effects have become clear, to “mainstream” it in the programmes. A close monitoring and comparison of the resulting mix of measures, especially during the transition

period, could provide a substantial feedback to the national and European level, as a result of which the introduction of some checks and balances may be decided.

### **Financing and budgetary issues**

Financing and budgetary issues are likely to play a key role in putting in place the vision proposed. This is due to the more general economic problems that the European economy is facing (slow growth) which influence the propensity to allocate substantial or additional resources for financing rural economies. It is in our view wrong to consider that the present expenditure for agricultural and rural policy is a given and stable component of the EU budget forever. The shrinking of Pillar 1 should not be tied to a necessary expansion Pillar 2 of the same magnitude. The financing of agricultural and rural policy should be determined on its own merits and should not have any permanent or automatic character. Some elements may involve enduring annual payments – for public environmental goods which would otherwise not be sufficiently supplied. However most of the new rural programmes are based on the logic of “development” that does not have these features. The financial envelopes allocated for expenditures in these programmes are limited to a specific period of time, will be monitored and evaluated systematically, and cannot be extended automatically but have to be renegotiated periodically on the basis of emerging needs or as a result of enlargement.

The possibility of giving Member States higher margins of discretion in the allocation of funds (a sort of “national envelope”) to different priorities, and of exploring preferred “transition” paths in the phasing out of the old policy and the phasing in the new vision, with an agreed schedule and the evaluation of results, should give the EU the necessary flexibility and the margins of manoeuvre for getting the reform process off the ground. Such an approach should also encourage stakeholders to help overcome the inertia which is always found amongst beneficiaries for the present policy arrangements.

The order in which the different steps of the transition period are implemented have a “carrot and stick” rationale that should create an incentive to change that may counterbalance the resistance of the present beneficiaries. Another advantage of the flexibility margins during the transition period would be to follow up the reform process, observing and comparing alternative approaches by Member States and regions and getting a feedback from real processes of what is working well and what needs to be adjusted in the overall vision on the basis of its experimentation during the transition period. This procedure could stir up competition between “best ways” of addressing rural development in all its dimensions.

Another critical ingredient in moving in the proposed direction is to waive or temporarily reduce the need for national co-financing of rural development measures. This could greatly facilitate the willingness for eliminating the present distinctions in the financing procedures of the two pillars. This of course should no longer be possible at the end of the transition period, after which most expenditure will be in the co-financed rural development part of the policy.

In the next two sections we will outline how the transition in the first and in the second pillar could be put in place.

### **3.4 Steps required to change Pillar 1 and Pillar 2**

The challenge is two-fold: to shrink Pillar one measures and expenditures to perform the residual agricultural policy functions outlined in section 2.1, and to reshape and expand the rural development measures to the vision of section 2.2.

## Shrinking and adapting the elements of Pillar 1

The vision for the agricultural part of the new policy discussed in Section 2.1 concluded that there would have to be a significant contraction in the magnitude of existing public support in the new policy. There are two strong qualifications to this conclusion.

The first is to recognise that starting from the position where the total support to European agriculture is approximately 40% of the final production value and most of this is granted through Pillar 1 supports, implementing this policy *ceteris paribus* will cause significant pain to the present generation of producers. If the *only* approach is to reduce existing agricultural supports, this is a policy for contracting EU agriculture. It will achieve this by accelerating labour outflow, reducing investment in agriculture, bringing about a further concentration of output onto a smaller number of larger more commercial farming structures, and causing a retreat in the margin of cultivation.<sup>4</sup> It is necessary to give *time* for the industry to adjust, and *to assist* with the adjustment process. The former suggests a transitional period for reducing the payments and supports – one criterion for the length of such a period is the time horizon for large capital investments undertaken before the policy change, say 15 years. The latter suggests that producers should have maximum flexibility to use supports, as they are phased-out, to rearrange their businesses. This is an argument in favour of decoupling payments. There should also be significant assistance made available – through Rural Development measures and Structural Policy – to strengthen their agricultural and food activities, by raising quality, value-added, improving marketing and productivity, and to enable farmers and their families to diversify the range of income sources available to them.

The second qualification to the reduction in agricultural production-related support is the explicit recognition that there are significant market failures surrounding rural land management concerning biodiversity, cultural landscape, rural heritage and rural resources. The supply of these joint products of land management will be imperilled by the contraction and restructuring of agriculture stimulated by the reductions in Pillar 1 supports. Much environmental land management is labour intensive so the contraction in farm labour could be a particular problem in some regions. It is therefore necessary that the reduction of Pillar 1 support is counteracted by appropriate expansion of the Agro-environmental and other measures in the Rural Development Programmes.

The programme of reducing intervention prices to an agreed margin below world market levels should continue. Given the possibilities of increased volatility in market conditions (see chapter “Price and income stability”) it is wise to retain the possibility of safety-net intervention for core, and for practical reasons, storable commodities. The test that these are indeed safety net measures and not semi-permanent support is the low frequency of their being used, and the absence of accumulating stocks. In principle this reduction of market support should apply without exception for all storable commodities. As price supports are reduced to this minimal level, supply controls, including production quotas and set-aside, will be eliminated.

As market price supports are diminished, this enables the EU to lower its border protection. This process is also not expected to reach the point of tariff elimination. Residual tariffs will serve three functions. They will provide a continuing, but much smaller, degree of Community Preference. They will be there to partially offset the

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<sup>4</sup> This is not speculation, it is a factual description of the adjustments observed in the UK during the period 1996-2002, during which it was exposed to a systematic reduction in supports brought about principally by the rise in the €/£ exchange rate.

higher environmental and other standards Europeans choose and which are not reflected in world market prices which, at the margin may involve some element of environmental and animal welfare dumping. There must be the possibility of employing special safeguard tariffs in the event of unusual surges in the rest of world exports of collapse in prices. It is expected that in the horizon under consideration the use of export subsidies will have ceased (see the contribution of ANANIA in this volume).

The third adjustment to current Pillar 1 instruments concerns the future of direct payments – both coupled and decoupled payments. The main challenge is to reduce them. The key decision is to agree a schedule of reductions. Of course, this will not be popular amongst the present beneficiaries. There are two elements which could make the new policy easier to swallow. The first is assurance that there will be a significant shifting of support to pay for the production of positive externalities. Options for doing this are examined below. The second is to provide credible assurance that some degree of collective assistance for stabilisation will be provided by the mix of: safety net intervention, safeguard tariffs, Member State organised crop insurance, a shared-cost animal health contingency fund, and assistance for farmers to learn to use private sector financial risk management instruments.

With the assurances of provision for payment for environmental services, and of help for stabilisation, the target must be to agree a schedule of payment cuts which leaves only the residual payment for compensation for the higher animal welfare standards and certain plant and animal health precautions in place. To the extent that this residual will be accepted at all in international trade rules, the magnitude of such payments and their distribution<sup>5</sup> will require some objective basis in the incremental costs imposed by stated regulations.

In parallel with this reduction in on-going annual direct payment and price subsidies further efforts have to be made in strengthening the infrastructure, and regulatory frameworks, and improving connections in the food chain, in order to stimulate and encourage the production and better marketing of products with high quality attributes.

If the above steps were politically feasible the remaining big question is where and how to arrange the delivery of public environmental and cultural landscape services. The first-best solution for this is that agro-environment schemes are integrated into Rural Development measures as the two must be arranged in a regionalised or territorial approach. Also the operational principles (multi-annual, menu-driven, programming approach) and financing arrangements (co-financed measures) for Pillar 2 are the rational ones for this sort of policy instrument. Agro-environmental goals and willingness to pay for these services will be different across regions. These are the arguments for inclusion of agro-environment schemes in the territorial part of the rural development policy. Programmes to contract with land managers to deliver these services should be set to run for many years at a time. It is also right in principle that such programmes should attract an element of regional or national financing to reflect the regional demand for such services.

However, political realities and administrative problems may prevent this solution (see the contribution of SUMPSI VIÑAS; GARCIA AZCARATE in this volume). The experience for the last five years is that it is not possible to get political agreement for a major shift of funds from Pillar 1 to 2. This is mostly because of the additional demand

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<sup>5</sup> This is more than a trivial issue. The most frequently quoted examples of products where EU high-standard and thus higher-cost production is undermined by imports from regions with lower standards are poultry and pig products. It is surely no one's intention to introduce (coupled payments) for such products. The compensation can only come from residual border protection justified in terms of the additional costs.

for Member State match funding for the co-financed Pillar 2 measures. But it is also, in part, because there is no universal agreement that a significant part of current payments *should* be redefined as environmental payments. There is still, amongst some groups and in some Member States, a reluctance to accept the arguments that production linked payments have to be phased out. The administrative problem is how to affect the switch (of the appropriate part of the funds) from production payments to environmental payments. If there are constraints to the political acceptability of such a switch, broad programmes for agro-environment which would apply across a large fraction of the land and be attractive to farmers cannot be set up. Scarcity of programme funds will force the administration to design more specific schemes with higher requirements which are cumbersome, have lower up-take rates and will leave large residual payment programmes in pillar 1 that would work as additional disincentive to join Agro-environmental schemes. There is no easy way to break this vicious circle.

In the face of these problems, the compromise proposed in the 2003 CAP reform proposals is that production payments are decoupled – and eco-conditionality is applied to these payments. This halfway house cannot be an enduring solution. It is unlikely to deliver environmental outputs commensurate with the scale of the payments – as the conditionality is defined as respect for existing EU environmental law. Also, the distribution of the payments bears little relation to demonstrated demand for the environmental services as they are based solely on previous agricultural production.

The alternative ways out of this conundrum are either to more systematically ‘green’ the decoupled payments within Pillar 1, or to relax the Member State co-financing element of funds switched to Pillar 2 to set up broad application environmental schemes. This choice is developed in more detail in SUMPSI VIÑAS and BUCKWELL, ARL 2003. Whichever solution is pursued there are the same three challenges:

- each region or Member State has to decide the quantum of environmental services it wishes to pay for;
- the payment rates for the services have to be agreed;
- And the integration of any new environmental schemes with the existing agro-environment programmes (including less favoured area payments), and the Pillar 1 eco-conditionality, has to be arranged.

## **Steps to adapt Pillar 2**

The adaptation of present Pillar 2 measures to the new rural development plans presents less problematic aspects for the transition than the “shrinking” of Pillar 1. The new approach is in itself easier to introduce, it responds to the present needs of rural areas, and therefore should attract attention and support for its implementation. While the objective of diversifying the rural activities as a way to improve their viability is quite well known and has been tried in many regions, the more difficult and challenging aspect of the adaptation is strengthening the complementarities between the agricultural sector and the overall rural economy by conceiving and implementing an integration between the sectoral and the territorial elements of a Common Agricultural and Rural Policy. There is a long-established pattern of having a fixed list of measures from which to choose, and then repeat the recipe over time. This pattern may initially make difficult to adopt a more “entrepreneurial” attitude in identifying self-defined strategies and measures, adapted to particular types of farmers and areas, finding modes for exploiting the positive externalities offered by the presence of a diversified rural economy

The approach outlined requires a transition phase that should allow for a significant degree of flexibility in implementation. Such flexibility does not refer to the general



objective of improving the viability and sustainability of rural economies but only to the ways in which the new vision is extended to different domains of the present policy. The fact that it allows for diversity without abandoning the unity of common regulations makes it coherent with the nature of the construction of the European Union. This flexibility is also extremely useful for dealing with the problems posed by enlargement. Accession countries may be given the possibility to choose between alternative uses of their funds opting to move faster towards the proposed vision or implementing the same transition phase agreed for present Member states.

### **Exploiting economies of diversification without giving up economies of scale**

The core purpose of the new policy is to seek sustainability (economic, social, and environmental) of Europe's rural economies following a different philosophy than the one that has been followed until today. It assumes that all sectors of the rural economy have to contribute to sustainability. Furthermore it supposes that agriculture in this way acquires a further advantage from strengthened integration, in terms of positive externalities from the environment, the provision of services for their conservation and maintenance, orienting production towards quality and safety, improving its relative strength in the production chain, obtaining resources for innovation and entrepreneurship, acquiring a stronger and more diversified resource base to earn an income and to provide employment opportunities for the rural population as a whole. None of the advantages, acquired from a production strategy based on economies of scale (increase in farm size and productivity) needs to be abandoned. Both strategies can be complementary rather than alternative, and they can be applied to most individual sectors as well as to more than one sector.

### **Using the experience of the Community Initiatives and the Structural Funds**

The European Union has developed since the end of the 1980s an innovative approach to territorial development that has been appreciated and raised interest outside the EU. The Community Initiatives (13 of them, among which we find the LEADER approach, specific to rural areas) that have been tried in all the Member States, have proved to be effective in stimulating rural economies, including remote and peripheral areas. Their characteristic features are well codified by now: the area based approach, which is bottom-up and participatory, using partnership principle, with integrated and multisectoral actions, exploiting networking, transnational cooperation, programming and co-financing. Besides the Community Initiatives, there is the experience of the regular programmes of the Structural Funds, which after the reform of 1988 have been operating also on some of these principles (regional base, partnership, consultation, integration between actions, and programming). During the transition phase the experiences with the Community Initiatives could provide a good reference (see the contribution of SARACENO in this volume).

One of the most important lessons indicates the importance of the interplay between the partnership principle (both horizontal, between local actors, and vertical, between institutions at different levels) on the one hand and the integrated, multisectoral approach on the other. Both these features allow the different actors to negotiate among themselves and external institutional actors, the overall strategy, the priorities and the links between actions and sectors at an appropriate territorial level.

Another reason why this new approach could be relatively less problematic is that it is not so demanding of funds. Starting with small experimental programmes, with modest funding, could be a good choice to gain experience of the substance of the new vision, especially in those areas where this approach has not been tried previously.

Then, once it is accepted and understood as a new approach, it should be easier to expand, incorporating new funding and new tasks.

The most difficult aspect is the “merging” of the present standardised and top down approach of the agriculturally-based structural measures with the more self-defined, mostly “one off” measures of the territorial approach. Incentives to make the merging attractive (for example suspending temporarily the need for co-financing) combined with a well-defined and agreed in advance schedule for the phasing out of Pillar 1 measures as outlined above could improve the willingness to adopt the new approach. The sooner the present rigid distinction, within the Rural Development Regulation, between the measures for farmers and the measures for the rest of the rural population disappear, the better for accelerating the transition. A single European Structural Fund, to be used for all types of measures, would greatly simplify the integration of agriculture in the wider rural economy.

### **Adding a new dimension: services to the population, investing in human and social capital**

The past experience of the Community Initiatives and the Structural Funds has, in our opinion, focussed more on economic development or employment objectives rather than in the human and social capital of rural areas, and the provision of adequate and modern services to the population of rural areas. These dimensions are not missing, but have been managed with a sectoral approach and at a national level, rather than territorially and at a decentralised level. This has led to standardised interventions that often do not consider the particular impoverishment of the human resource base in rural areas, for example in the case of training and education, or access to basic services.

Human and social capital are increasingly considered strategic components of economic development and should receive equal attention than the provision of infrastructures. This is true of the farming community, facing problems of turnover and labour, as well as for the wider rural population, and opens the question of adopting a policy towards newcomers and immigration. Trying to link these dimensions with the other interventions in the rest of the rural economy should be also be desirable.

### **Extending the scope of payments for environmental land management services**

The integration of environmental aspects should be a key and strategic feature of the rural policy. This form of intervention may take different forms: the already mentioned payment for environmental and land management services. The beneficiaries of these payments may be farmers, who are one type of land managers, as well as managers of forests and other particular habitats, who would undertake to preserve and maintain the environmental resources according to agreed regulations of best practice, or conservation of the natural and cultural heritage.

When putting more emphasis on payments for environmental services two risks have to be avoided. The first is that the environmental dimension becomes the only one considered, simply substituting agriculture as the new “specialisation” of rural areas. This could result in the *a priori* definition of market failures, with the consequent need for public subventions. Yet in some circumstances there may be opportunities for other mechanisms to arrange the privately provided and financed delivery of these services. It is important that market failures be defined concretely and for specific landscapes and heritage of rural areas, in order not to ignore the presence or opportunity offered by activities and services that instead could be profitably developed. The second risk is that payments for the provision of these goods may be limited only to farmers as a sort of “compensation” for the shrinking of Pillar 1 support.

### 3.5 Closing remarks

The vision for a further evolution of the CAP presented in this paper may look frightening to some of the readers. The changes envisaged go beyond those of the Mid-Term Review and the discussion initiated by the Commission's 2003 proposals for CAP reform. This is partly due to the long-term perspective we deliberately decided to choose for our considerations, partly the result of our methodological approach to start from the needs of a Common Agricultural and Rural Policy in a European Union quite different from the present one within a world that has also undergone fundamental changes. It is not surprising that a policy conceived within such a perspective is different from a policy designed by taking the existing CAP as point of departure and adapting it to changing needs, taking account of constraints to such modifications imposed by considerations of what may be politically feasible and what not.

A Common Agricultural and Rural Policy 25 years from now will have to cope with a situation that will differ from the present one in many aspects.

- A further expansion of the EU to the East may have taken place.
- World agricultural commodity prices may have recovered from the present low because of economic development in the large countries of Asia and at least some progress in lifting poverty in the poorest parts of the world.
- Globalisation and world trade liberalisation will continue leading to heightened competition in agricultural commodities and to increased volatility in international markets.
- Different values attached to environmental goods and to animal welfare will still create some tensions in international trade and will justify some degree of border restrictions.
- Farm business enlargement will continue resulting in a further concentration of production and an increasing number of small farms either remaining in subsistence form or developing into pluri-active farms.
- Farming will increasingly become a supplier of agricultural raw materials, but on the other hand there is an equally important counter-trend towards product differentiation and higher quality, often linked to regionally produced food.

It is not surprising that the present CAP which despite the various reforms still has the basic characteristics of the original CAP, designed when the European Economic Community was in its initial stage in the early sixties in order to provide the conditions for a free movement of agricultural commodities within the Common Market and to achieve the objectives laid down in the Rome Treaty, is inadequate to satisfy future needs. At the time when the original CAP was designed the European Economic Community was a net importer of agricultural commodities and it was generally perceived that this situation would continue for quite some time. To increase production in order to meet increasing demand and to become less dependent on imports was a logical aim of the CAP and technical progress was seen as a precondition to enable those engaged in agriculture to achieve an adequate income. The import gap offered an opportunity to institutionalise a strong community preference and to set internal prices far above world market prices in the interest of the income goal for farmers. Receipts from import tariffs were welcomed as a contribution to the EEC budget.

When in the late seventies this set of parameters together with a declining increase in per capita food consumption resulting from Engel's law led for major agricultural commodities to a change from the position of a net importer to that of a net exporter the

foundation on which the CAP was built collapsed. Unfortunately, the EEC was unable quickly to adapt the policy to the new situation. Increasing resort to export restitutions was the immediate reaction. When this resulted in dramatically increasing costs and international tensions, measures to limit production (the milk quota system, the so-called “stabilisers”, a voluntary set-aside scheme) were introduced but failed to bring about the basic change that was required. The MACSHARRY Reform and the Agenda 2000 were successful in increasing the efficiency of public support to agricultural income and reducing international tensions but they have not brought about a fundamental solution. Many of the concerns of the society were not adequately addressed by these reforms and thus problems of acceptability continue to exist for the partially reformed CAP, pressures that will increase as time passes. These reforms were steps in a process, which has some considerable way still to run.

How we see the situation in 25 years is outlined in this paper. We see a strong European agriculture that is internationally competitive on major commodity markets in an international economic setting different from now, that is able to meet the society’s demand for safe food, of high quality, as well as for the environment and cultural heritage, and for good standards of animal welfare. We see an agricultural policy that supports agriculture in reacting to new demands not least by remunerating farmers for those goods and services, which the society wants and is willing to pay for but for which the market process does not function. We also see an agricultural policy that helps farmers to cope with risk and protects them against extreme situations on the world markets.

As we have emphasized in our vision, rural areas comprise much more than agriculture and a policy designed to enable agriculture to better correspond to society’s demand should also contribute to the development of rural areas. Rural areas are an integral part of European Society. More than 80% of European land territory is rural, and 25% of the European Union’s population lives in rural areas. They are also important for the development of the natural and cultural heritage, contributing to the formation of people’s identity and feeling of belonging.

Rural areas in Europe are quite diverse. Some of them successfully assimilated structural change and economic diversification; others have not yet managed to achieve structural change. The structural weakness of these areas can have many causes, such as an extremely low population density, inaccessibility, peripheral location, climatic disadvantages, poor infrastructure, outdated industrial structures and outdated production conditions. Where structural change has not yet occurred diversification of rural economies is essential in order to make them viable.

We strongly emphasize the need for a Common Agricultural and Rural Policy in which the sectoral and the territorial components are closely integrated. Policy actions should provide an approach to achieve the objectives of rural development rather than a recipe or specific measures to be followed. There is no need to establish a menu of eligible measures. Each area should be free to develop its own strategy and measures. A list of non-eligible actions and instruments may be the only constraint as well as limits on the levels of aid. This method is based on decentralised institutions with strong participation of private and public stakeholders. The partnerships of rural interests, with Regional Administrations, should be responsible for the preparation of pluri-annual programmes and the allocation of financial resources to the chosen measures. We see two major references to guide the implementation of this vision: the experience of the reformed Structural Funds and the experience of the LEADER programme.

We are well aware of the fact that we have not been able to develop a comprehensive Common Agricultural and Rural Policy, which includes all aspects and is detailed enough to serve as a blueprint for decision makers. Our ambition has been limited to describe a broad vision of a Common Agricultural and Rural Policy that we believe better corresponds to the needs of an enlarged Europe. We have tried to set out the development requirements of rural areas, in the economic setting to be expected for the future, and to indicate in rather general terms, how we see the transition from the present to the future policy. To deal with the specific aspects of the Common Market Organisations which have not yet been reformed, was not among our tasks. We were also not in a position to deal with the financial aspects of our vision and to analyse, which Member States may gain and which may lose as a result of the proposed changes, although we recognise the importance of such considerations for the decision making process. We did not try to follow the approach of political economy to identify potential supporters and opponents of our vision and to analyse possible coalitions in order to assess its feasibility from a political point of view. We know how complex the problems addressed are in reality and how much we had to resort to simplifications and abstractions but nevertheless we hope to have made a useful contribution to the ongoing debate and given some encouragement to expand thinking beyond the scope of past and present reforms.

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## **Part II**

### **Background Papers**





## **Expectations and Challenges - Reasons for Re-initiating the Discussion on a CAP Reform<sup>3</sup>**

### *Contents*

- 1 Introduction
- 2 Domestic dissatisfaction with the CAP
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### **1 Introduction**

It is obvious that there is continuing and perhaps even growing domestic dissatisfaction with the CAP.<sup>4</sup> This dissatisfaction leads to demands for change and to expectations concerning the improvements to be brought by reforms. Many of these expectations are diverse and sometimes are in conflict with each other.

The occurrence of BSE has made consumers sensitive for food safety. All consumers want safe food and expect from agricultural and food policies institutional regulations that make sure that all food offered to consumers is safe. Food quality is another issue of increasing interest to consumers. Many citizens are concerned about environmental and animal-welfare aspects linked to agricultural production and expect from agricultural policy a regulatory framework that makes sure that agricultural production is friendly to the environment and to animals. Farmers expect from agricultural policy that farm incomes achieve levels commensurate with other incomes. Taxpayers are concerned about the high expenditures for the CAP and want to see these expenditures

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<sup>2</sup> These papers reflect the opinion of the authors alone and should not to be interpreted as the position of their organisations.

<sup>3</sup> Paper prepared as a contribution to the Working Group on “*The future role of agriculture in Europe*” of the Akademie für Raumforschung und Landesplanung (ARL), Hanover, 2000-2003.

<sup>4</sup> European Commission, Directorate-General for Economic and Social Affairs: *Towards a Common Agricultural and Rural Policy for Europe*, p. 8.

reduced. Economists regret the distorting effect the present CAP has on the allocation of the factors of production and want to see a CAP which leads to efficient factor use in the interest of general economic welfare. Politicians want a CAP which best serves the interest of their countries, as they see it.

The existence of dissatisfaction indicates that many people believe that the present CAP falls well short of meeting their expectations and that a different CAP would be more appropriate in this regard. Given the inherent conflict between many of the expectations, the question arises whether this would be possible at all. It will certainly not be possible to fulfil all expectations, but a better compromise between conflicting expectations may be possible.

In addition to internal dissatisfaction, challenges resulting from multilateral agreements in which the EU has a major interest have to be taken into account. As a member of WTO, the EU has committed itself to certain rules, which the CAP has to respect. This holds also for ongoing negotiations into which the CAP has to be integrated in a way that does not put at risk the ultimate objective of rule-bound, undistorted trade in agricultural and in non-agricultural commodities as well as in services for the benefit of all countries. Moreover, the EU has a strong interest in political stability in the Central and Eastern European Countries (CEECs) based on sound economic and social development. It has therefore offered the CEECs the prospect of becoming members of the EU, from which specific requirements result which a reform of the CAP will have to take into account.

This paper tries to highlight the most important issues of domestic dissatisfaction with the present CAP and the expectations deriving therefrom for a reform. It also deals with the challenges resulting from existing WTO commitments and ongoing negotiations as well as with those resulting from the eastward enlargement of the EU. This is done in the sense that these challenges set some limits to the room for manoeuvre of the CAP or make some options more appropriate than others. It is not the purpose of this paper to offer solutions. What can be done to make the CAP more responsive to expectations and challenges is dealt with in other papers prepared by the working group, in which the authors present their opinions and the results of the discussions within the group on some of the main issues.

## 2 Domestic dissatisfaction with the CAP

### 2.1 New needs for change

The incidence of BSE (Bovine Spongiform Encephalitis) has made consumers concerned about **food safety**.<sup>5</sup> There is a general suspicion that intensive production is itself a threat to food integrity and food safety. One may argue that, from a scientific point of view, never in history has food been safer than at present, but the perception of the public at large is completely the other way round. It cannot be denied that the BSE crisis revealed weaknesses in the control system of food safety. Responsibilities, including that of controlling the controllers, are not assigned in a clear and coherent system that guarantees effective checks.

**Food quality** also ranks high among consumers' expectations. Their perception of quality may include quality of the product as well as quality of the production process. Some consumers may be prepared to pay higher prices for food which meets their

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<sup>5</sup> For more details as regard food safety and food quality see the contribution of A. BUCKWELL in this volume.

perception of quality, whereas others may be more interested in cheap food. All consumers expect from agricultural and food policies that they will be able to find on the market what they wish to purchase.

That there are **environmental problems** caused by agriculture is beyond dispute. There is a fundamental conflict between many systems of intensive crop and animal production and many aspects of the environment. In the past, EU agro-environmental measures (under Regulation 2078/92) have been used by Member States in different ways. The programmes were largely accepted by farmers, but their environmental impact from a scientific point of view was limited. Problems that generally result from highly intensive agriculture were not solved by these programmes. Standards that specify good farming practices to be respected by all farmers have partially been defined by Member States but not at the Community level. The Nitrate Directive of 1991, which can be seen as an attempt in that direction, met with tremendous difficulties when it came to implementation. The Rural Development Regulation (Reg.1257/99), as part of the Agenda 2000, offers the possibility to continue agro-environmental schemes along the lines of Regulation 2078/92 within a different institutional arrangement but does not tackle the general problems of highly intensive agriculture.

**Animal welfare** is a growing concern for many people. It is mostly seen in connection with the number of animals kept on a farm and the intensity of production. This connection may be questioned. Small herds do not necessarily mean that the way animals are kept respects the conditions of their wellbeing, as many examples from the past may illustrate. Better respect for animal welfare can only be brought about by standards. There is an inherent conflict here because such standards must take into account the competitiveness of European farmers vis-à-vis imports. If standards lead to a shift of production into countries outside the EU, the purpose will not be fulfilled. The EU is working on such standards (batteries for layers, rearing of calves, etc.), but given the complexity of the issue one cannot expect fast progress.

During the last few years a new discussion on the need to change the CAP has started. This is particularly the case in Germany, where a new word “Agrarwende” was even created. At the core of this development was the question as to whether the problems of BSE and FMD should be used as a stimulus for a fundamental reform. The call for a fundamental overhaul of the CAP was not limited to Germany. In other EU countries as well one can find consumer groups, environmental organisations and officials expressing the view that massive public support for farming practices which do not adhere to appropriate food-safety, environmental and animal-welfare standards should be unacceptable.<sup>6</sup>

The concerns mentioned above are concerns about modern types of farming. They are linked to the CAP by the argument that the CAP, by setting incentives (wrong incentives in the eyes of the critics), has encouraged these types of farming and has failed in bringing about necessary control mechanisms. Comparing the EU with other developed countries that have different agricultural policies but are facing similar problems leads to the conclusion that linking the unwarranted effect of modern farming directly to the CAP is at least an oversimplification.

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<sup>6</sup> SWINNEN, J.F.M.: A. FISCHLER Reform of the Common Agricultural Policy, Special Report, Centre for European Policy Studies (CEPS), Version: 27 June 2001, p. 18.

## 2.2 Traditional criticism of the CAP

Besides the increasing dissatisfaction with the CAP mentioned in the previous section, longer established criticism and the expectations deriving therefrom should not be forgotten. **Farmers are frustrated** because the CAP has failed in achieving its aim of enabling farmers to earn an income that by large reflects general income development and allows them a standard of living comparable to other groups in society. Moreover, they feel unfairly exposed by the visibility of the compensation payments and discouraged by increasing environmentally motivated restrictions on farming practices, which they do not consider necessary.

In some Member States, citizens, primarily politicians, are concerned about the **high expenditures of the CAP**, which – despite the upper limit of 40.5 billion Euro per annum (at 1998 prices) imposed by the Berlin Summit – still absorb about 50% of the EU budget. Economists in general regret the low efficiency of the expenditures.<sup>7</sup> Public expenditures and transfers from consumers resulting from price support exceed the income effect of policy measures for European farmers, primarily because of the low efficiency of export subsidies, through which consumers in the countries that import EU surpluses are subsidised.

Economists also tend to blame the CAP for leading to a **misallocation of resources**. At the level of the national economy, price support or income support for farmers linked to factors of production such as land has the effect that more factors of production will stay in agriculture than otherwise would have been the case. According to economic theory, these factors of production would have made a greater contribution to welfare if allocated to other activities. The same holds true at the international level. The argument mainly used to justify the deviation from an allocation by markets and prices is the existence of external effects (external benefits originating from agricultural production). Critics doubt its validity. One question raised is whether these external benefits are really as important as argued and whether they are really wanted by society at current levels. Another question to which no answer can be given refers to the causal connection between the CAP and the actual amount of external benefits of agriculture.

Besides external benefits, market failures are an argument to justify market interventions. In an imperfect world in which world market prices are distorted by all sorts of interventions, it would be unwise to rely completely on a free-market philosophy. A certain degree of protection may be a second-best solution, if the first-best solution, world-wide liberalisation, cannot be brought about (see section 6 and the contribution of EWA RABINOWICZ in this Volume).

Some of the interventions lead to misallocations within the agricultural sector. This is particularly the case for production quotas. Before milk quotas became tradable they led to a freezing of the historical distribution of milk production irrespective of efficiency. In maintaining milk production in less favoured areas they have been successful. Tradable quotas allow milk production to become concentrated in the hands of the more efficient producers, but in many countries these have to share the rent originating from the quota system with those who discontinued production and sold their quotas.

Among the general criticisms of economists is the **distribution effect between factors of production within agriculture**. Price support and income support, if not completely decoupled from production, automatically lead to higher prices for land.

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<sup>7</sup> Wissenschaftlicher Beirat beim Bundesministerium für Ernährung, Landwirtschaft und Forsten: Zur Weiterentwicklung der EU-Agrarreform, Schriftenreihe des Bundesministeriums für Ernährung, Landwirtschaft und Forsten, Reihe A: Angewandte Wissenschaft, Heft 459, Bonn 1997.

Insofar as farmers own the land they operate, they are the beneficiaries. If more and more land is taken on a rental basis, which is the natural result of structural change, an increasing part of the land rent does not go to the farmer but to the landowner. Thus, money collected from the taxpayer or the consumer and spent in order to increase farmers' incomes, or to bring about desired effects originating from farming, becomes a rental income of landowners often not belonging to the farming community.

From a social point of view, the **distribution effect between large and small farms** is criticised by old and new critics as well. It is evident that the major part of price support and direct payments per hectare or per livestock unit goes to farmers who operate big units and apparently do not belong to the lower income groups.

Efficiency of the CAP with regard to the **development of rural areas**<sup>8</sup> is also less than satisfactory. Many rural areas are still lagging behind in economic development, despite high CAP expenditures, due to the fact that these expenditures are not adequately geared to development purposes but mainly distributed depending on the volume of production.

**Lack of coherence between the CAP and other policies** – development policy in particular – has long been a matter of concern. With globalisation this issue becomes more and more important. In its bilateral and multilateral agreements, the EU has to take into account legitimate export interests of its partners. It has done so in its “everything-but-arms initiative” and – to a varying degree – in the Cotonou Convention and in its agreements with the Mediterranean Countries and with South Africa. An agreement with MERCOSUR has not yet materialised among other reasons because of the difficulties related to agricultural trade.

A **need for simplification** of the CAP is widely felt. There are many complaints – most of them justified – that the CAP rules and regulations have become excessively comprehensive and complicated.

### 2.3 Where to go?

Some of the reform ideas coming out of the new wave of dissatisfaction with the present CAP tend to go in the direction of more regulation rather than less, and more protection and/or public payments, albeit redirected, rather than less. This contrasts with the “more traditional” pressure for CAP reform pushing towards less regulation, subsidisation, and intervention and favouring more liberalised trade and markets. Whereas “old reformers” tend to look sceptically upon the concept of “multifunctionality”, which the EU is pushing in the WTO negotiations as an argument to maintain a large part of its support system, “new reformers” tend to appreciate this concept as it is consistent with their desire to protect a certain farming system. There is a large consensus that something needs to be done, but it is less clear in which direction a reform should go.<sup>9</sup>

Part of the confusion is due to the fact that the terminology is not as clear as it should be. In addition to “old reformers” and “new reformers”, a third group can be identified, i.e. those who are convinced that the provision of public goods related to land management is an important dimension which will not automatically be brought about as an external effect of farming and therefore has to be paid for. Instead of supporting a certain type of farming, assuming that it will bring about the desired public goods, they

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<sup>8</sup> See the contribution of ELENA SARACENO in this volume.

<sup>9</sup> SWINNEN, J.F.M.: A. FISCHLER, Reform of the Common Agricultural Policy, Special Report, Centre for European Policy Studies (CEPS), Version: 27 June 2001, p. 19.

advocate specifying the goods and services the society wants and paying land managers for providing them, something that is completely different from subsidising farming.

Positions of Member States seem to cover a wide range. The direction in which Germany, represented by Green minister RENATE KÜNST, wants to see a fundamental change in the agricultural policy can be summarised as “greening” in combination with more emphasis on consumer protection and on social aspects (more support for organic farming, no large-scale production, more employment in agriculture, more emphasis on animal welfare, high food-safety standards) under the implicit assumption that there is a strong positive correlation between the underlying objectives.<sup>10</sup> France is apparently committed to a “re-orientation” rather than wholesale reform of the CAP. In its agro-environmental policy, France, before the new government came into power, built a contractual relationship between farmers and society represented by public authorities on a regional basis. Spain is primarily concerned with the future of the structural policy. The UK government has always been one of the more liberal Member States and emphasises that the CAP has to encourage market-oriented and consumer-focused farming taking into account environmental issues.<sup>11</sup> The Swedish government stresses that agricultural reform should be linked to a clear environmental strategy. Other priorities for a CAP reform include improving animal welfare, and food quality and safety.<sup>12</sup>

Following the submission of the Mid-Term Review by the Commission on 10 July 2002 (see section 4) one may identify two camps within the EU Member States. Germany, the UK, the Netherlands and Sweden support in principle the substantial changes to the CAP proposed by the Commission, whereas the rest of the Member States, particularly France and Ireland, but also (for somewhat different reasons) the Mediterranean countries, strictly oppose them.

### **3 The issue of re-nationalisation of agricultural policy**

The increasing importance of direct payments in comparison to the costs of market interventions has initiated a debate as to whether these payments could and should be co-financed by the Member States. The discussion is intimately linked with the never-ending issue of net payers and net beneficiaries of the CAP. The distributional effect of the market and price policy has been an object of criticism since the time when common financial responsibility came into being. In 2001 an amount of 10.3 billion Euro of the Guarantee Section originated in Germany, whereas expenditures in Germany were only 5.9 billion Euro, thus resulting in a German net contribution of 4.4 billion Euro. Other net payers were the Netherlands, Austria, Sweden, Belgium and Italy. Net beneficiaries were Denmark, Greece, Spain, Ireland, Portugal, Finland, France, and – surprisingly – the United Kingdom.<sup>13</sup> The main criticism is that the distribution effects do not follow the principle that comparatively rich countries support poor countries, but are accidental, sometimes benefiting rich countries with a strong agricultural sector.

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<sup>10</sup> Bundesministerium für Verbraucherschutz, Ernährung und Landwirtschaft: Agrarbericht der Bundesregierung 2001, p. 9/10.

<sup>11</sup> European Parliament: Assessment of Agenda 2000 in the agricultural sector, Working Paper, October 2001, p. 47.

<sup>12</sup> European Parliament: Assessment of Agenda 2000 in the agricultural sector, Working Paper, October 2001, p. 49.

<sup>13</sup> Bundesministerium für Verbraucherschutz, Ernährung und Landwirtschaft: Agrarbericht der Bundesregierung 2003, Annex, p. 151.

German requests in the past to introduce co-financing for market expenditures did not meet with success. The counterargument was that the financial burden resulting from jointly decided policies has to be borne jointly. Moreover, one has to take into account that the incidence of expenditures of the market and price policy is not as straightforward as they seem to be. If surpluses are withheld from the market by interventions, and thus prices stabilised, the beneficiaries are all farmers who produce the respective commodity within the single market, and not only those of the country in which the intervention actually takes place. If surpluses are reduced by exports with the help of export restitutions, the beneficiaries are European farmers and not the country in which the exporter resides.

The shift from price support to direct payments fuelled the debate on co-financing. A favourite argument is that, in contrast to market interventions, these payments directly benefit farmers within the respective Member States. It would therefore be fair – so the argument – to put part of the burden on the national budgets. Among the German *Länder* (states), Bavaria goes further by arguing that even the amount of the direct payments (in their present form) should be left to the decision of national or regional authorities, thus allowing them to maintain small farms under unfavourable conditions if they give high priority to traditional farm structure and are prepared to pay for it in addition to EU payments.

One may, however, have serious doubts as to whether nationally co-financed or national payments are feasible from both a legal and a political point of view. Would it really be possible for the Council of Ministers to decide on the level of payments which have partly to be paid by the Member States? Most probably the answer is no.<sup>14</sup> Would it be possible for EU compensation payments to be topped up by national payments? Does this not imply a violation of the principle forbidding national subsidies, which may distort competition? In order to allow national direct payments, their character must be different from the compensation payments introduced by the CAP reform of 1992 and increased by the Agenda 2000.

## 4 The framework set by the Agenda 2000

### 4.1 Market and price policy

The shift from market interventions to direct payments, brought about by the reform of 1992, was continued by following the decisions of the Agenda 2000. A new element is Council Regulation No.1259/99 setting out common rules for direct support schemes under the CAP that offer Member States the options of cross-compliance and modulation.

The principle of **cross-compliance** establishes a link between the receipt of direct payments and respect for particular environmental considerations (see the contribution of JOSÉ M. SUMPSI VIÑAS; ALLAN BUCKWELL in this volume). In order to ensure the integration of the environment into the various commodity regimes, Member States have to define appropriate environmental measures to be applied by farmers. These may include support in return for agro-environmental commitments; general mandatory environmental requirements; or specific environmental requirements constituting a

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<sup>14</sup> SEIDEL, M.: Rückführung der Landwirtschaftspolitik in die Verantwortung der Mitgliedstaaten? Recht- und Verfassungsfragen des Gemeinschaftsrechts, Zentrum für Europäische Integrationsforschung, Policy Paper B00-17, Bonn 2000.



condition for direct payments. In the event of a farmer not complying with these commitments, Member States can withhold, reduce or withdraw direct payments.

**Modulation** allows Member States to reduce payments to farmers (for example as flat-rate reductions) according to three criteria:

- the labour force on their holding falls short of limits set by Member States;
- the overall prosperity of their holdings exceeds limits set by Member States;
- the total amount of payments granted under support schemes exceeds limits set by Member States.

However, any reduction in support given to a farmer through modulation cannot exceed 20% of the total amount of payments granted to the farmer. Any money saved by a Member State through applying the principle of modulation can be used for agro-environmental measures, early retirement schemes, less favoured areas and areas with environmental restrictions and forestry.

Only six Member States, France, Denmark, Finland, Austria, the Netherlands and Greece, have applied new environmental constraints to direct payments. For the first three, application of cross-compliance is seen as an extension of current government policy regarding agro-environmental schemes since similar schemes were in operation prior to Agenda 2000. In the Netherlands, the introduction of cross-compliance in two sectors only (starch potatoes and maize) suggests the caution of the Dutch government, and in Greece the introduction is designed to improve practices where no such measures had previously existed.<sup>15</sup>

France and the UK introduced modulation, but France discontinued when the new government came into power. Germany started implementing modulation in 2003.

There is a strong tendency among “new reformers” to make cross-compliance and modulation compulsory. The question as to why it should be made compulsory, given the flexibility the present regulation allows, is normally answered by the argument that the present regulation may lead to a distortion of competition to the disadvantage of farmers in countries where cross-compliance and modulation are applied.

## **4.2 Structural policy**

The Berlin Summit decided an allocation to the structural funds of 258 billion Euro for the period 2000-2006, of which 45 billion Euro should go to the Central and Eastern Europe Countries. Of the 213 billion Euro planned for the EU-15, 18 billion Euro were earmarked for the Cohesion Fund. The number of objectives was reduced from 7 to 3. Objective 1 was practically maintained. About two-thirds of the total amount was allocated to this objective. The newly-defined objective 2 (“Economic and social restructuring”) brought together measures for other regions suffering from structural problems. These are areas undergoing economic decline, including declining rural areas, crisis-hit areas dependent on the fishing industry and urban areas in difficulty. The new programmes to support the objective 2 areas, to which 11% of the total financial means were allocated, will favour economic diversification. As compared with the previous objective 5b regions, covering an area in which 9% of Europe’s population were living, rural areas within the new objective 2 regions will only comprise 5% of the population. A new objective 3 will be introduced for regions not covered by objectives 1 and 2 to develop human resources.

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<sup>15</sup> European Parliament: Assessment of Agenda 2000 in the agricultural sector, Working Paper, October 2001.

Following the Commission's proposal, the Berlin Summit decided on – and the Council of Ministers adopted – Regulation No 1257/99 on Promoting Rural Development, which is considered as the “**second pillar**” of the CAP and to which 30 billion Euro were allocated for the period 2000-2006 within the Guarantee Section of the EAGGF. Regulation 1257/99 established a new framework embracing:

- the accompanying measures of the 1992 reform (agro-environment scheme, afforestation, early retirement) plus the Less Favoured Areas scheme;
- all types of measures supporting structural adjustment (former objective 5a measures) and rural development (former objective 5b measures), plus measures to diversify agriculture and to support income-earning activities going beyond agricultural production.

For areas located in objective 1 regions, the approach of integrated development programmes was maintained. In all areas outside objective 1 regions, the measures mentioned under the second indent are financed by the EAGGF Guarantee Section. They are applied horizontally and implemented in a decentralised way at the appropriate level, at the initiative of Member States.

Taking into account that most of the measures mentioned under the second indent were formerly financed by the Guidance Section of the EAGGF, the annual amount available of 4.3 billion Euro is practically the same as it was in the period 1994-1999 for the measures that are now integrated into the Regulation on Rural Development (see the contribution of ELENA SARACENO in this volume). The concept of the new approach consists in offering a broad spectrum of potential measures and leaving it to national or regional authorities to choose among these measures and to design programmes according to their development priorities.

#### **4.3 Shortcomings of the Agenda 2000**

The decisions of the Agenda 2000 regarding market and price policy were a major step in the shift from price support to direct payments. It is vital, however, not to forget that this was limited to major arable crops and to the beef sector. A reform of the milk sector was postponed and other sectors, sugar in particular, were not even touched. From a logical point of view, it is difficult to find a justification for the coexistence of two completely different types of farm-income support within the CAP.

Neither the MACSHARRY Reform nor the Agenda 2000 reduced budget expenditures for the CAP. They were not meant to. They made the real costs of the CAP more transparent, shifted part of the burden from the consumer to the taxpayer, and increased cost effectiveness with regard to farm income. At present 60% of the costs of the Common Market Organisations are absorbed by direct payments. With the increasing importance of direct payments, the total amount redistributed among Member States via the CAP has increased and the direction has changed in favour of countries in which reform products play a major role – and to the disadvantage of countries whose agriculture is dominated by non-reform products. This has increased old problems and created new ones.

An evaluation of the implementation of the Rural Development Regulation reveals a mixed picture.<sup>16</sup> First, one has to note that practically all measures already existed

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<sup>16</sup> NEI Regional and Urban Development: Rural Development in the Context of the Agenda 2000. Mid –Term Review in the European Union and in Applicant Countries, Rotterdam, November 2001.

previously, albeit in different administrative settings, and that the total amount for these measures did not increase.

The most innovative approach in implementing the new regulation was that developed by France. The “contrats territoriaux d’exploitation” were innovative in the sense that they created a new contractual relationship between the state and the farmer, encouraging the latter to integrate his holding, for a 5-year period, into a coherent and comprehensive programme incorporating a socio-economic dimension as well as an environmental and regional-development aspect. In its turn, the government provides financial support for this approach for the same period of time. The new instrument was designed to assist farmers who agree to implement systems of production providing services to the community but which can not be completely remunerated by the market and thus require a financial contribution from society.<sup>17</sup> The administrative burden of this detailed approach was quite heavy.

In all Member States the programmes have a strong sectoral focus on agriculture (see the contribution of ELENA SARACENO in this volume). A new element can be seen in their regional orientation. With the exception of France, almost all measures existed previously. Some of them have been slightly adapted by strengthening and/or adding conditions. What is new is the form and the format of the rural development policy based on the experience and prime example of the structural fund approach. In particular:

- all existing measures have been put together in one single reference framework
- each Member State had to produce regionalised Rural Development Programmes which formed the basis for further programming
- a programming period of 7 years was enforced.

## **5 Mid-Term Review and Reform Proposals of 2003**

The Commission reacted to some of the expectations and challenges mentioned in the previous sections in its Mid-Term Review of the Agenda 2000, submitted on 10 July 2002 as a Communication to the Council and the European Parliament followed by detailed proposals for Regulations by the Council on 27 January 2003.

With regard to the common market organisations, the Commission sees a need for adjustment in order to reinforce the role of intervention as a safety net without compromising the potential for European farmers to benefit from trends on world markets. Agricultural production should be more orientated to the products and services that the public wants and not to artificially created price incentives or product-specific aids. Direct-income payments should not steer the production decisions of farmers.

In the cereal sector, the Commission proposes completing the Agenda 2000 by reducing the intervention by an additional 5%, thus bringing the total reduction to 20% (as originally proposed), abolishing the monthly increments, abolishing the intervention for rye (because three-quarters of the production goes into intervention), reducing the supplement for durum wheat in traditional areas and abolishing the special aid in established areas, while introducing a quality premium for durum wheat sold to the processing industry under contracts specifying quality criteria (in order to combat the

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<sup>17</sup> NEI Regional and Urban Development: Rural Development in the Context of the Agenda 2000. Mid –Term Review in the European Union and in Applicant Countries, Rotterdam, November 2001, p. 11.

trend that durum wheat is increasingly used as animal feed). For rice the Commission proposes a reduction of the intervention price by 50% and a reduction of the maximum guaranteed areas in order to be coherent with the expected increase in imports as a consequence of the “everything-but-arms initiative”.

For beef the Commission proposes a decoupling of headage payments and their replacement with a single income payment per farm based on historical entitlements (see below). Together with reinforced cross-compliance conditions, including land-management obligations, this should reduce pressures towards intensive production and help achieve a more balanced market situation.

With regard to the dairy sector, the Commission in its original Communication referred to a technical study dealing with the advantages and disadvantages of several options without making proposals. In its January 2003 proposals, the Commission advocated: (1) an annual reduction of the intervention price for butter of 7% and for skimmed milk powder of 3.5% over five years, leading to a total reduction in the milk price of 28%; (2) beginning the implementation period in 2004/05; (3) an extension of the quota system until 2013; (4) an additional increase of the quotas by 2%.

Crucial in the Commission’s proposals is the introduction of a single, decoupled payment per farm, based on historical payments, adjusted to take into account the full implementation of Agenda 2000. Only specific payments related to quality or limited to traditional production areas should be exempt from decoupling. Farmers under the decoupled payments scheme will have complete flexibility for increasing market orientation, but payments will be conditional on compliance with statutory environmental, food-safety, and animal-health and welfare standards. Cross-compliance will be applied as a whole-farm approach with conditions attached to both used and unused agricultural land. In the case of non-respect, direct payments should be reduced while maintaining proportionality with respect to risk or damage concerned. The Commission proposed that a system of farm auditing will be mandatory as a part of cross-compliance requirements for producers receiving more than EUR 5,000 per year in direct payments.

In order to maintain the supply-control benefits of set-aside, while reinforcing its environmental benefits under the decoupled system of support, the Commission proposed introducing compulsory long-term set-aside (10 years) on arable land instead of the present rotational set-aside. The existing arrangement for non-food crops that can be grown on set-aside land should be replaced with a non-specific aid for energy crops.

The Commission emphasised that a better balance of support between market policy and rural development would increase both the social acceptability of the CAP and the possibility of addressing consumer, environmental and animal-welfare concerns within the second pillar. In order to achieve such better balance and to release funds required for introducing a premia system in Common Market Organisations which have not yet undergone a reform, the Commission proposed introducing a system that combines compulsory modulation with degressivity. Under this system, direct payments above a franchise of 5000 Euro should be reduced annually to reach 12.5% (19% above 50,000 Euro) within seven years. About half of the cuts will be regarded as modulation, which means that the amounts saved will be distributed to Member States for rural development on the basis of agricultural area, agricultural employment and per capita GDP. The remaining savings, regarded as savings from degressivity, will be available for funding payments in Common Market Organisations that are still to be reformed.

The Commission proposed consolidating and strengthening the second pillar by increasing the scope of the accompanying measures and widening and clarifying the

scope and level of certain measures. Among these are measures aiming at encouraging farmers to participate in quality-assurance and certification schemes and measures to help farmers to adapt to demanding standards on Community legislation in the field of the environment, food safety and animal welfare, as well as implementing farm audits by direct payments that should cover part of the additional costs. The agro-environment chapter should be widened by introducing the possibility to offer animal welfare payments for efforts that go beyond a mandatory reference level. Article 33 of the Rural Development Regulation should be clarified to include the eligibility of the costs of setting up quality-assurance and certification schemes as well as of farm-auditing systems.

At the time when the last update of this paper took place, a fierce and controversial debate was going on in the Council of Ministers. There seemed to be little prospect of full acceptance of the Commission's proposals. A majority of countries was against decoupling of the major parts of direct payments – particularly direct payments in the livestock sector – and also against the proposed reductions in the milk price. Without bold decisions on decoupling, the reform will be a further step along the lines of the MACSHARRY reform and the Agenda 2000, and will certainly help to ease the WTO negotiations, but will fail to bring about the fundamental changes required to meet future expectations and challenges.

## **6 Implementing the decisions of the Agreement on Agriculture and WTO negotiations**

Among the reasons for a revision of the CAP, the WTO negotiations play an important role. They are briefly summarised here. A comprehensive analysis is given by ANANIA (see his contribution in this volume).

In the Agreement on Agriculture (AoA) of the Uruguay Round, the EU – like all developed countries – agreed (1) to reduce its internal level of support by 20% as compared to 1986-88 over a period of six years, (2) to replace variable import levies by tariffs and to reduce the level of protection by 36% within the same period, (3) to reduce the amount of export subsidies by 36% and the quantities exported with the help of export restitutions by 21%, (4) to open up a minimum access to the internal market of 3% of domestic demand at the beginning, increasing to 5% at the end of the transition period. Members agreed on a peace clause, which remains in force until December, 31, 2003, under which export subsidies that comply with AoA commitments cannot be challenged under WTO rules.

There is a broad consensus that the Uruguay Round was successful in bringing agriculture back on to the GATT/WTO agenda as a step in an ongoing process aimed at rule-bound and less distorted trade. A new element was seen in establishing a link between domestic policy aspects and international trade implications. The factual impacts of the commitments have, however, been limited.

The commitment on domestic support has not become binding, neither for the EU nor for any other country, primarily because of the exemptions specified in Annex 2 of the AoA, such as direct payments per hectare or per livestock unit linked to set-aside regulations or to production levels in a defined and fixed base period (blue box) or measures that are regarded as non-trade-distorting (green box). Developing countries complain that the internal support agreed upon in the AoA distorts competition to their disadvantage.

Tariff-reduction commitments had also little impact on trade flows because nearly all countries were successful in using tariffication to bind their tariffs at levels much above the actually applied levels (“dirty tariffication”) with the result that the reduction commitments based on the bound tariffs left them with sufficient scope for effective protection. Also market-access commitments were of little practical importance. Since existing concessions were considered as part of the access commitments, this is not surprising.

From the EU’s point of view, the commitment on export subsidies (reduction of quantities to be exported with the help of export restitutions) was practically the only one that became binding during the implementation period. This was particularly the case for rice, cheese, other milk products, poultry, beef, wine, and fresh fruit and vegetables. From the point of view of exporting countries, the existence of export subsidies is heavily criticised because they are seen as the measure that most distorts international trade. For the EU it will be essential that the CAP, after accession of the countries of Central and Eastern Europe, prevents the creation of surpluses that exceed the limits set for export subsidies by the AoA, or perhaps more constraining limits resulting from future negotiations.

Part of the AoA was the decision to start new negotiations one year before the end of the implementation period, recognising that the long-term objective of substantial progressive reduction in support and protection resulting in fundamental reform is an ongoing process. In the negotiations, which started on the basis of Art. 20 of the AoA, some of the major players strongly advocated substantial changes required to achieve the stipulated objectives.

The USA started with attacks on the “blue box” and on the philosophy that differentiation should only be made between two kinds of measures: those which are subject to reduction commitments and those which are not. This was when the Federal Agricultural Improvement Act (FAIR Act) of 1996 had practically decoupled most support to US farmers from production. The US Government considered all remaining measures as eligible for the “green box”. However, during the last years the US has to a large extent re-introduced payments linked to production, which other WTO members will find difficult to accept as being eligible for the “green box”. They will also have difficulties accepting the argument that State Trading Enterprises (STEs) and export enhancement should be treated as purely domestic measures.

The Cairns Group was most outspoken in demanding abolition of the “blue box” and restrictive criteria for the “green box”. They also criticised the consolidation of tariffs at high levels (dirty tariffication) and advocated a reduction formula aimed particularly at reducing tariff peaks. According to the Cairns Group, export subsidies should be abolished and STEs should pursue transparent and market-oriented policies. Developing countries condemned the protectionism of developed countries, particularly the EU, and demanded tariff reductions or improved market access for their products and, at the same time, generous exemptions from reduction commitments for themselves. A further extension of “special and differential treatment” was high on their agenda as well as the establishment of a “development and food-security box”.

The EU took the position that there was no need for a fundamental change, i.e. that the instruments of agricultural policy and their categorisation into the “green”, “blue” and “amber” boxes should be maintained. The EU argued that further reductions in tariffs and export subsidies, as well as in improving market access, should be seen as part of a long-term process, as stipulated by Art. 20 of the AoA. It requested more transparency in the management of tariff quotas and of the role of STE in importing and

exporting agricultural commodities. With regard to the United States, the EU emphasised that, on the export side, not only export restitutions should be taken into account, but also export credits and other means of export enhancement. The EU was interested in getting non-trade concerns acknowledged as subjects of the negotiations.

With the Ministerial Conference of Doha of November, 9-13, 2001, a new full round of trade negotiations was initiated. With regard to agriculture, Art. 13 of the Ministerial Declaration states: “..... We recall the long-term objective referred to in the Agreement (i.e. the AoA,) to establish a fair and market-oriented trading system through a programme of fundamental reform encompassing strengthened rules and specific commitments on support and protection in order to correct and prevent restrictions and distortions in world agricultural markets. We reconfirm our commitment to this programme. Building on the work carried out to date and without prejudging the outcome of the negotiations, we commit ourselves to comprehensive negotiations aimed at: substantial improvements in market access; reduction of, with a view to phasing out, all forms of export subsidies; and substantial reductions in trade-distorting domestic support ..... We take note of the non-trade concerns reflected in the negotiating proposals submitted by Members and confirm that non-trade concerns will be taken into account in the negotiations as provided for in the Agreement on Agriculture”.

The wording of Art. 13 reflects a compromise. The EU finally accepted the formula “reduction of, with a view of phasing out, all forms of export subsidies” because it includes all forms of export subsidies and it is subject to the condition “without prejudging the outcome of the negotiations”, on which France insisted until the very last moment. Reference to non-trade concerns includes the notion of the European model of multifunctional agriculture, which may be used to defend exemptions from reduction commitments.

To what extent new commitments will be more constraining than those of the Uruguay Round (UR) is difficult to predict. From the negotiations preceding the Ministerial Conference of Doha and of the Ministerial Declaration, one may, however conclude that the results of the new round will be less severe for the EU than it was felt in the beginning. Among the reasons for this estimation, the position of the USA has to be mentioned, which has lost much of its credibility as an advocate for reducing protection for agriculture. The new US Farm Bill, recently passed, not only allocates \$ 73.5 billion of extra spending to agriculture over a ten-year period (additional to so-called baseline spending, representing the projected cost of extending the 1996 FAIR Act for a further ten years), but also re-introduces – in addition to the existing decoupled payments – as a means of counter-cyclical support modified deficiency payments, which do not fulfil the green-box requirements.

In contrast to what happened in the UR, the EU took the initiative and presented its own proposal along the lines outlined above in December 2002. This was followed by proposals of the chairman of the Committee on Agriculture, STUART HARBINSON, in February 2003 which went much further concerning reduction commitments for internal support, import tariffs and export subsidies. A revised version presented one month later was not very different. It was rejected by the EU. Non-agreement before the end of March 2003 implied that it was not possible to agree on the modalities of countries’ commitments as planned in Doha. No prediction can be made for the Ministerial Meeting in Cancun in September 2003, but, whatever the result may be, it is clear a CAP reform will have to take into account any commitments to which the EU agrees in the WTO negotiations.

## 7 The eastward enlargement of the EU

In the eastward enlargement of the EU, agriculture and agricultural policy were among the most critical issues. Again, in this introductory paper the issues can only be highlighted. For a comprehensive analysis, see the paper by WILKIN (see contribution of JERZY WILKIN in this volume).

From the point of view of the CEEC the importance placed on agricultural policy is comprehensible because the role of agriculture in their national economies is much more important than in the EU-15.<sup>18</sup> Taking the 10 CEECs together, about 23% of the economically active population works in the agricultural sector, in the EU-15 the corresponding figure is only 5%. In the mid-1990s, 10.3 million persons were employed in agriculture in the CEEC-10 compared to 7.6 million in the EU-15, which roughly corresponds to the combined agricultural workforce of Poland and Romania. There is still a high degree of disguised unemployment in the agricultural sector of the CEECs. They expected large financial transfers via the CAP and hoped that acute economic and political problems would be eased.

European farmers feared increased competition from the large production potential of the CEECs bringing about 45% additional agricultural land to the EU, while increasing its population only by 28%. At present the production potential of the CEECs is not fully used. Yields have recovered from the low level to which they had fallen after the collapse of the old system, but are still below the EU level. Animal production is still 30-50% below the level of 1989. Feed consumption per unit of production is extremely high. Input use is below the EU level and the quality of inputs is not always comparable. Farm equipment is largely worn out but could not be replaced because of lack of capital. Most of the farms have no access to the capital market.<sup>19</sup> Markets do not function properly. The processing sector is largely inefficient and quality standards are low. Contrary to initial fears, a positive trade flow in agricultural commodities from the EU towards the CEECs has occurred and increased over time.

Many of the CEECs are characterised by the dual structure of their agricultural sector. A major part of the land is operated by large-scale farms either as co-operatives or commercial enterprises. At the other end of the spectrum there is a large number of small farms, many of them part-time or subsistence farms. Large-scale farms find it difficult to generate the salaries of their employees, although the salary level is still low. Small farms survive because the opportunity cost of labour is zero or they are primarily used to produce food for home consumption. In general the agri-food sector of the CEECs is far from being competitive in the Single Market.<sup>20</sup>

The question as to whether eastward enlargement can take place without changing the CAP has several aspects:

- What will happen to agricultural production in an enlarged EU without changing the CAP?
- Would the result be feasible from a financial point of view ?
- Would the result be feasible under WTO commitments?

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<sup>18</sup> EUROPEAN UNION: Agricultural Situation and Prospects in the Central and Eastern European Countries, Summary Report, Brussels, June 1998.

<sup>19</sup> POULIQUEN, A.: Competitiveness and Farm Income in the CEEC Agri-food Sectors – Implications before and after Accession for EU Markets and Policies.  
[www.europa.eu.int/comm/agriculture/publi/reports/ceeccomp/index\\_en.htm](http://www.europa.eu.int/comm/agriculture/publi/reports/ceeccomp/index_en.htm)

<sup>20</sup> POULIQUEN, A.: Competitiveness and Farm Income in the CEEC Agri-food Sectors.



- Would the result be desirable from the point of view of the accession countries?

Several model calculations have been used to find an answer to the first question. A recent one, done by the IAMO in Halle/Germany,<sup>21</sup> in which the situation in the CEEC-10 in 2007 with and without accession was calculated, came to the conclusion that the implementation of the Common Market Organisations in their present form in the CEECs would lead to considerable additional export surpluses in the case of milk<sup>22</sup> and beef and to a smaller extent in the case of sugar. Export surpluses in wheat, coarse grains and pork would be reduced. With regard to eggs and poultry, additional import demand would absorb part of the surpluses of the present EU-15. To some extent the results reflect the inefficiency in the conversion of feed grain into pork, poultry and eggs. Vegetables would lose part of their competitiveness and be replaced by imports.

According to the simulation model, additional expenditures from the EU budget for export restitutions in 2007 would be 848 million Euro at 1999 prices. Expenditures originating from the Communal Market Organisations (CMOs) for fruits, vegetables, wine, olive oil, tobacco and sheep, as well as direct payments and expenditures for rural development, are not included in this figure. In spite of these omissions, the conclusion may be allowed that additional costs for handling market surpluses should not be a major problem. The question of direct payments will be dealt with in one of the subsequent paragraphs.

Regarding potential conflicts with WTO commitments, one has to take into account that, in GATT/WTO terms, accession of the CEECs to the EU is the enlargement of a customs union. The EU and the CEECs will have to satisfy the other members of the WTO that enlargement does not result in a rise in the overall level of agricultural protection. Since tariffs in the CEECs are in many cases significantly below those found in the EU, negotiations will have to be held in the WTO on how to compensate other countries for the increase in tariffs on their agricultural and food exports to the CEECs.<sup>23</sup> A similar problem applies in respect of export-subsidy commitments. The amounts and quantities notified by many of the CEECs are small, which means that the permitted subsidised exports they contribute to an enlarged EU are small in comparison to their potential export production. The problem is exacerbated by the fact that the permitted subsidised exports of the enlarged EU will probably be less than the sum of the permitted exports of the EU-15 and of the CEEC-10; this is because EU-CEEC and CEEC-EU exports, which become internal trade as a result of accession, will be deducted (netting-out). It can therefore not be taken for granted that the effects of extending the present CAP to the CEECs will be compatible with WTO commitments.

Seen from the accession countries' point of view, accession with an unchanged CAP would have advantages and disadvantages. It would certainly satisfy farmers' expectations and induce financial transfers to the agricultural sector of the new members. It would not help to solve the problems of the processing sector. On the contrary, it may even worsen the situation of this sector because high prices for raw

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<sup>21</sup> FROHBERG, K.; WEBER, G.: Ein Ausblick in die Zeit nach vollzogener Ost-Erweiterung. Schriftliche Fassung eines Vortrags, gehalten auf der wissenschaftlichen Akademietagung „EU-Osterweiterung: Was erwartet die deutsche Landwirtschaft?“ des Deutschen Bauernverbandes und der Deutschen Landjugendakademie in Bonn-Röttgen, 12./13.10.2000, Halle, Juli 2001.

<sup>22</sup> The result is based on the assumption that the CEECs receive milk quotas corresponding to their production in 2000-2001, projected on the basis of the actual production in 1997 and the growth between 1992 and 1997.

<sup>23</sup> SWINNEN, J.F.M.: A. FISCHLER Reform of the Common Agricultural Policy, Special Report, Center for European Policy Studies (CEPS), Version: 27 June 2001, p. 15.

materials may further reduce competitiveness. In countries where 30% to 60% of consumer incomes are spent for food, one also has to take into account the effect of high prices for agricultural commodities on low-income consumers.

In the case of sugar and milk, the debate on the quotas was one of the difficult issues in the accession negotiations. The CEECs demanded quotas that take into account their production potential on the basis of historical levels of production before the collapse of the socialist system, whereas the EU offered quotas at the much lower level of present production, which the Accession Countries finally had to accept.

Most controversial was the issue of *direct payments*. The decisions of the Berlin Summit were based on the hypothesis that direct payments were not to be granted to farmers in the CEECs, based on the argument that direct payments were compensations for price cuts and that for most of the CEECs accession to the EU would lead to a price increase. A convergence of agricultural prices in the CEECs and the EU has taken place over the last few years narrowing the price gap, so that finally the original argument was no longer valid. Direct payments have become a regular component of the CAP, the change in terminology from “compensatory payments” to “direct payments” being indicative of this. In the eyes of the CEECs, direct payments were an essential element of the CAP. They vehemently rejected what they called “second-class citizenship”.

The legitimacy of financial arguments for excluding the CEECs from direct payments can be questioned. According to the simulation model of IAMO mentioned above,<sup>24</sup> direct payments to CEECs in 2007 would amount to 7.8 billion Euro (at 1999 prices). This amount is not included in the financial framework decided at the Berlin Summit and would exceed the Agricultural Guideline, but, in the context of the total costs of eastward enlargement, the amount – below previous estimates – does not seem to be really threatening.

The question may be raised to what extent direct payments can really contribute to solving the problems of the CEECs. It has been argued that it would be unwise to grant direct payments to the accession countries in the same way as they are granted to EU farmers because this would contribute to a cementation of the present dualistic agrarian structure. It would help large-scale farms to finance investments, and thus to some extent be a substitute for access to a capital market, but for the majority of small farms direct payments would mean an encouragement to continue farming in a manner which is uneconomical and can only be justified by social reasons. In both cases, the effect of direct payments could be achieved by better targeted measures. Moreover, direct payments would lead to an increase in land rents and thus benefit landowners, who in the majority of cases are not farmers.<sup>25</sup>

The validity of these arguments cannot be denied, but they also hold for the EU-15. The proposal not to deprive the CEECs of the financial transfers which would otherwise have originated from direct payments, but to use the corresponding amounts for different purposes – such as rural infrastructure, investment aids for “sustainable” farms, investment aids for processing industries, etc. – had some appeal to economists, but one had to question its feasibility. The critical aspect of the absorptive capacity in

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<sup>24</sup> FROHYBERG, K.; WEBER, G.: Ein Ausblick in die Zeit nach vollzogener Ost-Erweiterung. Schriftliche Fassung eines Vortrags, gehalten auf der wissenschaftlichen Akademietagung „EU-Osterweiterung: Was erwartet die deutsche Landwirtschaft?“ des Deutschen Bauernverbandes und der Deutschen Landjugendakademie in Bonn-Röttgen, 12./13.10.2000, Halle, Juli 2001.

<sup>25</sup> POULIQUEN, A.: Competitiveness and Farm Income in the CEEC Agri-food Sectors – Implications before and after Accession for EU Markets and Policies.  
[www.europa.eu.int/comm/agriculture/publi/reports/ceeccomp/index\\_en.htm](http://www.europa.eu.int/comm/agriculture/publi/reports/ceeccomp/index_en.htm)

the CEECs for investments in rural areas in addition to the interventions of the structural funds, for which financial allocations had been made, was omitted.

At the Copenhagen Summit of 15-16 December 2002, the Accession Countries finally accepted the EU proposal of phasing in direct payments by EU funds over a period of ten years, starting with a level of 25% of what EU farmers receive. However, this compromise was only achieved after the EU had accepted the possibility of topping up of these direct payments by 30 percentage points, financed by national funds of the Accession Countries, including a transfer of funds allocated for rural development up to a limit of 20%. This result demonstrates the high interest of the new Member States in immediately channelling financial means into the agricultural sector of their economies. After the outcome of the Copenhagen Summit, it seems more likely that the new Member States will become supporters of the present or a slightly modified CAP than promoters of a fundamental change.

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# **The Future of the CAP - A Discussion about the Needs of a Shift in Instruments<sup>2</sup>**

## *Contents*

- 1 Introduction
- 2 Agenda 2000
- 3 Dominant forces during this decade
- 4 Consequences for agriculture and the rural areas in Europe
- 5 Necessary changes in instruments and institutions
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## **1 Introduction**

The agricultural sector in the EU is a dynamic one, continuously reacting to market forces, new technologies and institutional changes. The CAP has not delayed this process, but has facilitated it by mitigating the social consequences of this ‘gale of creative destruction’<sup>3</sup> for the rural population. The CAP has been adapted to the changing conditions of agricultural markets, the increasing number of members of the EU and international developments. One can argue about the speed of changes, but this can only be understood by taking into account the political process; it is just the outcome of a complex of institutional and political forces.

This paper is about the future dynamics of the agricultural sector and the consequences for rural areas in Europe. The following questions will be discussed: 1) what forces will dominate changes in the agricultural sector during the next decades? 2) What consequences are expected for the agricultural sector and the rural areas in Europe? 3) What changes in CAP instruments are preferable and possible, given institutional and financial constraints? We will start with an overview of the current CAP under Agenda 2000.

## **2 Agenda 2000**

Agenda 2000 not only addresses a number of changes in commodity policies, but also sees at an integrated rural development policy. This is called the second pillar of the CAP. The change in the different commodity policies is mainly intensifying the policy changes that were introduced by MACSHARRY, the former agricultural Commissioner. The integrated rural policy is a first step on a way to recognise that farming in many areas of the EU plays a number of roles: besides the production of food and fibres it

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<sup>1</sup> LEI, Wageningen UR, The Hague, the Netherlands. The article reflects the individual opinion of the author and not necessarily the opinion of his/her organisation.

<sup>2</sup> Paper prepared as a contribution to the Working Group on “*The future role of agriculture in Europe: food production versus environmental responsibility*” of the Akademie für Raumforschung und Landesplanung (ARL), Hanover 2000-2002

<sup>3</sup> Cf. J.A. Schumpeter, chapter VII on the process of creative destruction.

includes the preservation of the rural cultural heritage, the landscape and natural resources. This section gives a comprehensive overview of the main features of the most important commodity policies and the aims of the rural development policy.

### **Commodities**

From 2000 to 2006 a yearly budget between 36,6 and 39,6 billion Euros will be available for market policies. This is about 90% of the budget for the CAP. More than 90% of the budget for market policies has been spent in the past on the commodity groups we deal with in this paper. Table 1 shows the specific measures for the different products.

- Arable crops: cereals, protein plants
- Sugar
- Olive oil
- Fruit and vegetables
- Wine
- Milk products
- Beef and veal
- Sheep meat and goat meat

### **Rural development**

Rural development policy (Regulation 1257/1999) is seen as an accompanying policy. It is complementing market policies in the framework of the CAP. It will therefore strengthen the agricultural and forestry sector. It will strengthen the competitive position of the rural areas and it will support the preservation of our natural resources and rural cultural heritage. Rural development policy is closely related to the structural policy financed from the Guidance Section of the European Agricultural Guidance and Guarantee Fund (EAGGF).<sup>4</sup>

Rural development policy is implemented with a variety of measures related to the objectives mentioned before. Countries have to develop integrated rural development plans, which should show the contingency of the different measures to achieve the objectives.

## **3 Dominant forces during this decade**

The agricultural sector in Europe is confronted with at least three dominant forces that will impact the sector and the CAP deeply. In the first place there is the public debate about the role of agriculture in society. Not only is the sector supplying food and fibres, but it also is an inherent part of the countryside with a number of different functions. The sector has a co-responsibility for an attractive country side that forms an habitat for plants and animals, tourists are visiting the countryside in search for silence and rest and it is a place where one can find an interesting historical heritage.

Secondly food production has become an issue in public debate. This debate is about food **safety** and food **quality**, two separated but closely related issues (see the

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<sup>4</sup> See Annex 1 for more information about the implementation of this part of a rural development policy.

contribution of BUCKWELL in this volume). For instance the content of saturated fat in some meat and dairy products is a quality aspect of food and will have an impact on human health. Still we will classify butter as a safe product. Nevertheless we follow the definitions as used by BUCKWELL (in this volume), where food **safety** refers to human health and food **quality** to the totality of characteristics of the food that bear on its ability to satisfy stated or implied preferences.

Tab. 1: A selection of Commodity regimes under Agenda 2000

<b>Commodity group</b>	<b>Market policies</b>	<b>Direct income policies</b>		
<b>Arable crops</b>	Intervention price for cereals incl. Corn Export restitution and import levies	Hectare payments		
<b>Sugar</b>	Intervention price Export restitution Import levies	Quota system Self financing		
<b>Olive oil</b>	Production target price <sup>1</sup>	GMQ and GNQ's	Production aid	
<b>Fruit and Vegetables</b>	Withdrawal operations and processing aids	Producer organisations and Quality standards		
<b>Wine</b>	Intervention storage Withdrawal by distillation	Control of plantings Quality standards		
<b>Milk products</b>	Intervention of butter and skimmed milk powder Export restitution Import levies	Quota	National envelopes	
<b>Beef and Veal</b>	Safety net intervention system Slaughter premiums	National ceilings for premiums	Male premiums Suckler cows premiums	National envelopes
<b>Sheep meat and Goat meat</b>	Private storage aid		Annual Ewe premium	Less favoured area supplement

<sup>1</sup> There is little external trade

Not only food safety has been criticised but also the way it has been produced. The average age of the population is increasing and more information is available and discovered about the relationship between food and health. This change in consumer preferences gives market opportunities for products and production processes qualified as healthy. On top of this, there is a growing awareness of ethical issues concerning food production and the technologies used in production and research. Animal welfare and the use of new techniques in biotechnology are just examples of a much wider concern about the food production processes. These debates have been stimulated by a number of recent well-known crises, but economic prosperity, education and information fuel the underlying trend.

The consequences of these trends are that national governments are confronted with an electorate that wants guarantees about food safety and questions the efficiency of the CAP. This debate questions the legitimacy of a public policy, based on price support and direct income payments, while paying little attention to food safety and quality, the rural area and ethical issues.

The accession of Central and East European countries is a third factor that will especially have consequences for the CAP. The general concerns are the costs and effects of the introduction of the current CAP in the CEEC's. Of course the extra costs for the EU budget will be substantially if we introduce the current CAP in the CEEC's. Silvis et al. (2001a) calculated an extra 15 billion Euros in 2015 when the twelve new member states have completed their accession process with the EU. This is an increase of the agricultural budget with more than one third, which cannot expect a warm welcome in Europe, to say the least. Even more serious are the consequences of the introduction of the current CAP in the new member states, because the consumers will be confronted with higher prices as well as the farmers in these countries. As the average income is substantially lower, this policy will hurt the consumer. Secondly, production will be stimulated with an increase of surpluses for the main agricultural products. In both cases the wrong signals are given and therefore it is not very reasonable to introduce a policy that has to be adapted.

The consequence of this trend is that the EU will be forced to change the current CAP, in order to reduce the costs of the accession and to prevent distortions in the new member states. This means that less income and price support will be available for the farmers in the current EU.

WTO and bilateral trade negotiations will be on the future agenda of the EU (see the contribution of ANANIA in this volume). It seems reasonable to expect that these negotiations will lead to lower tariffs and more opportunities for import and export of food in the EU. Being true in general it seems of more interest to think about the non-tariff barrier issues. What is the kind of quality guarantees that the EU can compel from the importers of food. Is this only the guarantee that it will not be harmful to consumers, or can the EU compel that it is produced in a sustainable way. One step further might be that the food is produced according to the ethical standards we obey in the EU. The latter two seem to stand little chance to be honoured. Nevertheless they seem to be of great importance for the legitimacy of a further liberalisation of food markets in the world. There is a great need for internationally accepted standards in this field. Otherwise the world wide free market for food will not work at all.

The consequences of this trend is an increase of competition in food markets world wide and thus also in the EU. For farmers in the EU this will mean lower product prices. The consumers can benefit from this development, but possibly at the costs of a greater risk with respect of the guarantee of food safety and quality. The legitimacy to compel farmers in the EU to respect sustainability and other important values will be weakened if these conditions in third countries are not respected. Measures to guarantee product safety and quality to the consumer might be used as effective non-trade barriers (see the contribution of RABINOWICZ in this volume)

#### **4 Consequences for agriculture and the rural areas in Europe**

The role of farming in Europe has so far been seen as a supplier of food and fibres. It is only recently that the public function of farming has been acknowledged by a wider public. Notwithstanding the fact that in countries like Austria and Switzerland the

public function is already known and respected for a long time. With an increasing prosperity and a surplus of food, the social attention tends more to the public function of agriculture. The countryside is seen as a place for stillness and recreation, as a habitat for flora and fauna and we are becoming more and more aware of the cultural and historical roots of society in the landscape of today. This is seen as an asset of society, which merits marketing of public goods, but pricing is still difficult.

The role of agriculture as the main driver for rural development is an obsolete idea. Other functions of the countryside are becoming more and more important for the economic development. Some of these heavily depend on the quality of the landscape and accessibility of countryside. Others will depend on the possible genetic diversity. Given the fact that agriculture has a dominant position in the rural area as a user of space it is clear that farmers have a role to play as a steward of the countryside. An important question is what incentives will stimulate the farmer to fulfil this role. It seems not very reasonable to leave this simply to market. At the same time we have to acknowledge that the countryside is a complex system with public and private aspects.

Consumers become critical about the safety and quality of their food. This awareness is a consequence of the affluence of food supply, the increase of the average age of people, our awareness of the impact of our diet on our health, but also the complexity of the food production process and its logistics. Recent food scandals bring this tendency to the surface, but underneath there is a more important trend, also seen in the marketing of functional foods. It is not only food safety and quality that matters here. It is also a way of life: care for your own health and care for the conditions of life. Food is becoming more than the intake of calories. Up to now, food markets and the food production process are not adequately organised to address this trend in consumer demand.

There is an interesting disparity between an unconditional internalisation of food markets and the increasing awareness of the importance of the food production process among consumers. Recent research of the Consumer Association in the Netherlands showed that all large retailers in the Netherlands did not have information about the origin of the meat they were selling. This means they are far off from what consumers think important about their food. Globalisation and an increase of import and export will enhance the possibilities that these shortcomings in consumer markets will increase. Only improved and internationally accepted standards for food safety measures as well as an effective control of these regulations will counteract the risk of globalisation of food markets with respect to food safety (see the contribution of BUCKWELL in this volume).

If we want to force our own farmers to respect a number of rules concerning animal welfare, sustainability of production methods and respect for our cultural heritage, landscape and nature, how do we explain them the legitimacy of imported products that do not respect these rules in the country of origin? And how do we give a choice to consumers if the retailers are not able to guarantee the origin of their products and the way they are produced? The asymmetry in information between consumers and producers is one of the reasons that the market system is failing so far. In order to fill this gap, farmers, food processors and retailers will be asked to give more information about the production process. But it is the whole chain of food supply that has to obey the rules of keeping records and in the end there is a need to communicate it to the consumer in a comprehensible way. This is not an easy task but seems being possible with the information technology of today.



A further complicating factor is the accession of the new member countries that have no long market tradition yet. In these countries agriculture is still an important economic sector in the countryside and people have little other opportunities. Their relative backwardness might be a good position to introduce new technologies and efficient organisations to compete the agricultural sector in the EU-15. This will only enforce the competition that is already expected from outside the EU. In the CEEC's this means that a lot of people will lose their job in the agricultural sector and that they have to find other one's. Especially for the elderly people this will be a hard task. It seems reasonable to develop policies to stimulate this process with attention to this social problem. Important is to respect the lessons we learned in Western Europe about agricultural development. Consider the experiences with the environmental problems and the animal welfare issues. As far as the common rules will hold in the whole EU we might expect this will happen.

Recently we have been confronted with another possible negative consequence of increasing international trade in food and animals. Epidemic diseases like foot and mouth disease and swine fever show the vulnerability of an open market system without an effective control. On the hand the market system seems to force us to stop with preventive vaccination while the risk is increasing because we have little control over the movement of food and animals. It is clear that government has to play a role in these matters, but I shall not discuss these kinds of policies any further in this paper.

## **5 Necessary changes in instruments and institutions**

As a benchmark for the discussion in this section I will use the BUCKWELL report (BUCKWELL 1997). In this report four different policies are distinguished: stabilisation of agricultural markets; temporary direct income payments; rural development and environmental and landscape payments. In the BUCKWELL report these policies were seen as an integration of the different policies that affect agriculture. The report did not go into the consequences of these policies for specific instruments. This paper aims to contribute to the discussion about the instruments, about the necessary institutional changes and the financial responsibility. However we will first address the question of what policies seem to be necessary and then focus on main innovations that seem to be most urgent and got less attention so far.

The agricultural sector should address two major missions from society: 1) contribute to production of healthy food in a sustainable ethical accepted way and 2) contribute to a vital and desirable countryside. As these missions might be clear, this is certainly not the case with the way this should be achieved. The market does play an important role, but it is clear that the market system does not simply deliver what we want. There might be a need for additional organisation and possibly a renewing of institutions. A priori I will express that what the market system can do, should be left to the market, but we have to look at the system with an open mind.

The BUCKWELL report has been clear about the stabilisation of agricultural markets and temporary direct income payments. It has been assumed in the BUCKWELL report that agricultural markets should be left to the market forces, with the acknowledgement of possible disruptions in which case we need some stabilisation measures. Recent experience in the USA demonstrates the realism of this position. The American government has compensated market failures in American agricultural markets in an unforeseen and unexpected way. It is our aim to propose a policy that will capture these problems in a controlled and policy aimed way. This means that some of the existing instruments should be used, such as temporary set-aside and production limits. Some of

the instruments might have a private character, such as an income stabilisation fund or a risk insurance programme (see e.g. Silvis 2001 b). This stabilisation policy will be the last relic of the CAP, as we see direct income payments as a temporary and therefore vanishing instrument of income policy. It is an instrument to adapt farmers to new market conditions.

The report was less plain about the responsibilities with respect to the promotion of healthy food. This issue is a complex one and the role of government, let alone the CAP, is less clear as desirable. We did make already a distinction between food quality and food safety. The complexity has different dimensions: a technical one and an organisational one. From a technical point of view it has to be decided, what is safe? And what do we mean by healthy? This is not an easy task, but has to be done in order to develop standards and regulations. This work is done in expert committees and organised by governmental organisations. The other question is: who is responsible for what? Of course it is private business producing food with respect for the food quality and food safety. But who is responsible for control? Who is responsible for the practicability of regulations? Who is responsible for a level playing field in the market? Who is responsible for adequate consumer information? And even if we can answer all these questions, is the system working as we expect it to work? It is not easy to answer these questions. Generally speaking we can say that a number of ministries on a national level are responsible for most of these issues. But also the EU has its responsibility and a number of questions can only be answered on a global level within WTO. If we take it serious that the CAP has a role to play in the production of healthy food it should be clear that this role can only be accomplished in cooperation with the private sector and ministries on a national level, as well as other commissioners within the Commission. It is certainly not only a matter of DG Agriculture. Given the importance of the agricultural sector with respect to food production and the responsibility of DG Agriculture for agricultural markets it is also clear that there is a role for DG Agriculture in the framework of the CAP.

What role can this be? At least a number of issues deserve attention from an agricultural sector point of view: 1) harmonisation of standards in the EU and possibly within the WTO; 2) a proof of practicability of regulations and 3) the achievement or maintenance of fair competition in food markets with respect to food safety and food quality regulations.

The second mission will be addressed by the environmental and landscape policy. In the framework of Agenda 2000 this part of the policy is dealt with under pillar two and needs a further development. SUMPSI VIÑAS and BUCKWELL (in this volume) do show in a convincing way that this will be a hard task under pillar two, at least for two reasons. In the first place by developing, implementing and monitoring accepted standards and secondly for reasons of financing. What such a policy has in common with a food safety and food quality policy is the extension of its domain, which is not exclusively the agricultural sector. But the sector has again an important role to play. Therefore it is important not to narrow the subject by a limited environmental scope, but to extent it to the role of agriculture and the rural area with respect to a number of other topics, like for instance the cultural heritage functions its role with respect to recreation and the accessibility of the countryside.

The environmental and landscape policy needs in the first place a European framework in order to prevent the Union from uncontrolled national payments to agriculture under the flag of Environmental and Landscape Payments (ELCP's). In the second place there is a need to analyse the different functions of the countryside under this heading. Not only are there different functions, but also there are different

beneficiaries from such policies. Such analyses will give an indication about those who are involved, those that will gain from the policy, those who have to deliver and those who might have a say in the design of the countryside (annex II gives an example of such an analysis). Of course this type of analysis is region specific. The simple analysis in annex II makes clear that there might be a European, a national or a regional dimension if we go into the aims and functions of the rural area. If for instance the baiting place for migratory birds is a part of the Bird Directive, it seems reasonable that the EU finances partly for these aspects of the ELCP's in the region. The cultural heritage will be most of the time a national concern, while the experiences of tourists and residences will be a regional affair. If it is important for tourist, it seems reasonable that the tourist industry in the region pays partly and when the residents see the value of their houses rising as a consequence of the policy it is reasonable to expect a contribution from them. All we can say is that this policy is strongly needed, but that it will also be a complicated one. It can only be given shape and executed on a regional level, but it should be integrated in a national and European policy. On a regional scale there is a need for institutional development in order to organise the process of policy implementation and decisions about the content of the programme.

A full dressed rural policy aims for the economic development of the rural areas. Agriculture will be an aspect of this policy, but certainly not the most important one. SARACENO (2002) calls the agricultural element the sectorial function of a rural policy. The wider focus should be on the creation of supportive measures to stimulate economic activities in a broad sense. It will especially be important for backward regions and it seems reasonable to finance the policy from the structural funds. In this wider context it is not a part of the CAP, but it is important to integrate agricultural policy with rural policies. Table 2 summarises the different proposed policies and their instruments.

Tab. 2: Policies and instruments: an overview

Policy	Aspects	Instruments or approach	Comments
Sector	Stabilisation	<ul style="list-style-type: none"> <li>Set aside</li> <li>Production limits</li> <li>Income stabilisation fund</li> <li>Risk insurance programmes</li> </ul>	Stabilisation policy will be the last relic of the CAP.
	Income	<ul style="list-style-type: none"> <li>Temporary direct income payments</li> </ul>	This instrument will only be used as a temporary compensation for policy changes
	Food safety and quality	<ul style="list-style-type: none"> <li>A review food safety measures and food quality regulations with respect to practicability and a level playing field.</li> </ul>	This is not only a matter for the EU level and not only for DG Agriculture.
Rural	Environment and landscape	<ul style="list-style-type: none"> <li>European framework</li> <li>National framework</li> <li>Regional policy development and implementation</li> </ul>	On a regional level there will be a need for institutional development in order to bring together those involved in deciding about the design of the region.
	Rural development	<ul style="list-style-type: none"> <li>A package of measures for regional development</li> </ul>	Financing from the structural funds, especially to support backward regions.

## 6 Discussion and conclusions

Agenda 2000 was a small step in the direction of a necessary change of the CAP. Apart from the deepening and extension of the MACSHARRY measures - price decreases to world market levels and direct income payments - Agenda 2000 introduced the rural

development policy. Not enough progress was made in the dairy and beef sector. Environmental and landscape payments were an integral part of rural development and got too little attention. The reform that Agenda 2000 generated was therefore too scanty to give an answer to the reorientation of the farming sector. Much more has to be done.

The sector has two important missions to fulfil in this century. The first is to deliver a contribution to the production of healthy and reliable food in a sustainable ethical accepted way. The second one is to make a contribution to a desirable and vital rural area. Well-organised markets can help us a lot to accomplish these missions, but markets will not do it alone. The experiences with contaminated food, animal welfare standards, genetically modified organisms and environmental regulations do show that the rules of the game have to be redefined. If we want open markets for food the standards should be known as well as the effectiveness of the control system. A balanced public policy should support these aims.

The Mid Term Review (MTR) shows the same direction as Agenda 2000: a further extension of the MACSHARRY approach and going in the direction of direct income support. New is the idea of the farm auditing approach as a condition for direct income payments. The MTR presents no proposal for the dairy sector, which is important for discussions within WTO and the budget limits in the EU. If direct income payments in this sector will get a more important role in this sector this will certainly affect the EU budget and the EU position in the WTO. Neither does the MTR answer the question of the effects on structural development, while it is proposed to limit the payments for large farms and not to bind direct payment to conditions on small farms. Finally the MTR does not define policies with respect to the other functions of agriculture. Are those a by-product of good farming practices?

The 'classic' CAP was aiming for income stability but has been used mainly for income support. This policy was exclusively focussed on the agricultural sector. Also in the years to come the CAP has to play a role in income stabilisation, but not by isolating the European market from the rest of the world and not by isolating the agricultural sector from the rest of the economy. The focus of the new policies is not a matter of the agricultural sector only. While the sector has to play an important role, this can only be done successfully in cooperation with institutions and organisations outside the agricultural sector as well as the public at large. This will be a major change in thinking, designing and implementation of agricultural policy in the EU. 'Classic' policy will become a minor task and new policies will only be successful when they become an integrated part of other policies on a regional, national or European level.

Income support has to be diminished by a gradual lowering of the direct payments and a decrease of price support. The consequences of decreasing income support can be softened by the introduction of environmental and landscape payments, dependent on the region and circumstances of a specific farm. But these payments will certainly not compensate all farmers and there will be no relationship between income decreases caused by decreasing direct payments and the possibilities for ELCP's. Attention to food safety and food quality is necessary to protect and to inform the consumer and at the same time it is an opportunity to enhance the competitive position of the European agricultural sector with respect to third countries. The role of the CAP with respect to a food safety and food quality is limited, because other DG's within the Commission and a number of national ministries will be responsible too for aspects of such a policy. But a critical review on the practicability of regulations and their impact on a level playing field seems a logical role from the perspective of the CAP. A rural development policy has to play a role in integrating policies at a regional level. Rural development can compensate for shrinking farm income by generating alternative employment, and

stimulating farm sector development. Some of the new opportunities for the rural areas can be created in close cooperation with the agricultural sector, in the way the farm protects nature, landscape and the cultural heritage.

The pressures coming from society, EU enlargement and further internationalisation demand a clear answer from politics. The wrong answer will be simply to compensate income losses in the agricultural sector by direct payments. The other wrong answer is that markets will simply give the right solutions. The challenge is to develop a policy to stimulate market participants to take their roles and to organise society in making the right choices with respect to food production and the vitality of the countryside. Ignoring the needs will lead to irreparable damage.

## Annex I

### Structural funds versus rural development under the CAP - A comparison

Structural funds	Rural development under CAP Regulation 1257/1999
<p><b>Objectives</b></p> <p>Objective 1: promoting the development and structural adjustment of regions whose development is lagging behind</p> <p>Objective 2: supporting the economic and social conversion of areas facing structural difficulties</p> <p>Objective 3: supporting the adaptation and modernisation of education, training and employment policies and systems</p>	<p><b>Objectives</b></p> <p>Rural development measures shall accompany and complement other instruments of the CAP and thus contribute to the achievement of the objectives laid down in Article 33 of the Treaty. Rural development measures shall be integrated with measures promoting Objective 1 and accompany the measures supporting Objective 2.</p>
<p><b>Financial provisions</b></p> <p>European Regional Development Fund (ERDF)</p> <p>European Social Fund (ESF)</p> <p>European Agricultural Guidance and Guarantee Fund (EAGGF-Guidance section)</p> <p>Financial Instrument for Fishery Guidance (FIFG)</p>	<p><b>Financial provisions</b></p> <p>European Agricultural Guidance and Guarantee Fund (EAGGF) Guarantee and Guidance section.</p>
<p><b>Budget period 2000-2006</b></p> <p>135,9 billion Euro for Objective 1</p> <p>22,5 billion Euro for Objective 2</p> <p>24,0 billion Euro for Objective 3</p> <p>195,0 billion Euro in Total</p>	<p><b>Budget period 2000-2006</b></p> <p>30,4 billion Euro</p>
<p><b>Implementation</b></p> <p>Finances from the Guidance Section shall form part of the programming for Objective 1 regions.</p> <p>Rural development measures other than those referred to in Article 35 (1) may form part of the Objective 2 regions (see Joint Measures)</p>	<p><b>Implementation</b></p> <p>Rural development plans. Rural development support measures to be applied in one area shall be integrated, whenever possible, into a single plan.</p>
<p><b>Joint Measures</b></p> <p>The EAGGF is the financial instrument supporting the rural development policy, which is considered as the second pillar of the CAP. It finances rural development measures throughout the European Union. Measures will be financed by the Guidance section of the EAGGF in Objective 1 regions (with the exception of compensatory allowances for disadvantaged areas and the three accompanying measures of the CAP<sup>1</sup> [Article 35 (1)]), and elsewhere by the EAGGF-Guarantee section.</p> <p>The EAGGF-Guarantee section is not a Structural Fund, but contributes to the implementation of the new Objective 2. In the areas, Member States can choose whether to integrate rural development measures into the regional development programmes funded jointly with the other Structural Funds, or to incorporate them into a horizontal programme for rural development measures outside Objective 1 areas.</p>	

<sup>1</sup> These accompanying measures are: early retirement; agro-environment measures; afforestation of agricultural land

## Annex II

### Functions and policy aims in the rural area

Function / Policy aims	Nature	Landscape	Cultural heritage
Natural resources	XXX	X	
Habitat flora	XXX	X	
Habitat fauna	XXX	X	
Baiting place for migratory birds	XXX	X	
Residences experiences	XX	XXX	XX
Tourist experiences	XX	XXX	XX
Historical values	X	X	XXX

XXX means an important function for this policy aim

XX means that we expect that a moderate relationship between this function and the policy aim.

X means that there might be a relationship between this function and the policy aim

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## **How could the CAP pillars be balanced for the promotion of a multifunctional European model?<sup>3</sup>**

### *Contents*

- 1 Introduction
- 2 The levels at which the environment is integrated into agriculture
- 3 Ways of integrating the environment into agriculture
- 4 Prospective scenario for the articulation of the two pillars
- 5 The articulation of the two pillars would benefit from clarification
- 6 A re-balancing of budget allocations between the two pillars
- 7 Tools for the future...
- 8 Conclusions

### **1 Introduction**

At the root of strategy in the agricultural sector lies a concern for the maintenance and promotion of the European model of agriculture: as a sector of the economy, European agriculture must be competitive, able to adapt and cover the entire territory of Europe, including regions with special problems. It must contribute to the maintenance and creation of employment, the preservation of the countryside and the protection of nature, injecting greater vitality into the rural world. It must meet the concerns and requirements of consumers in terms of the quality and safety of food products, protection of the environment and defence of animal welfare. It is to this set of objectives that the concept of “multifunctionality” relates.

In order to ensure that these different functions of agriculture are given their full worth, Europe has equipped itself with legislative and financial instruments. The Berlin reform lays down environmental objectives and defines measures to attain them.

The second pillar of the Common Agricultural Policy, “rural development”, has thus been created, the first pillar being market support.

This second pillar is based around three new instruments:

- The rural development regulation, a set of 22 measures available for use for rural development, and which are co-funded by Europe;
- Eco-conditionality, which allows agricultural aid to be made conditional upon meeting environmental requirements;
- Differentiation of aid payments, this being a measure that it is possible to implement in Member States to redirect agricultural aid away from the first pillar

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<sup>3</sup> Paper prepared as a contribution to the Working Group on “The Future Role of Agriculture in Europe” of the Akademie für Raumforschung und Landesplanung (ARL), Hanover 2000-2002



and toward rural development, while limiting the total amount of direct aid paid to farmers.

As an example of this, France, in harmony with the Community system as a whole, has passed a statute, the agricultural reform law, promulgated on 9 July 1999, which acknowledges the multifunctional dimension of agriculture in its first article.

The promotion of this dimension must therefore shape all public agricultural policies. A special tool has also been created in order to redirect agriculture towards a greater multifunctionality. This is the Land Use Contract (*Contrat territorial d'exploitation* - CTE) which provides for adequate remuneration of the various functions society at large expects from agriculture.

To achieve this objective, the CTE encourages farmers to develop holistic operating projects combining socio-economic, environmental and regional goals. The project takes the form of a five-year contract signed by the farmer and the State: the farmer undertakes to abide by a certain number of commitments relating to the expectations of society and to his overall operating project, with the State undertaking in exchange to remunerate him for the programmes he puts in place. Some of these commitments are mandatory for all contracts since they correspond to essential regional goals or issues. For example, it may involve commitments relating to official quality emblems enabling greater value to be added to local products, or farming practices directed at the prevention of erosion if the local region is subject to a high risk of erosion. An agricultural policy board at the level of the territorial département (La Commission Départementale d'Orientation Agricole, CDOA) defines the major goals for the local region, in conjunction with all the representatives of civil society, professional workers and government agencies.

These contracts are co-funded by the European Union and combine for this purpose a number of measures for which the rural development regulations provide.

## **2 The levels at which the environment is integrated into agriculture**

Three theoretical levels can be distinguished at Community level where the integration of the environment into agricultural activity is concerned.

- A level that can be described as “minimal”, which corresponds to obedience to environmental regulations. Below this level, farming activity is harmful to the environment and is open to sanction (the so-called “negative” incentive).
- A level equivalent to “good agricultural practice”, which corresponds to the practices of reasonable farmers in the region concerned.

Farmers must abide by the minimum general requirements in the field of environmental protection without receiving any specific remuneration for doing so. Farmers are obviously obliged to obey restrictive legislative provisions on the use of fertilisers, pesticides, water and, where relevant, the national and regional policy directions relating to good agricultural practice.

- The “amenity” level: when society at large asks farmers to attain objectives of environmental character which go beyond the basic level of good agricultural practice and where, because of this, they must bear a higher level of expenditure or a loss of revenue, society should then provide remuneration for what is a service rendered to the community as a whole.

### **3 Ways of integrating the environment into agriculture**

The “new CAP” has tools that allow these various theoretical levels to be attained.

The role of the CAP in the management of the environment obviously cannot replace environmental regulations. On the other hand, such regulations must be seen to be enforceable and verifiable if they are to play a full role in guiding agricultural activity.

The CAP’s allotted role is not to replace environmental regulations but to supplement them usefully in three ways:

- through its methods for managing aid payments, which contributes to the geographical distribution of farming and therefore the amenities associated with production, doing so in a balanced fashion over the whole of the national territory, adding value to marginal zones;
- through the provision of financial compensation for positive amenities, enabling the generation of production of services for society, which certainly cannot be imposed by regulation;
- through the implementation of a form of eco-conditionality, which may play a leverage role to ensure obedience to the regulations in force, and which will encourage lagging farmers to catch up with the main body.

The implementation of Article 3 of the horizontal regulations may lead in theory to several types of scheme, according to the objectives defined and the options selected, notably:

- definition of a system of requirements and sanctions related to direct aid intended to transfer part of Communal Market Organisations (CMO) funds to rural development measures;
- incentives for obedience to *regulatory* environmental requirements through conditions or sanctions related to direct aid payments (“regulatory eco-conditionality”),
- incentives for obedience to *non-regulatory* environmental measures on the basis of conditions or sanctions related to aid.

The principle of eco-conditionality as applied to aid can thus be seen to be a powerful horizontal tool insofar as it enables regulations, environmental requirements and CAP aid to be coordinated.

In this way, it confers greater legitimacy upon aid under the first pillar and may assist it to survive over time.

### **4 Prospective scenario for the articulation of the two pillars**

The promotion of the European model of agriculture based on multifunctionality in international negotiations and with respect to society at large, can be seen to require in the long run a more structured and balanced approach to the two pillars of the CAP.

#### **4.1 The articulation of the two pillars would benefit from clarification**

At the present time, where agri-environmental issues are concerned, aid payments are calculated on the basis of surface area and according to loss of revenue, additional costs and the financial incentive necessary to encourage farmers to enter into the relevant commitments.

Those commitments relate in theory to services rendered by the farmer to society. In practical terms, they may allow pre-existing practices to continue on the holding or lead to changes in the management of the farm through the adoption of new practices.

As for first pillar aid, its original basis was the provision of support for the income generated by certain types of production. Payment is however increasingly subject to obedience to the conditions governing the granting of such aid, and this makes it possible to influence modes of production, as well as the localisation of agricultural activity.

In connection with the changing nature of the CAP under the pressure generated by a range of constraints to which it is subject – society's demands in the areas of the environment, food safety, international negotiations, especially in the WTO, the widening of the European Union to include the CEECs, and so on – the need to promote a “multifunctional” agriculture is increasingly pressing.

This promotion must be supported by genuine changes in the agricultural world, which must take more account of the environment and social criteria in the management of holdings.

In order to assist the continuation of this movement with greater transparency and effectiveness, the objectives of the two pillars of the CAP would benefit from clarification.

The first pillar, with its philosophy of support for farming income, could have as its assigned task the adding of value to existing schemes by granting favourable market conditions (through aid payments partly linked to production factors) to types of production which meet a minimum standard in terms of “sustainability”. Sustainability could be assessed on the basis of verification of compliance with environmental requirements (which might equally be territorial or social) which would determine whether aid was paid or not for each COM. As a tool, eco-conditionality (possibly extended to social and territorial criteria) would, in this arrangement, be a guarantee that the aid paid under the first pillar was in fact going to farming that met a minimum standard.

The issue where the legitimacy of aid payments is concerned is therefore the positioning of the standard at a level of stringency that is credible: are requirements of regulatory character or do they relate to “good practice” defined at the national, or even regional, level?

The difficulty that arises for this preoccupation with credibility (and therefore the effectiveness of policy in terms of its impact on the environment) is the attainability of the standard for producers.

As a consequence, this arrangement, if it were to be developed, would probably be upgradeable: it would be attainable initially by a substantial fringe group of producers and would then progress in terms of its requirements.

Eventually, we might imagine a framework in which the payment of direct aid under the CAP would be governed by the formal qualification of holdings on the basis of a set of specifications founded on general management requirements taking account of environmental performance.

It is also worth noting that in the theoretical framework for the levels of integration of environmental concerns in agricultural practice, the “minimum”, regulatory level is assumed to be economically neutral. This in turn assumes that holdings not able to meet such requirements are condemned to closure. Given this, we need to look at the fact that

the most “fragile” agricultural holdings are frequently the most “multifunctional”: small holdings, those located in marginal areas, for example. The income support allowed by first pillar aid then takes on its full importance in the context of reinforcement of environmental regulations.

The function of the second pillar would be clearly directed at the following:

- support for systems meeting essential regional requirements, especially in terms of achieving a good fit between the region and its production, notably in areas of exceptional ecological interest;
- support for holdings producing social amenities: over and above the requirements laid down for the payment of direct aid (standard), it must be possible to grant special support for the production of amenities as part of a holistic, sustainable management project for the holding. It must be possible to assess the level of “sustainability” on the basis of indicators or quality intrinsic to the holding: for example, diversified holdings, organic holdings, extensive farming, or farms that are of particular interest due to the employment they generate (as in the case of small holdings).

The issue of the way in which aid may be granted could be reviewed: calculations based on the number of hectares tend to benefit larger holdings and may be a driving force for enlargement.

The rules for the implementation of such aid must in any event be reviewed if the budget for the second pillar is increased, in order to ensure that deployment is made easier (through simplification and, probably, greater regionalisation).

#### **4.2 A rebalancing of budget allocations between the two pillars**

The rebalancing of the pillars has been made possible by the transfer of budget allocations from the first to the second pillar due to the implementation of horizontal instruments: differentiated aid payments and eco-conditionality. This transfer is now possible only up to a limit of 10% of the budget for the first pillar.

While, in theory, differentiation and eco-conditionality may make it possible to transfer funds from the first to the second pillar, it is necessary to establish a distinction here between these two instruments. This is because eco-conditionality has as its goal the protection of the environment (and not the transfer of budget allocations). If this reasoning is pushed to its extreme, the more the eco-conditionality tool is effective in terms of driving the farming community toward environmentally friendly practices, the less numerous would be the penalties and the smaller the transfer of funds from one pillar to the other.

While the design of an aid differentiation scheme may be based on a budget objective of rebalancing the CAP’s pillars, eco-conditionality has as its prime objective the integration of the environment into agriculture and it is difficult to see how it could be compatible with the objective of transferring budget funds between the pillars.

In the eventuality that this possibility of rebalancing the two pillars should gain ground, and if the relative size of the second pillar were to increase, it would nevertheless be prejudicial to reduce the volume of the first pillar sharply in favour of an overdeveloped second pillar.

Aid under the first pillar is totally (guaranteed price levels) or partly (direct aid) coupled to the factors of production. It is frequently said that the high level of price support can lead to excesses. But the productive function itself may also lead to a

number of environmental advantages (countryside, biodiversity, etc.), these are the spin-offs of production.

The reduction, or the elimination of the first pillar in favour of the totally uncoupled aid payments of the second pillar is in this way dangerous and would undoubtedly lead to distortion where the environmental objective is concerned.

This is because with the disappearance of the productive function which could be the result, the supply of such production spin-offs would stop.

However, the dual nature of agricultural production allows economies of scale: the farmer supplies some goods and services whose total cost to him may be less than that which would be generated by the separate production of each.

Detailed targeting of agri-environmental aid payments entails high transaction costs (administrative costs). For example, a programme of support for biodiversity would entail a battery of different measures whose implementation would certainly cost more than a measure that was more comprehensive and partly uncoupled from support for holdings contributing to the maintenance of biodiversity.

Direct aid may also enable targeting of population and regional policies that it is desirable to develop, through the criteria and arrangements for the making of payments. For example, the Suckler Cow Premium Scheme (SCPS) provides for payments subject to constant ceilings in terms of premium rights per territorial department, the effect of this being to maintain in the desired areas extensive dairy farming well suited to the characteristics of soil and climate of the regions concerned.

Certain modes of production that are less profitable but more environmentally friendly may be encouraged. In this way, many extensification level criteria govern the payment of livestock production aid, and an extensification premium is even paid out for livestock production. Moreover, the practice of leaving land fallow must ensure that the soil is maintained and that the environment is protected, if necessary by adding plant cover.

First pillar aid is therefore likely to be an important potential lever for the inclusion of environmental concerns in agriculture. As part of the development of multifunctional agriculture, the negative effects on the environment of excessive productive activity must nevertheless be kept under control to ensure that the pillar enjoys its full legitimacy.

The prospective clarification of the objectives of the two CAP pillars described above, or at least, initially, eco-conditionality, offers a means of making aid under the first pillar “greener” while stabilising the system. (See also the contribution of SUMPSI VIÑAS / BUCKWELL in this volume)

By combining in this way the two objectives of “production” and “protection of the environment” or “sustainability” within the direct aid system, the multifunctional character of the first pillar would be substantially strengthened. This makes it possible:

- to preserve a harmonious distribution of production over the areas concerned, and
- to produce a number of amenities with limited transaction costs.

Alongside this, differentiation is an instrument that could enable reinforcement of the second pillar and/or the generation of budget savings.

## **5 Tools for the future...**

In the system as described above, transaction costs were seen to be one of the factors restricting the development of agricultural policy directed at improving consideration for the environment in agricultural practice.

As for regulations, these require substantial human resources to ensure effective compliance.

While eco-conditionality may be part of the answer insofar as it allows two management systems to be coupled, it also entails the setting up of compliance checks.

Incentives for voluntary moves toward the environmentally-friendly management of agricultural holdings (or product chains) could be a winning strategy for all those involved:

- Firstly, for agricultural professionals, who would thus be enabled to improve their productivity, ensure the long-term survival of their outlets, and add value to the image of the profession in its dealings with society at large,
- For society, through the improvements to the condition of the environment that could arise if these approaches involve a large proportion of agricultural producers (given the extreme fragmentation of agricultural production, only mass take-up is likely to generate any effect in terms of environmental improvement),
- For the consumer, whose confidence in European agricultural production and its “production standard” would be increased,
- For processors and distributors, whose businesses would be made more secure,
- For the authorities, who would be enabled to save on the implementation of restriction-based tools (notably regulations) and by the same token on the associated transaction costs. This latter scenario is also beneficial for producers, who would voluntarily anticipate (at less cost, in theory) measures that could be forced on them by regulation.

The tools for acknowledging such voluntary measures exist but would doubtless benefit from greater development.

Certification is developing to an increasing extent in certain production sectors (grain, fruit and vegetables, for example).

The qualification of holdings, as adapted for the world of agriculture, could make it possible to reach out to a substantial proportion of such holdings, and to acknowledge the value of horizontal, holistic approaches of “rational agriculture” type, if however the technical content of such approaches is common to all those involved.

A strategy based on encouraging this type of approach, for example by means of a regulatory framework, as is the case for “rational agriculture” in France, or other types of incentive, would make it possible to develop synergy and a convergence of resources between the objectives of the Common Agricultural Policy and those of the farming profession.

The break with a production-driven philosophy would then be complete at all levels of the “world of agriculture”, and a new contract would be in place between farmers and society.

## **6 Conclusions**

The CAP has got some tools which can promote the European model for a multifunctional agriculture.

In this respect, the two pillars of the CAP must be promoted, with complementary impacts in terms of integration of the environment into agriculture.

Following on from the reform of 1992, Agenda 2000 provides Member States with the tools to allow the development of the European model for multifunctional agriculture.

In this way, the CAP can be a useful addition to environmental regulations through constraints imposed on production attracting aid and may even go beyond this to the implementation of incentive measures aimed at developing positive, social amenities at regional level.

The recent implementation of these tools in Europe does not however as yet allow any evaluation of their effectiveness or their impact on the condition of the environment, or, at the very least, a modification of farming practices.

It does open the way to promising prospects for the development of a more sustainable agriculture.

Beyond this two balanced CAP pillars, we must imagine how we could promote transparency, quality and food security as a third pillar of the CAP strategy.

## Obstacles and Constraints for a New CAP<sup>3</sup>

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- 2 Obstacles and constraints coming from the new political-institutional scenario of the EU
- 3 Obstacles and constraints coming from lobby pressures
- 4 Obstacles coming from distributional effects of a new CAP
- 5 Obstacles and constraints coming from financial effects of a new CAP
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- 7 Obstacles and constraints coming from the imbalance between EU and Member State (MS) rules (subsidiarity)

### **1 Introduction**

We have tried to order the discussion on obstacles and constraints for a new CAP in six points. Nevertheless, and before a detailed presentation of them, we would like to make some general remarks.

The discussion on agricultural policy is polluted by other agendas, private or public, such as the net-contribution of each Member States to the EU budget or the balance of competencies between different European institutions.

These concerns are relevant. But they should be addressed through specific and explicit measures, and not through the use or abuse of sectoral policies. We should be aware that this is not what was decided by the Fontainebleau summit in 1984.

We have learned some lessons from the previous reforms of the CAP, the MACSHARRY reform of 1992 and the Agenda 2000:

A reform has to be seen as a winning process by ALL contributors. This has been relatively easy to achieve in a context of possible increased expenditure. The transfer of support from consumers to taxpayers, more efficient from an economic point of view, has implied an increase in overall agricultural expenditure. If we take into account a drastic budget restriction (to the current level or even below), an agreement will be more difficult.

Reform proposals have to be balanced. The impact should not be concentrated on some regions. This is, for instance, the major political difficulty with European-level

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<sup>3</sup> Paper prepared as a contribution to the Working Group on “*The future role of agriculture in Europe*” of the Akademie für Raumforschung und Landesplanung (ARL), Hanover, 2000-2002



modulation, the effect of which will be concentrated in the “new German *Länder*” (the former East Germany) and in East Anglia.

Even more, there should never be a rupture with the past but rather an evolution to a more desirable set of policies.

## **2 Obstacles and constraints coming from the new political-institutional scenario of the EU**

In addition to the slowing-down of the adaptive capacity of the Union (see point 7), the approval process will be each time more difficult due to *enlargement*. The Union will no longer be manageable in the same way.

This reinforces the debate on the “*new European governance*”. This debate is just starting, but different actors have different agendas: to increase regional influence, to decrease the margin of manoeuvre for central government, to decrease Brussels competencies, to develop European networks both horizontally and vertically, to increase the Committee of the Regions’ relevance or European Parliament responsibilities or Council competencies.

The current discussions around what is called the “German Proposal” or the “French position” are a good example of the complex mixture of targets and goals, condimented with public-relation aspects. Is it possible at one and the same time to decentralise the core of EU spending (agriculture and regional funds) and to promote a federal status? Is it possible to imagine a federal State with a budget below 0.5% of EU GDP?

## **3 Obstacles and constraints coming from lobby pressures**

Traditionally, the farmers’ unions were the most conservative lobbies on CAP reform. Traditionally, the Agricultural Ministers were conservatives. In order to obtain some reform agreement, it was necessary to promote “Jumbo Councils”, mixing farming and Foreign Affairs Ministers.

The Agenda 2000 represented a major change in this scenario. The Agricultural Ministers were more reform-oriented than the European Summit. Agricultural Conservatives entered into a joint venture with Finance Ministers in order to limit and delay a CAP reform.

Now, and this is a new element in the debate, other lobbies such as environmentalists, consumers, animal-welfare partisans and hunters are becoming increasingly relevant. The Council of Agricultural Ministers is no longer a farmers’ club but has become a more accurate representation of European society.

This change is the result of a double evolution, of society and of policy. On one hand, the economic and political influence of farmers is decreasing, even in rural communities. On the other, direct payments have made support to farmers more transparent and, therefore, have fed the debate on the legitimacy of agricultural spending.

These multiple actors open an interesting field for promoting reforms but also make the precise perception of the real expectations of European society more difficult.

Today’s situation is a good example of this confusion. It is said that:

- Farmers should be competitive in a more open economy.

- Farmers have to respect a minimum set of rules, as far as environment and animal welfare is concerned.
- Special rules have to apply on transport of live animals.
- But we cannot easily impose our own and internal rules on other countries (principle of extraterritoriality).
- Consumers have to understand that they have to pay a “correct” price for healthy food. A high standard of quality has to be guaranteed for food offered to consumers.
- But the farming industry has to collaborate with the macroeconomic target of keeping inflation under control.
- In addition, with enlargement a larger share of the population will spend a significant part of their income on food and will be highly sensitive to an increase in food prices.
- Agricultural expenditure has to be controlled or even to decrease.

Today the major obstacles do not come from lobbies but from the lack of political will to continue on the same track in the process of building Europe. The relevance of budget issues is the most spectacular demonstration of this identity crisis. When you do not know why you are paying, you always complain that you are paying too much.

#### **4 Obstacles coming from distributional effects of a new CAP**

One of the more difficult-to-justify aspects of the CAP is the distribution of the benefits and costs it generates. This can be looked at in many different ways: the distribution between commodities, between farms of different sizes, between producers, consumers and taxpayers and between Member States. The latter distribution is of greatest political significance. In fact, one of the major obstacles to reconverting current agricultural policy into a more integrated rural policy is the distributional effects among Member States (MS) provoked by reducing the first pillar and increasing the second. As a consequence of this sort of CAP reform, some countries would become winners whereas others would become losers, which would increase the difficulty of a Council agreement on CAP reform.

Up to now (MACSHARRY 1992, Agenda 2000), this redistribution issue was mitigated by the overall increase in EU agricultural expenditure. “Loser” Member States were losing parts of their shares in total expenditure, but the decided increase in direct payments represented an increase in agricultural expenditure in all Member States. The final Berlin discussion showed that this approach has found its own limits.

Certainly the full implementation of such a new CAP has the potential to alter greatly the distribution of support among MS. But this is not just an obstacle but also a benefit. It is a benefit because it is reasonable to expect that the EU’s largest spending policy should make a positive contribution to fulfilling the general objectives underlined by the Treaties in general, and the economic and social cohesion target in particular. If this cannot be done, it reflects either that the political institutions of the EU are not functioning as they should, or there is no real determination on the part of the Member States to achieve one of the most important objectives of the EU.

The main effects of reducing individual transfers, resulting from this sort of CAP reform, will be felt by the larger commercial farmers producing price-supported products and currently receiving large direct payments. Unless such farmers engage in the significant provision of environmental public goods and services, they will not

extract as much benefit from the new common agricultural and rural policy as under the current CAP. Such farmers are to be found in all Member States, but their relative weight varies greatly across them. In several Member States, they are influencing the position of some farmers' organisations against CAP reform in general and modulation in particular.

## **5 Obstacles and constraints coming from financial effects of a new CAP**

It is often argued that agricultural expenditure has to be capped in order to allow other EU policies to develop. As Delors has demonstrated with the regional funds, it is the lack of political will which limits the development of EU policies. There are budget margins in the current financial rules in order to allow such moves. Where is the political will?

Nevertheless, and as we have already underlined, in the future one of the most important constraints to the new CAP will be the EU budgetary constraint. The mid/long-term budgetary availability in real terms for CAP reform will stabilise or could even decrease. Given this budgetary constraint, the increase of the budget for the second pillar would need the reduction of the budget for the first pillar. This reduction could be achieved by:

- modulation;
- eco-conditionality;
- co-financing direct payments (first pillar);
- cutting direct payments.

The Agenda 2000 has already included the first two options to transfer EU funds within the agricultural budget from first pillar to second pillar: modulation and eco-conditionality. Concerning modulation, most MS have not applied it, nor do they appear to have any intention of doing so. The second option, eco-conditionality, is, in practice, very difficult to implement.

If Member States have an ambitious target for the Code of Good Practices, far more than what is foreseen in the current legislation, they are seriously limiting the impact of agro-environment support, which can only compensate farmers' activities in addition to good agricultural practices. This means that the farming community will lose public support, that farmers in some regions could suffer from market-competition distortion from other regions or from outside the Union, that protection of the environment would be seen by some farmers only as a constraint and not also as an opportunity.

Moreover, in the case of federal Member States, such as Spain or Germany, the regional governments also have a legal capacity to implement eco-conditionality, which makes it much more difficult.

The third option would allow to confront some of the most important EU concerns with:

- a greater responsibility of MS in the management of CAP direct payments,
- a reduction of EU agricultural budget share in total EU budget,
- a re-balancing of financial balance in some MS (net contributors).

Co-financing first pillar has some risks. The most important is re-nationalisation, as in this option the MS could claim some rules to allow national differences in applying first-pillar measures. Another risk is the relaxation of national contributions for all or some first-pillar measures by establishing a maximum amount of direct aid, a fixed EU contribution and an optional national contribution. Such an approach would imply another sort of re-nationalisation as finally the farmers could also receive different levels of direct aid across MS.

Co-financing first pillar would be unacceptable to poorer MS, especially to Accession Countries, but also to the MS receiving payments from the Cohesion Fund. In order to lessen this problem, it would be interesting to establish different rates of national co-financing according to the economic development level of Member States.

Co-financing will not be useful in the WTO context. Both co-financed or EU-financed amber and blue box are under discussion in this international context.

Therefore, in order to reduce the budget of the first pillar the most effective way would be cutting the CAP direct payments. Nevertheless, we can consider some different ways to reduce the CAP direct payments:

- Degressivity or linear reduction of direct payments. This option does not provoke distributional effects and is very easy to apply (English modulation).
- Progressive reduction of direct payments. This option provokes distributional effects and can be very complex to apply (French modulation).
- Reduction of arable-area payments in those EU regions where cereal yields are above the European average. This option would have positive effects on economic cohesion and would be very easy to apply but difficult to agree in the Council (see last paragraph of point 6)

Moving EU agricultural budget from first pillar to second pillar would reduce the total amount of EU budget allocated to the CAP by increasing the co-financing of agricultural expenditure on behalf of the Member States (MS). However, this change would work against countries that are in a weaker economic position, which in turn would act against the principle of cohesion. These countries would oppose such change, unless the level of Community co-financing of the second pillar were very high (80–90%) or new flexibility were introduced in the national co-financing, allowing, for instance, an increased share of private financing.

## **6 Obstacles and constraints coming from higher transaction costs of the new CAP**

One of the most important obstacles to moving the current CAP towards a more integrated rural policy (moving from first pillar to second pillar) is the higher transaction costs of the new CAP.

The two key elements of the new CAP are agro-environmental payments and rural-development incentives, both included in the new Rural Development Regulation (second pillar). Concerning the first element, to strictly establish public payments for the provision of landscapes, environmental and cultural goods and services, it would be necessary to fulfil two conditions: first, to pay separately for each public service or good provided by farmers according to its value (which gives rise to very complex problems of valuing environmental goods and services), and, second, to verify that farmers have really provided the specified public goods and services for which they are going to

receive the corresponding payments. Both questions need a lot of foregoing studies, designing, bargaining, monitoring and enforcement costs. Research results show that the transaction costs of agro-environmental programmes vary between 5% (some general and light agro-environmental programmes) and 30% (some ESA schemes). Concerning the transaction-costs constraint, the question is: who has to pay transaction costs? At present these costs are paid by the Member States, but this adds further financial problems to the MS when applying agro-environmental programmes

But there is not just a financial problem. Most of the MS' agricultural administrations are not well prepared to apply these kinds of programmes on a large scale. The organisation, structure and human resources of the agricultural administrations should be significantly adjusted to adapt them to the new CAP requirements (not only in agro-environmental programmes, but also applying eco-conditionality and new environmental less favoured areas (LFA) scheme). In many countries we have identified a lack of co-ordination between agricultural and environmental administration in applying agro-environmental measures. In other words, it is not just the farmers who have problems adapting to the new CAP, but also the officials and administrations are failing to adjust.

Concerning rural-development incentives, the problem is the capability and initiative of rural actors to generate projects and investments for on-farm and off-farm activities (diversification). So far the experience of the EU LEADER initiative shows that a lot of work and capacity building is necessary to change the conservative attitudes of rural people and encourage them to undertake new activities and rural affairs.

Moreover, the evaluation of the LEADER initiative shows that, in spite of intensive technical work and meetings with rural people carried out by the Local Action Groups, very few projects have been undertaken.

We still see difficulties to implement the multifunctionality in a sound way. The concept of multifunctionality raises some critical questions: To what extent does society demand non-food agricultural functions? What amount should be paid for non-food agricultural functions and in what way?

Regarding the first question, the way of knowing whether society really wants these public goods and services is by determining the willingness to pay for them. Studies carried out so far have produced a wide range of results depending on the country and public goods or services provided by farming. In the case of Spain, the conclusions of several studies on the provision of certain public goods and services (natural values, biodiversity, landscape) by farming show that the willingness to pay is minimal. These results suggest that the demand of Spanish society for non-food agricultural functions is very low.

Regarding the question how to pay for non-food agricultural functions, there are two answers based on two different methods of applying the concept of multifunctionality. The first consists in paying for all activities as a whole by means of CAP direct payments (first pillar). This way of operating is not very correct and really only attempts to justify the current amount, or even higher amounts, of CAP direct payments. The implicit reasoning is as follows: without CAP direct payments there would be no agriculture and without agriculture there would be no maintenance of the landscape, nor conservation of the rural environment, etc. The main problem is that this method of applying the concept of multifunctionality does not ensure that farmers provide the public goods and services that constitute the non-food functions of agriculture.

The second method of applying the principle of multifunctionality consists in paying for each function separately once it has been verified that the function in question has indeed been carried out. By treating each activity separately, it is possible to tackle the question of payment in a more correct way. Thus, the food function of agriculture is rewarded by the market and therefore, at least from a theoretical point of view, does not require public funding. On the other hand, non-food functions of agriculture as provision of environmental public goods or maintenance of marginal rural areas are not rewarded by the market and thus require public funding. Nevertheless, private initiative should participate in co-financing payments to farmers whenever possible (environmental goods or services in which it is possible to apply the exclusion principle, for example entrance fees for visitors to a National Park). Nevertheless, fixing the level of these payments and checking that provision of environmental goods has really been delivered implies high transaction costs.

In general terms we can say the first method of implementation is defended by farmers' organisations and the national and regional agrarian administrations, whereas the second one is defended by environmental organisations, rural development networks (LEADER programmes) and some groups of academics. The first method implies consolidating the first pillar of the CAP, whereas the second method leads to reducing the budget of the first pillar and increasing the budget allocated to the second pillar. This explains why many MS are rejecting this second way to implement multifunctionality as the first pillar is fully financed by Brussels, whereas the second pillar is only partly financed by Brussels.

The shift towards area payments (by the 1992 Reform and reinforced by the Agenda 2000) was the first step towards a more territorial approach to rural policy, instead of a purely commodity- and production-based approach. Farmers must receive public support for what they do on the land, not for the commodities they produce. But decoupling needs to be taken further, removing the current massive bias in favour of intensive, high-yielding systems. In that sense, the Spanish Ministry of Agriculture (MAPA) is preparing a proposal on arable-area payments based on a common payment for all of the EU, and thus independent of regional yield of cereals. This change from the current differentiated area payments (partly decoupled) to common area payments (fully decoupled) would contribute to the social cohesion and extensification of farming, which is environmentally beneficial. But such a proposal will be difficult to accept by the MS with the highest yields of cereals (e.g. France) due to the negative distributional effects (losers). A more realistic option would be to reduce the current differences in the arable-area payments across EU countries/regions.

## **7 Obstacles and constraints coming from the imbalance between EU and MS rules (principle of subsidiarity)**

Changes are needed at all levels. Many of the current problems lie in the design of EU regulations, but national and regional implementation also plays a significant role. For example, under existing arable regulations it is possible for the Member States to establish national rules for set-aside. Equally, the afforestation of farmland could be implemented in a far more targeted and environmentally-sensitive manner under the existing EU regulation. The Agenda 2000 has introduced eco-conditionality, which is applied in a different way by Member States.

However, an excess or abuse of the principle of subsidiarity leads to a lack of "environmental cohesion" across the EU, with some Member States making greater

efforts than others to address environmental issues. EU regulations should give clearer guidance and require more specific commitments to prevent this “two-speed” situation. For example, applying eco-conditionality to all support regimes should be obligatory, and a clear guideline and timetable for implementation, monitoring and revision of measures should be established at EU level. Targeting of afforestation programmes to prevent negative impacts on habitats and to deliver specific environmental benefits should also be obligatory. The funding for the CAP is common to all, so the rules should ensure that environmental integration is equal as far as possible across all countries.

In some cases the abuse of the principle of subsidiarity can provoke a significant distortion of competition among Member States. For instance, the way in which the Berlin Summit passed the eco-conditionality is a clear example. The farmers from countries applying eco-conditionality in a stricter way will be in a worse position to compete than farmers from countries applying eco-conditionality with a lighter touch.

In other cases the abuse of the principle of subsidiarity leads to CAP re-nationalisation. For instance, the way in which the Berlin Summit adopted modulation is an example of this perverse effect (re-nationalisation). This sort of abuse of the principle of subsidiarity normally happens when the Council is unable to reach an agreement on some measure (in this case modulation).

The ideal scenario to balance common and national rules for a new CAP could be:

- Agreement between Member States (including accession countries) on the need for a new direction for EU rural policies, based on the principles of sustainability. At the moment there is no agreement (the last attempt at Cork failed). As a consequence, reforms are hopelessly piecemeal and there is always resistance.
- Agreement on a broad strategy of reform over 10–15 years, to be applied to all regimes of the CAP, involving removal of mechanisms which promote and/or maintain intensive farming systems and which conflict with the aims of agro-environment programmes and/or environmental legislation; re-balancing of support in favour of low-intensity production; shift of financial resources towards agro-environment and sustainable rural development.
- At Member State and regional levels, comprehensive review of the environmental effects and tendencies of agricultural land/resource use, leading to strategies with quantified targets for addressing issues. Cross-compliance, agro-environment payments and rural-development aids should be implemented with the aim of delivering these specific, quantified targets. Implementation of mainstream CAP measures would be adjusted to prevent conflicts with environmental objectives and measures.

## The WTO Negotiation on Agriculture and the Common Agricultural Policy<sup>2</sup>

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### 1 Introduction

This note briefly discusses the linkages between current WTO negotiations on agriculture and the on-going CAP reform process. Before discussing the implications for the CAP of the possible outcome of current negotiations, an assessment of the impact of the implementation of the 1994 GATT “Agreement on Agriculture” (AoA) for the agriculture and food sector in the EU and for the CAP is offered. Then, the linkages between the CAP reform process and the current negotiations are discussed. Finally, the issues currently on the agenda of the WTO negotiations are identified and the main elements of a possible final agreement briefly discussed.

### 2 The 1994 GATT “Agreement on agriculture” and the CAP

The “*domestic support*” commitment has not been a problem, neither for the EU nor for (hardly) any other country. This constraint not being binding for the EU is the result of the “blue box”, and of the fact that price support in the EU significantly declined between the “base period” (1986-88) and 1995 (i.e. the decrease in the difference between domestic and world prices). However, even if the “blue box” did not exist, in the first five years of the implementation period (those for which EU notifications to the WTO are available) support in the EU as measured by the AMS would have stayed within the limits dictated by the Agreement (Figure 1). The same should be true for year 2000 and beyond. Agenda 2000 determined a further shift of support from the “amber box” to the “blue box”; in 2002 (when Agenda 2000 decisions for the cereals and beef

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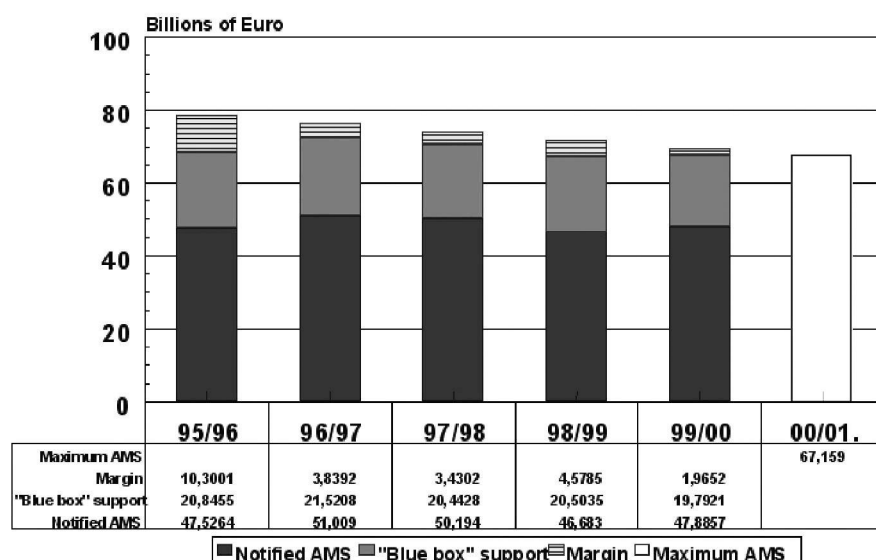
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<sup>2</sup> Paper prepared in the Summer 2002 as a contribution to the Working Group on “*The future role of agriculture in Europe:*” of the Akademie für Raumforschung und Landesplanung (ARL), Hanover, 2000-2202. An earlier version of this paper was presented at the Executive Seminar on *The WTO and International Trade Prospects*, University of California, Agricultural Issues Center, Sacramento, December 9-10, 2001. Financial support received by the Italian Ministry for Education, University and Research is gratefully acknowledged (Scientific Research Program of National Importance on “*WTO negotiations on agriculture and the reform of the Common Agricultural Policy of the European Union*”).



sectors are fully implemented) this shift should determine a 20% reduction (9 billion €) of the Aggregate Measurement of Support (AMS) of the EU and in an increase of the support in the “blue box” by a smaller amount.

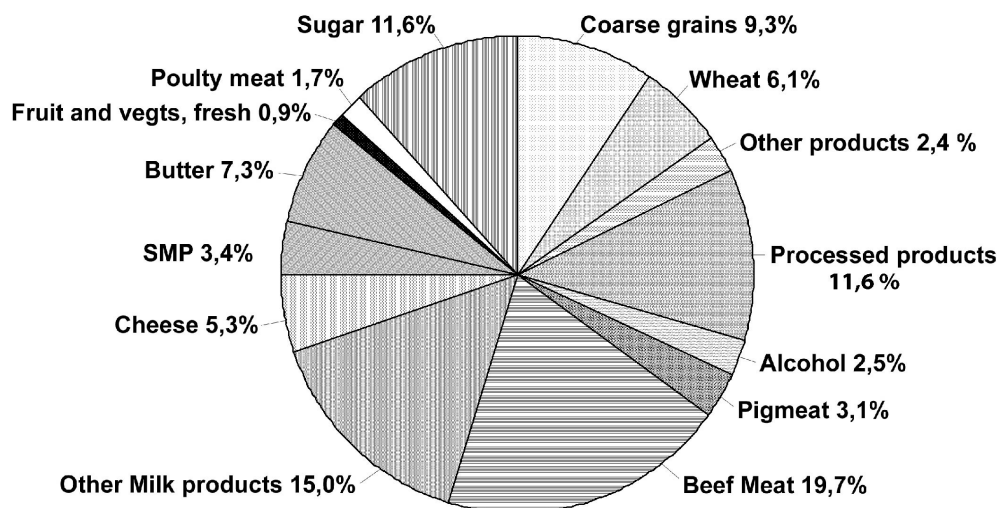
Fig. 1: European Union. Domestic support reduction commitments: notified AMS, support falling in the “blue box” and margin left with respect to the maximum allowed AMS.



“Market access” commitments did not imply a significant reduction of EU border protection, except for Tariff Reduced Quotas (TRQs) in specific markets. “Tariffication” of EU variable levies did not lower market protection mainly because of the high level of the levies in the “base period” *vis a vis* those in 1995. As a result of the Blair House agreement, the EU essentially kept using variable levies for cereals and rice, although giving up the option to impose higher tariffs (allowed by its high binding tariffs). For fresh fruit and vegetables, the new “entry price” system does not look different enough from the old “reference price” system to induce a significant change either in the level of protection, or in its “quality”. Tariff reductions over the implementation period were not a problem because of both the “dirt” in the tariffs resulting from the “tariffication” of variable levies, and the reduction of the distance between domestic and world prices for many commodities which occurred between the “base period” and 1995. However, TRQs were indeed a problem for dairy products and had a non marginal impact in all meat markets.

“Export competition” commitments proved to be those most often binding for the EU. The AoA had a limiting effect on EU subsidised exports in at least one of the six years of the implementation period for rice, cheese, “other milk products” (these account for almost 50% of total EU export subsidies in dairy products; Figure 2), poultry, beef, olive oil, wine, fresh fruit and vegetables (Tables 1 and 2). In several cases, including poultry meats, wine and fresh fruit and vegetables, increased non subsidised exports took place when the constraint on the volume of subsidised exports became binding.

Fig. 2: European Union - Export subsidy expenditure by product (1995-2000)



Tab. 1: European Union - Actual subsidized exports as a percentage of the maximum subsidized exports allowed under the GATT “Agreement on agriculture” (1995-2000)

	1995	1996	1997	1998	1999	2000	1995-2000
<b>Wheat and wheat flour</b>	13,6	75,0	72,4	83,3	99,8	70,7	67,0
<b>Coarse grains</b>	48,2	90,3	69,9	123,3	161,0	65,3	91,6
<b>Rice</b>	54,4	144,2	50,2	99,0	100,8	99,2	99,7
<b>Rapeseed</b>	0,0	0,0	0,0	0,0	0,0	0,0	0,0
<b>Olive oil</b>	96,4	103,7	72,6	0,0	0,0	0,0	48,3
<b>Sugar</b>	55,0	80,1	117,8	111,5	73,0	69,3	84,3
<b>Butter and butter oil</b>	30,0	58,7	37,4	38,0	46,5	49,4	43,1
<b>Skim milk powder</b>	72,0	83,6	56,6	74,5	146,4	47,0	79,7
<b>Cheese</b>	99,0	99,1	84,3	62,3	89,2	94,8	88,5
<b>Other milk products</b>	97,6	100,0	102,0	90,7	110,0	91,1	98,6
<b>Beef meat</b>	89,6	109,6	93,7	76,1	86,6	57,8	86,9
<b>Pigmeat</b>	69,8	54,8	42,3	153,8	149,8	29,0	82,6
<b>Poultry meat</b>	96,2	99,2	105,0	99,4	100,8	91,1	98,8
<b>Eggs</b>	75,4	56,3	90,1	104,1	96,5	84,8	83,8
<b>Wine</b>	75,8	110,7	114,6	97,9	98,9	98,9	99,2
<b>Fruit and vegetables (fresh)</b>	98,8	98,6	98,1	93,0	110,9	98,0	99,5
<b>Fruit and vegetables (processed)</b>	53,5	80,7	60,7	55,8	72,4	53,1	62,8
<b>Raw tobacco</b>	5,9	1,1	0,0	0,0	0,0	0,0	1,5
<b>Alcohol</b>	32,1	79,2	74,0	88,2	166,8	77,7	84,6

Source: EU notifications to WTO

Tab. 2: European Union. - End of the year subsidised exports “credit” as a percentage of the Uruguay round subsidised exports reduction commitments up to that year. (1995-1999)

	1995	1996	1997	1998	1999
<b>Wheat and wheat flour</b>	86,4	56,6	47,6	40,6	33,6
<b>Coarse grains</b>	51,8	31,2	30,9	18,2	3,8
<b>Rice</b>	45,6	1,6	0,2	0,4	0,2
<b>Rapeseed</b>	100,0	100,0	100,0	100,0	100,0
<b>Olive oil</b>	3,6	0,0	8,8	30,3	43,1
<b>Sugar</b>	45,0	32,7	16,5	9,9	13,0
<b>Butter and butter oil</b>	70,0	55,9	58,1	59,0	58,0
<b>Skim milk powder</b>	28,0	22,3	29,1	28,2	14,5
<b>Cheese</b>	1,0	0,9	5,6	13,0	12,6
<b>Other milk products</b>	2,4	1,2	0,2	2,3	0,1
<b>Beef meat</b>	10,4	0,7	2,4	7,3	8,4
<b>Pigmeat</b>	30,2	37,6	44,0	21,0	7,9
<b>Poultry meat</b>	3,8	2,3	0,1	0,2	0,0
<b>Eggs</b>	24,6	33,9	26,3	19,2	16,4
<b>Wine</b>	24,2	7,1	0,2	0,6	0,7
<b>Fruit and vegetables (fresh)</b>	1,2	1,3	1,5	2,8	0,3
<b>Fruit and vegetables (processed)</b>	46,5	33,2	35,2	37,3	35,5
<b>Raw tobacco</b>	94,1	96,4	97,5	98,0	98,3
<b>Alcohol</b>	67,9	44,8	38,8	32,4	14,1

Source: EU notifications to WTO

When the GATT AoA was reached, in December 1993, the stand of the Commission (as well as of many others) was that the Agreement was fully “compatible” with the CAP, i.e. it did not entail introducing any binding constraint. However, as some had predicted, the Agreement did in fact introduce binding constraints for the CAP in several sectors. Subsidised export commitments will likely be binding beyond 2000/01 (when “credits” cannot be used any more and subsidised exports must remain within the commitments spelled out in the “schedules” for the last year of the implementation period) for rice, dairy products, wine and fresh fruit and vegetables.<sup>3</sup> If Agenda 2000 had not taken place, the EU, starting in 2001, would very likely have had to face binding constraints on its subsidised exports of wheat, coarse grains, beef and poultry as well. Large increases in EU intervention stocks as a result of the AoA took place for coarse grains (in 1998 and 1999) and dairy products (from 1996 to 2000 and, again, in 2002). In general, the commitment on export subsidy expenditure has not been a problem (due to the market reorientation of most EU domestic prices), apart from rice, wine, alcohol, and “other processed products” and, to a lesser extent, sugar (leading to the reduction of quotas “A” + “B”) (Tables 3 and 4).

<sup>3</sup> Export subsidies for olive oil have not been used since 1998 without any explicit policy change.

Tab. 3: European Union. - Actual export subsidy expenditure as a percentage of the maximum export subsidy expenditure allowed under the GATT “Agreement on agriculture” (1995-2000)

	1995	1996	1997	1998	1999	2000	1995-2000
<b>Wheat and wheat flour</b>	5,1	15,1	9,3	29,5	34,1	8,4	16,0
<b>Coarse grains</b>	18,9	26,0	19,8	60,1	63,0	18,3	33,3
<b>Rice</b>	55,5	141,3	68,6	58,3	65,3	87,8	80,0
<b>Rapeseed</b>	0,0	0,0	0,0	0,0	0,0	0,0	27,1
<b>Olive oil</b>	77,8	52,2	11,2	0,0	0,0	0,0	0,0
<b>Sugar</b>	51,7	76,5	121,8	134,1	86,1	74,7	89,8
<b>Butter and butter oil</b>	18,4	42,3	25,6	25,4	32,2	35,7	29,6
<b>Skim milk powder</b>	34,7	44,8	32,9	58,4	111,9	9,5	48,0
<b>Cheese</b>	73,7	49,9	35,7	33,7	60,1	69,7	53,7
<b>Other milk products</b>	71,0	76,3	84,6	91,6	118,6	58,8	83,0
<b>Beef meat</b>	78,4	85,4	50,8	42,3	52,3	30,6	59,0
<b>Pigmeat</b>	34,8	26,4	29,8	154,6	115,3	17,7	61,0
<b>Poultry meat</b>	85,0	57,4	64,5	82,4	75,3	62,6	71,5
<b>Eggs</b>	21,3	12,0	24,1	34,3	29,9	18,5	23,1
<b>Wine</b>	88,9	110,6	74,1	63,0	61,2	60,5	78,3
<b>Fruit and vegetables (fresh)</b>	90,7	85,1	38,4	50,4	64,4	51,1	64,9
<b>Fruit and vegetables (processed)</b>	92,6	89,5	53,3	45,5	60,4	47,0	66,7
<b>Raw tobacco</b>	18,8	4,0	0,0	0,0	0,0	0,0	5,3
<b>Alcohol</b>	36,3	89,6	85,6	106,1	208,0	99,5	99,8
<b>Other processed products</b>	68,5	86,2	92,7	107	151,3	99,8	97,6
<b>Total</b>	<b>41,6</b>	<b>51,1</b>	<b>43,5</b>	<b>58,2</b>	<b>67,6</b>	<b>37,1</b>	<b>49,5</b>

Source: EU notifications to WTO.

The costs deriving from compliance with the GATT commitments in the sectors where these were binding have been borne by less competitive farmers, those selling their products at lower prices, and by taxpayers (when increased downward pressure on prices on the domestic markets deriving from the reduction in subsidised exports and TRQs led to a rise in intervention stocks). The distribution of costs between farmers and taxpayers has not been uniform among different sectors. While intervention prices for dairy products remained relatively high and profitable, intervention mechanisms for wine, fresh fruit and vegetables lost strength over time as a result of lower institutional prices and significantly reduced volumes eligible for the intervention. This meant that increased downward pressure on domestic prices as a result of the binding GATT commitments in some sectors did not find a lower limit in the intervention prices, while this was the case in others. This implied an uneven distribution across sectors of the costs of complying with binding GATT commitments among taxpayers and farmers.

Tab. 4: European Union. - End of the year export subsidy expenditure “credit” as a percentage of the Uruguay round export subsidy expenditure reduction commitments up to that year. (1995-1999)

	1995	1996	1997	1998	1999
<b>Wheat and wheat flour</b>	94,9	90,1	90,3	86,1	82,9
<b>Coarse grains</b>	81,1	77,7	78,5	69,9	64,4
<b>Rice</b>	44,5	3,0	11,8	18,5	21,2
<b>Rapeseed</b>	100,0	100,0	100,0	100,0	100,0
<b>Olive oil</b>	22,2	34,6	51,4	62,3	68,7
<b>Sugar</b>	48,3	36,3	18,3	6,6	7,8
<b>Butter and butter oil</b>	81,6	70,0	71,4	72,1	71,4
<b>Skim milk powder</b>	65,3	60,4	62,5	57,8	45,9
<b>Cheese</b>	26,3	37,7	45,7	50,1	48,5
<b>Other milk products</b>	29,0	26,4	23,0	19,7	13,2
<b>Beef meat</b>	21,6	18,3	27,8	34,4	36,6
<b>Pigmeat</b>	65,2	69,3	69,6	42,0	32,3
<b>Poultry meat</b>	15,0	28,3	30,5	27,7	27,2
<b>Eggs</b>	78,7	83,2	80,9	77,5	76,2
<b>Wine</b>	11,1	0,6	8,5	14,8	18,9
<b>Fruit and vegetables (fresh)</b>	9,3	12,0	27,4	32,4	32,9
<b>Fruit and vegetables (processed)</b>	7,4	8,9	20,7	28,3	30,2
<b>Raw tobacco</b>	81,2	88,1	91,6	93,2	94,2
<b>Alcohol</b>	63,7	37,9	30,6	22,4	0,1
<b>Other processed products</b>	31,5	23,1	18,3	12,9	2,6

Source: EU notifications to WTO.

The EU is not only the first world importer of food products, but the second largest exporter. The benefits deriving to EU agriculture from other countries implementing the agreement should not be underestimated. These gains mainly derive from the more “serene” trade environment (rather than from trade liberalisation, which was very limited) as a result of the 1994 agreement, which meant lower risks and, as a result, lower transaction costs. These benefits have been harvested by the more competitive exporting segments of the agri-food sector in the EU.

### 3 The WTO negotiation on agriculture: where are we today?

Negotiations on agriculture started in March 2000 as a result of Article 20 of the 1994 AoA. Failure (not because of agriculture) to agree in December 1999 in the WTO Ministerial Conference in Seattle on launching a “full round”, involving many negotiating tables, resulted in the negotiation on agriculture focusing before the November 2001 Ministerial conference in Doha on a “minimalist” agenda. This was mainly due to (a) the letter of the text of Article 20, (b) a widely shared concern to try to avoid creating additional problems to the credibility of WTO through a confrontation in

the negotiation on agriculture, and (c) the limited possible trade offs in the negotiation due to the fact that each country was forced to assess benefits and costs of the agreements reached based only on concessions and gains in the only two negotiation tables (“agriculture” and “services”) that were operating.

During the first year of the negotiations countries tabled their (starting) proposals. Although these contributions need not to be evaluated *per se*, but as part of the negotiation process, in general they were less ideologically extreme and less openly confrontational compared to those produced in the first steps of the Uruguay round. This was mainly due (a) to better market conditions (more profitable prices and a much more serene trade climate) than in the late 80s; (b) to the existence of a path (that designed by the 1994 AoA) which could be used as an initial reference framework for the definition of the steps to be agreed upon in the negotiation, and, (c) again, to the shared concern to avoid a heated and loud confrontation in the delicate stage for multilateral trade negotiations resulting from the failure to reach an agreement in the Ministerial Conference in Seattle.

In March 2001 countries agreed to devote the first part of “Phase 2” of the negotiations (which ended in March 2002) to the discussion of a list of specific issues: tariff rate quota administration; tariffs; amber box; export subsidies; export credits; state trading enterprises; export restrictions; food security; food safety; rural development. The list included (explicitly or potentially) all the elements of the AoA, plus some (but not all) of the issues which have been raised by some of the main actors in recent years: export credits, state trading enterprises, export restrictions, and “multifunctionality” (the latter hiding behind the less disturbing label of “rural development”).

The Ministerial Conference in Doha, Qatar, on November 9-13, 2001 led to the launch of a new round, sending the much needed message that the *impasse* resulting from the failure to reach an agreement in Seattle had been overcome. However, the cost paid for agreeing on a new round (or for not taking any chance of a new round not being agreed upon) is the limited agenda of the new negotiations, which does not include any of the potentially most controversial issues.

With respect to the on-going negotiations on agriculture at the time, the agreement reached in Doha did not introduce any significant change, but rather confirmed the validity of the preliminary work carried out in the negotiations started in March 2000, including working toward an agreement whose framework replicates that of the 1994 AoA. With respect to other relevant and potentially highly controversial issues, such as national standards to protect human, animal or plant life and health, or labour and environmental standards, the Declaration did not really go much beyond reaffirming what little had been agreed at the end of the Uruguay round.

With the beginning of Phase III of the negotiation in March 2002 the preparatory work devoted to the tabling and discussion of initial positions and statements ended and the real negotiations which will eventually lead to the text of the agreement started. The timetable which has been agreed upon is to have an “overview paper” on the status of the negotiations prepared by the Chair of the Committee on Agriculture by mid December 2002 and a draft of the “modalities”, the technical document describing in detail the content of the agreement, ready by January 2003. This should lead to a final text of the “modalities” approved by the Committee by the end of March 2003, and the country “schedules”, the legal documents describing the actual commitments deriving to each country from the “modalities”, approved by the 5<sup>th</sup> Ministerial Conference in September. Whether this tight schedule can be honoured is something which remains to be seen. Many believe that the new US Farm Bill has made it even less likely that an

agreement can be reached in such a short period of time; this is because there is a need to internalise the shock to the negotiation produced by the severe turn in the agricultural policies in the US, a shock which cannot be absorbed in few months. Let us now briefly review what the negotiation has been focusing on.

### **Domestic support**

Negotiations are focusing on (a) the elimination of the “blue box”, (b) a redefinition of the “green box”, and (c) how and by how much to reduce support in the “amber box”. Many countries call for the elimination of the “blue box”. While some countries call for a smaller “green box” (i.e. for more stringent rules defining policies exempt from support reduction commitments), other countries (including the EU) call for a larger one, to accommodate policy instruments aimed at achieving relevant “non trade concerns”, including food security, animal welfare and concerns related to the “multifunctionality” of agriculture. Proposals have been made to define the commitments based on a Measurement of Support calculated on a product by product basis, rather than on an aggregate basis as in the 1994 AoA, and to define reduction commitments using current AMS as a reference, rather than that in the “base period” of the AoA.

### **Market access**

Negotiations are focusing on (a) how to reduce tariffs; what to do with (b) Tariff Reduced Quotas (TRQs), and (c) the Special Safeguard Clause (SSC); (d) limiting implicit market protection by State Trading Enterprises (STEs). Proposals on how to reduce tariffs include those to further reduce legally binding tariffs; reduce currently applied (rather than binding) tariffs; introduce a maximum tariff level (to eliminate tariff picks); eliminate all trade distortions (including export subsidies) in specific markets (the *zero-for-zero* option); reduce tariffs using a formula which induces a reduction in tariff dispersion (i.e. a formula which reduces higher tariffs by larger percentages); reduce tariffs using a formula which causes a reduction in tariff escalation (i.e. a reduction in the widespread tendency to impose on processed products higher tariffs than those imposed on raw products, in order to protect the domestic processing industry). Negotiations on TRQs will focus on their administration (when the TRQ is binding there are rents associated to imports within the quota, and allocation mechanisms become sensitive; many TRQs are not filled and, in some cases, exporters claim this is a result, not of adverse economic conditions, but, rather, of how the quotas are administered) and an increase in their volume. The AoA includes a SSC for products which have been subject to “tariffication” which allows for increased protection when imports expand above certain thresholds, or prices drop below certain levels. Exporting countries feel that the SSC limits their ability to profit from the increased competitiveness of their exports and should be eliminated, or its use drastically limited.

### **Export competition**

EU actual export subsidy expenditure accounts for 4/5 of the total (across all countries); EU export subsidy expenditure allowed by the AoA equals 75% of the total. Negotiations are focusing on (a) the reduction or elimination of export subsidies and on limiting implicit export subsidisation by the means of (b) subsidised export credit, (c) the activities of exporting STEs and (d) “unfair” food aid practices.

### **Special and Differential Treatment**

Negotiations will focus (a) on additional provisions specifically addressing the needs of developing and least developed countries, including special concessions and less

demanding commitments, and (b) on improving the 1994 “Decision on Possible Negative Effects of the Reform Programme on Least Developed and Net Food Importing Developing Countries”.

### **Other issues**

Despite the “minimalist” character of the agenda of the agricultural negotiations, it does contain a few issues which cannot be seen as part of a “refinement” of the framework designed with the AoA. These include policies limiting exports, and those allowing food quality markets to develop. Some food importing countries would like export limiting policies (which make prices on the world market increase) to be made illegal, or their use strictly regulated. The EU is proposing to multilaterally recognise and enforce regulations limiting the use of certain geographical denominations identifying high quality foods whose production is closely connected with a specific location. The Doha Ministerial Declaration calls for a negotiation within the Council for Trade-Related Aspects of Intellectual Property Rights (TRIPS) “for the establishment of a system of notification and registration of geographical indications for wines and spirits” by the end of 2003 and opens the door for the extension of the results of this negotiation to other agriculture and food products besides wines and spirits.

### **What’s left out**

Among the issues which were raised before the WTO Ministerial Conference in Seattle as items to be on the agenda of the new negotiations on agriculture which are not going to be seriously considered in the negotiations, in the sense that there is a shared consensus that the negotiation will not lead to the introduction of effective disciplines, the most important probably are (a) food safety and (b) the use of trade policies to counteract distortions in competitiveness induced by differences in national regulations concerning labour and environmental standards.

## **4 What’s at stake for the CAP?**

If we look at the CAP as we know it today (i.e. including the full implementation of Agenda 2000, but without considering neither changes which will derive from the Mid Term Review of Agenda 2000 or those which might be needed in order for the enlargement to the Central and Eastern European Countries to take place), the elements of the WTO negotiations which are most sensitive for the CAP can be summarised as follows:

### **Domestic support**

A further reduction of the maximum AMS *as defined in the 1994 AoA* is not expected to create any need to modify the CAP. The AMS for the EU in 1999/00 was just below 70% of the maximum allowed by the GATT agreement in 2000/01 and beyond; in addition, the full implementation of Agenda 2000 determined an additional shift of support from the “amber” to the “blue box”.

The pressure on the CAP in the domestic support area of the negotiations comes from two fronts. The first is the need to keep EU current and future “partially decoupled” direct payments<sup>4</sup> to farmers exempt from the reduction commitments; the second is keeping reduction commitments linked to an AMS, rather than to a measurement of support calculated on a product by product basis. If direct payments have to be included

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<sup>4</sup> With the possible exception of current slaughter premiums for beef, which appear hard to defend as not being highly “coupled”.



in an *enlarged-as-much-as-needed* “green box”, they need to be modified to become (a) less trade distorting (more “decoupled”) and/or (b) linked to goals different from supporting agricultural production (such as environmental protection or animal welfare).

In this respect, the decision to fully “decouple”, although for a limited period of time, most direct payments to farms receiving less than € 1,250 per year is promising and potentially far reaching.

A shift to a product by product measurement of the support to be subject to reduction commitments would induce the need to modify the CAP in those sectors where very little change has been introduced in the recent past (dairy products would be a typical case in point). The actual relevance of such a move for the CAP would depend on the choices made on how to measure support, and on the reference “base period” to be considered to calculate the reductions.

WTO negotiations on reducing domestic support is providing additional pressure and setting a time horizon<sup>5</sup> for the EU to modify the instrumentation of the CAP, and, more specifically, all direct payments to farmers. How these will be changed will be determined by a decision making process which will be mainly driven by domestic concerns and will result from the resolution of conflicts involving opposing domestic interests. In this respect WTO negotiations on domestic support commitments will play mainly the role of an external force indicated as (but not really being...) one of the main reasons for the change.

In the recent past EU domestic wheat prices have been very close to those prevailing on international markets. This makes compulsory set aside hard to justify. However, it is worth noting that if compulsory set aside were set equal to zero, current direct payments for COP crops would become no more eligible for inclusion in the “blue box” (they would lose the “production limiting” feature which makes them exempt from GATT domestic support reduction commitments).

## **Market access**

The likely reduction of binding tariffs which will result from the new agreement is not expected to determine a significant reduction in protection for EU domestic markets. This is due to the market reorientation of many domestic prices (including grains, meats, fresh fruit and vegetables, table wine) resulting from the domestic policy reform process in the EU, with additional help from a weak Euro.

If expanded TRQs are part of the new Agreement they will potentially constitute a serious concern for the EU in those markets where domestic prices are still significantly higher than those prevailing on the world market (dairy products are, once more, the typical example).

If concerns have to be raised with respect to EU market protection, attention should be given not so much to the agreement at the end of the WTO negotiations, but to (a) EU enlargement and (b) current and future preferential trade agreements. These will likely prove to be much more relevant in providing increased access to EU markets than the tariff reduction and increased TRQs deriving from the WTO agreement.

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<sup>5</sup> The “peace clause” (Article 13 of the AoA) expires on December 31 2003, when all agricultural policies which are legitimate under the AoA but do not conform to general WTO rules will be no longer exempt from countervailing and retaliatory actions. The Doha Ministerial Declaration calls for the negotiations on agriculture to be completed by March 2003, with all countries producing their draft “schedules”, based on the agreement reached, “no later than the date of the Fifth Session Ministerial Conference”, which will take place in Cancun, Mexico, in September 2003.

## **Export competition**

Further reduction in subsidised exports and export subsidy expenditure would likely create minor problems in the sectors where the full implementation of Agenda 2000, coupled with the weak Euro, has driven EU domestic prices close to those prevailing on world markets (this has been the case of wheat, for example). If we forget for a moment the market impact of the BSE crisis, lower institutional prices and lower feed grain prices were expected to considerably reduce the distance between domestic and international prices for all meats. On the contrary, further reductions in subsidised exports will induce significant problems (a) in those sectors where domestic prices are still much higher than international ones (such as dairy products and sugar), and (b) in all other sectors, in marginal farms (and areas) unable to compete at world market prices.

## **5 The US Farm Security and Rural Investment (FSRI) Act, the Agenda 2000 Mid Term Review and the WTO negotiations**

The approval of the FSRI Act has impacted the WTO negotiations in many ways. First, the dramatic increase, with respect to the FAIR Act, of direct payments to farmers made the position of the US in the negotiation on domestic support reduction commitments much more conservative, more preoccupied to defend increased domestic support at home than to try to make other countries reduce the domestic support they provide their farmers. Second, expectations for limited liberalisation of domestic support policies, which are highly concentrated in a small number of developed countries, strongly reduces the willingness of other countries to consider accepting to liberalise their policies in other areas, such as export subsidisation and market access, strongly reducing the (already limited) expected potential liberalising effect of the final agreement as a whole. Third, the policy choice in the US provided very much needed new ammunition to those opposing for their own interests domestic policy reforms in other developed countries, which have now good ground to oppose a reduction in domestic support (*why should we do it, when “even the US” is moving in the opposite direction? Why do you want to reduce our competitiveness with respect to the US farmers?*)

The re-introduction of generous deficiency payments linked to reference prices, expected in most years to be higher than market prices, and the update in acreage and yields, makes for the US a significant additional reduction of the AMS and the redefinition of policies exempt from reduction commitments a very sensitive component of the negotiation. Most countries aligned on the vast and differentiated front of those committed to go after a significant liberalisation of domestic policies are pointing out to the “cynical hypocrisy” of the US stand and are not going to easily (and quickly) give up on their quest for a far reaching agreement.

Hence, the impact of the FSRI Act on the WTO negotiation is much stronger than that linked to its direct effect on the US stand in the negotiation itself.

In July 2002 the EU Commission tabled its proposal for the Agenda 2000 Mid Term Review. The proposal goes well beyond the minor adjustments one would expect from a mid term assessment of the policy changes introduced in 1999 with Agenda 2000; it is, in fact, a proposal for a radical redesign of the policy instrumentation of the CAP. However, the history of the CAP tells us that the proposals by the Commission are never accepted by the Council of Ministers; we can reasonably expect the final outcome of the tense negotiation which has just started will likely be much more conservative than the proposal by the Commission.

Nevertheless, it is certainly worth assessing the proposal from the point of view of the WTO negotiations. The main features of the proposal are: a 5.9% reduction of the intervention prices for cereals; a 50% reduction of the intervention price for rice; a further decoupling of all direct payments for the beef sector; and a reduction of all payments to farmers by 3% per year for 6-7 years, with the resources freed being used for what the Commission and the farmers refer to as “rural development” policies. In addition to (and, not surprisingly, separately from) these policy adjustments, the Commission proposed the replacement of all direct payments to farmers with one single farm “income support” payment, based on historical payments to the farm, irrespective of what is grown, but made conditional to the farm complying with environmental, food safety, and animal health and welfare standards. This means the decoupling of all forms of support provided to farmers by the CAP as we know it today.

Let us consider the proposal for the policy adjustments first, separately from that to decouple all direct payments. The lower intervention prices for cereals and rice and the decoupling of the payments for the beef sector only would (a) reduce the EU AMS and (b) help the realignment of EU domestic prices to world prices, reducing the pressure for intensification of production and contributing to compensate the negative effect of a stronger Euro on the international competitiveness of EU agricultural products; in turn, this would reduce the need for both, export subsidies and market protection.

In addition, if the Council opts for rejecting the Commission’s proposal for a full decoupling of all direct payments to farmers but retains the cross-compliance to environmental standards as a condition to receive direct payments as we know them today, these will become much more easy to defend as eligible for exemption from domestic support reduction commitments in a negotiation on the elimination of the blue box and on the contemporaneous partial redesign of the green one.

The EU is genuinely moving toward incorporating environmental protection goals in the CAP. Largely as a result of domestic concerns, the EU seems ready to introduce or strengthen cross compliance requirements related to farming practices as a condition to obtain direct payments. What appears to be less clear is whether farmers recognise this as a genuine strategic choice, or whether they see it just as a way to make them keep the support they have been granted in the past, “circumventing” domestic pressure to significantly reduce both such support and its undesirable effects on the environment (both seen as no longer socially acceptable). In other words, there might be a serious communication problem between European society at large and farmers, with the latter looking at environmental cross compliance constraints and at payments to induce action on their part to protect the environment as a way to keep a high level of support without really having to change the way they farm.

Of course, if the Council of Ministers agreed on accepting the Commission’s proposal for a full decoupling of all forms of CAP direct payments, these payments would be easily defensible as having minimal trade distorting effects and as being motivated by (genuine) non trade concerns, such as environmental protection, food safety and animal welfare and health domestic concerns.

In any case, the chances of the most liberalising components of the package proposed by the Commission being accepted by the Council are strongly reduced by the characteristics of the agricultural policy package approved on the other side of the Atlantic.

## **6 The WTO negotiations on agriculture: what may the outcome look like?**

Trying to anticipate what the final agreement of current WTO negotiations on agriculture may look like is clearly a difficult and risky exercise. The new round being characterised by a relatively “minimalist” agenda considerably reduces the possibility of a far reaching agreement. Many factors will influence the negotiations and its conclusion, the most obvious ones being the policy changes which have taken place and those which are expected to take place in the near future in some of the main players; China now being a member of WTO (which is expected to lend political weight to at least some of the issues of specific interest for developing countries); unexpected market developments; and the prevailing climate in international relations (one of the factors leading to the conclusion of the Uruguay round in 1993 was the on-going joint multilateral military effort in operation “Desert Storm”).

There are three main conclusions to be drawn from how the negotiations proceeded and eventually ended in the Uruguay round which can be useful in trying to forecast what may happen in the current negotiations. *First*, the distance between the starting negotiation positions and the content of the agreement eventually reached may be quite large. *Second*, despite the multilateral nature of WTO negotiations, many elements of the eventual agreement were in the Uruguay Round largely the result of bilateral deals struck between the US and the EU. *Third*, contrary to what many believe, the EU agreed on the conclusion of the round only when the agreement was shaped in such a way to be considered fully acceptable from the point of view of its implications for the CAP. In other words, the MACSHARRY reform was “written in Bruxelles”, nor in Geneva or Washington, and it was the AoA which had to be shaped, as needed, to conform to what the EU felt acceptable.

With this in mind, the main elements of the agreement at the end of the negotiations might look as follows:

### **Domestic support**

The “blue box” will be eliminated, but the “green box” will be enlarged as much as needed to include EU direct payments to farmers in use at the time the agreement is reached (i.e. they may be somewhat different from those we know today, for example significantly more “decoupled”, and/or associated to stricter environmental cross compliance conditions). Reduction commitments will again be defined on the basis of an Aggregate Measurement of Support (not on a product by product basis). The extent by which domestic support will be further reduced is clearly severely limited by the provisions of the FSRI Act.

### **Market access**

Tariffs will be subject to a significant reduction (having as a reference the binding levels, not currently applied tariffs), which will lower the degree of market protection with respect to that existing in the reference “base period” of the AoA (i.e. the new agreement will take the “dirt” and the “water” out of the binding tariffs). If a reduction rule similar to that used in the Uruguay round is chosen, then higher percentage reductions might be agreed upon; if, on the contrary, the formula used determines a reduction of the higher tariffs by a larger percentage, then the overall average reduction will be lower. TRQs will likely be increased.

## **Export competition**

Export subsidies will be further reduced based on a mechanism which will likely be not very different from that used in the AoA. Food aid, export credit policies and exporting STEs will be subject to somehow stricter and more effective rules (but the agreement will not go so far as to make export credits and trading by STEs subject to reduction commitments based on their export subsidy equivalent).

## **Other issues**

Export limiting policies will either become illegal or subjected to strict rules. An agreement on the sensitive issue (not only for the EU) of the multilateral recognition of rules limiting the use of “denominations of origin” will be reached, but its content and effectiveness are hard to predict. On the contrary, it is unlikely that an agreement will be reached on allowing payments to farmers to compensate for stricter standards to protect animal welfare; this derives from the potentially far reaching consequences to other areas that such an agreement would have (different environmental standards and working conditions are the first to come to mind). Although “food safety” is among the issues to be addressed in the negotiations on agriculture, it is very unlikely that a meaningful and effective agreement will be reached on how to improve on the 1994 Agreement on Sanitary and Phytosanitary Measures to deal with the trade implications of different national food safety standards.

The main achievement of the 1994 AoA was “to bring agriculture into the GATT”, while its impact in terms of trade liberalisation remained fairly small; on the contrary, the new agreement will induce a significant liberalisation of agricultural trade, at least with respect to the distortions existing in the base period of the AoA (i.e. years 1986-88). However, it is hard to assess how much this liberalisation will be the result of the WTO agreement, and how much it will derive from policy reform processes autonomously decided by many of the countries whose policy interventions were distorting trade the most. Whatever the answer to this question, the new agreement will move the limits of what countries can do to support domestic agriculture further inward, making policy U-turns toward higher protection impossible in the future.

## **7 Concluding remarks**

Although recent policy developments in the United States have seriously reduced the already relatively slim chances of a far reaching WTO agreement on agriculture, the outcome of the on-going negotiations is still likely to induce the need for significant adjustments in the CAP. This need is mainly limited to (a) changing the nature of direct payments to farmers to make them compatible with the new domestic support reduction commitments, and (b) reforming the CAP in those sectors where policy changes in the 90s were minor or nil (e.g. dairy products).

The policy changes which can be foreseen as a result of the likely ending of the WTO negotiations on agriculture seem to be compatible with what the EU has been saying it should do (but, so far, it has not been in a condition to do) to bring agricultural policies more into line with the role agriculture plays in EU society and economy today.

Moreover, policy changes which can be foreseen as a result of the likely conclusion of the WTO negotiations on agriculture seem to go in the same direction, but are of a much smaller order of magnitude, than those needed to make the current CAP financially compatible with the enlargement to Central and Eastern European Countries.

## **The future of EU agricultural and rural policy from the perspective of CEE candidate countries<sup>1</sup>**

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### **1 Eastward enlargement: a turning point in EU history?**

Eastward enlargement of the EU is the most challenging event for the Community since its establishment. The new candidate-countries group is the largest single enlargement group in EU history. It is a very heterogeneous group by economic and social standards, and it is also a group of countries with relatively large rural and agricultural sectors. Adaptation by this large group of new members requires significant changes in EU policies and institutional structures. In many aspects, eastward enlargement plays an important role as a mobilizing factor for accelerating institutional changes in the EU, which should be undertaken anyway. It is especially true in relation to the CAP and rural policy.

The eastward enlargement is not only the accession of 10 or 12 new members to the existing EU-15; it is a real integration process requiring mutual adjustment. The adjustment is not symmetrical; there are much more profound and fundamental changes on the side of the CEECs, which should adopt *acquis communautaire*, and build institutional structures necessary for functioning in the EU economic and political system. Necessary adjustments on the EU side in relation to imminent enlargement concentrate on CAP and structural policies. J. Swinnen used the term “minimal-change-to-meet-the-critical-constraints” to describe previous CAP reforms (SWINNEN, 2001). There are several circumstances pressing for more than “minimal-change reform” of the CAP in next few years. The most important are as follows:

- budget constraints related to enlargement,
- WTO pressure to reduce EU agricultural protectionism,
- growing concerns over food safety and the environmental aspects of agricultural activity,

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<sup>1</sup> This paper was prepared as a contribution to the Working Group on “The Future Role of Agriculture in Europe of the Akademie für Raumforschung und Landesplanung (ARL), Hanover, Germany, 2000-2002. The paper was written in 2002 but some revisions to the text were made in June 2003.

- emerging new paradigms of rural development and rural policy,

The earliest opportunity for introducing the CAP and CAP-related reforms will be in 2003-2004. It is not only an opportunity: it is also a necessity. What determines this necessity and opportunity?

- In 2002 a mid-term review of the implementation of Agenda 2000 was issued and some corrections to the existing CAP were proposed;
- The term of Commissioner FISCHLER runs out in January 2005 and he seems highly motivated to propose significant reforms to the CAP before the end of his term;
- At the Nice, Goteborg and Laeken Council meetings, 2004 was mentioned as the possible time for accepting new members from the CEECs. On December 14-15, 2001 the Laeken Council meeting listed 10 candidate countries, including 8 countries from Central and Eastern Europe, which were invited for negotiations about accession in 2004. The 10 candidate countries finished accession negotiations at the end of 2002.<sup>2</sup>
- In 2003 the Peace Clause accepted under UR AoA will end.
- WTO negotiations will start in Cancun in September 2003

Eastward enlargement, including 10 CEECs, will change the size of the EU, in terms of both population and area, by one third.<sup>3</sup> The main dimensions of the EU will change as follows:

1. Population: from 372.7 million to 477.9 million (by 28.2%)
2. Area: from 3.1 million square kilometers to 4.2 million square kilometers (by 35.5%)
3. Agricultural area: from 135.3 million hectares to 195.5 million hectares (by 44.5%)
4. Agricultural employment: from 7.5 million to 17.8 million (by 137.3%)

Until the end of 2002, no significant changes to CAP or structural policies had been proposed by the EU authorities in conjunction with the eastward enlargement.<sup>4</sup> The lack of CAP reforms before 2006 is explained with the argument that such a move would complicate and even delay the enlargement. There are minor changes only in the EU agricultural-policy measures in the support packages offered to the new members. These proposals were presented in the EU documents related to negotiations with candidate countries, issued in January and April 2002. The main points of interest in these proposals are:

- Offering to the new members from CEE a direct-payment aid for agricultural producers, starting from 25% of the present EU level combined with a 10-year phasing-in period;
- Putting more emphasis on rural development in the allocation of financial resources from the EAGGF. In the EU proposal, over 50% was allocated to the second pillar;

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<sup>2</sup> The European Council decided that 10 applicant countries will join the EU on May 1<sup>st</sup> 2004.

<sup>3</sup> The 10 CEEC candidate countries are: Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia and Slovenia. Due to very the varied progress in preparations for EU accession among CEECs, it is expected that in 2004 only 8 countries from Central and Eastern Europe will join the EU: Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia and Slovenia.

<sup>4</sup> During preparation of the revised version of this paper, a mid-term review of CAP ("The Common Agricultural Policy – An Evolving Policy") was published. This paper refers in some parts to this document.

- Some additional agricultural and rural support measures were added to the existing list of EU measures:
  - support for semi-subsistence farms undergoing restructuring (€ 750 per farm/year),<sup>5</sup> simplified system for distributing direct payments (for all users of agricultural land),
  - support for establishing producer groups,
  - support for advisory and extension service related to agriculture and rural development.
- New members can continue agricultural and rural support using the measures selected earlier for the SAPARD program; they can also add other measures from Reg. 1257/1999 for constructing Rural Development Plans.
- Access to the LEADER+ program for new members from CEE is very limited, due to the short programming period. The accession countries can select one of the two opportunities linked with LEADER+: the first one is the training program, preparing for future participation in LEADER activities, and the second one refers to the establishment of pilot Local Action Groups.

Basic questions which should be discussed in relation to the eastward EU enlargement in connection with agriculture and rural areas:

- 1) Are the goals and interests of the candidate countries in relation to CAP or CARPE (Common Agricultural and Rural Policies for Europe) identical or at least similar?
- 2) Do the outcomes of the transformation period significantly differentiate the interests of particular groups of farmers in CEECs towards the future structure of CAP?
- 3) What kind of changes in the CAP would be desired, taking into account special conditions existing in agriculture and in rural areas in CEECs?
- 4) How serious, and in what issues, are the interests and expectations of present members and candidate countries divergent in relation to the future CAP (or CARPE)?
- 5) What are the main experiences from the association and pre-accession periods which should be utilized in preparing CARPE for an enlarged EU?
- 6) Is the eastward EU enlargement a special factor influencing WTO talks on agricultural trade and protectionism?

## **2 Heterogeneity of the candidate countries group**

Countries which have applied for membership of the European Union form a highly diversified and heterogeneous group. The most important differences relate to the following features and areas:

- a. the level of economic development, measured by GDP per capita
- b. the performance of the economy during the transition period
- c. progress in the systemic changes in the economy
- d. the role of agriculture in the overall economy

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<sup>5</sup> During negotiations this amount per farm was increased to € 1,250,-.



- e. the structure of the agrarian sector before transformation and at the end of the 1990s
- f. the degree of “market orientation” among farmers, or commercialization of farm production
- g. competitiveness of agriculture in comparison with the EU
- h. the role of agriculture in the rural economy and society.

GDP per capita in the accession countries ranges from over € 18,000 in Cyprus and € 16,000 in Slovenia to € 5,400 in Bulgaria and € 6,000 in Romania.<sup>6</sup> There are also significant changes in respect of advancement in economic reforms in this group of countries. The most advanced are: Slovenia, Czech Republic, Hungary, Poland and Slovakia; less advanced in economic transformation are: Romania and Bulgaria.

The average share of agriculture in GDP in CEECs (10) is 6%, while in EU it is less than 2%, and varies from 14.5% in Bulgaria and 12.6% in Romania to 3.2% in Slovenia and 3% in Poland. As a result of systemic transformation and agricultural policies, agricultural production dropped to 30-40 % of pre-transition levels in the Baltic countries, to 70% in Hungary and 90% in Poland.

In the '90s the highest economic growth was achieved in Poland and the lowest in Bulgaria, Romania and in the Baltic republics. Until the end of the '90s Bulgaria, Romania and the Baltic republics had not reached the pre-transformation level of GDP.

There are also big differences in the rates of unemployment in the countries under consideration: from 42% in Romania, 19.6% in Lithuania, 18.8% in Poland to 5.1% in the Czech Rep. and 6.5% in Hungary. In all countries with a high rate of unemployment, a significant proportion of unemployed people live in rural areas. One of the most important causes of the high levels of unemployment was the restructured and privatized farming sector. Reduction of employment in agriculture during the transition period has been at its greatest in Hungary (by 70%) and in the Czech Republic (by 60%). Agricultural employment increased in the '90s in Romania and Bulgaria. In Poland agricultural employment has remained almost unchanged since 1990. In Hungary, Czech Republic, Slovakia and Estonia, post-socialist transformation has given the agricultural sector a chance to reduce employment, increase productivity and improve farm structure. In these countries, labor productivity in agriculture is higher than GDP per capita (DAVIDOVA; BUCKWELL 2000). The situation in other post-socialist countries is different. Agricultural and rural sectors in these countries have absorbed part of the labor force freed by the industrial sector.<sup>7</sup> Differentiation among CEECs in relation to agricultural employment, labor productivity and overmanning of agriculture should be taken into consideration in choosing agricultural and rural policies after accession of these countries to the EU.

The present structure of the farming sector in CEECs is very diversified. This is due to the pre-transformation structure and different privatization strategies during the transition period. Before transformation most of the agricultural land was in the co-operative and state sectors in all CEECs except Poland and Slovenia. In Hungary, Slovakia, Czech Republic and Lithuania, over 60% of agricultural land was in the co-operative sector and around 30% in the state-farm sector. Before 1990 the state-farm

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<sup>6</sup> GDP in purchasing power

<sup>7</sup> “During transition the poorer countries use agriculture as a buffer against high industrial unemployment and to ensure food supplies through subsistence farming. In such circumstances, people stay in agriculture or in some cases come back to agriculture from industry in times of recession. This maintains (or increases) the overmanning of the sector and results in low labor productivity.” (DAVIDOVA; BUCKWELL 2000)

sector was at its biggest in Bulgaria (90%) and in Estonia (50%). Most of the CEECs chose restitution as the main procedure for the privatization of land. Poland is an exception. In Poland 20% of the land which was previously in the state farm sector has been leased mostly to the new private operators. In the case of CEECs, privatization through restitution, privatization, voucher distribution and even through sale does not mean that collective or state farms are becoming private individual holdings. The so-called Farm Individualization Index (SWINNEN 2000) is over 80% in Poland and Latvia and below 50% in Slovakia, Czech Republic and Bulgaria. This index is especially low in Slovakia, where it does not exceed 5%.

CEECs differ significantly in relation to the agricultural land concentration ratio. The land concentration ratio, measured by the percentage of agricultural land in the biggest 10% of farms, is at its highest in: Slovakia (97%), Hungary (92%), Bulgaria (90%) and Czech Republic (82%). The lowest rate is in Latvia (20%) and Lithuania (30%). This concentration ratio in the EU-15 is 40%. In countries with a high concentration of land in large farms, a tendency can be observed to downsize them through division into smaller units (LERMAN 2000).

The results of transformation of agriculture in CEECs, especially in agrarian structures and in the levels of agricultural production, have great significance for selecting priorities linked to the future CAP:

- all CEECs have sufficient production potential and are interested in increasing agricultural production;
- countries with large commercial farms and a high concentration rate of land in these farms would be interested in the continuation of traditional price- and income-support CAP (pillar I);
- countries with a large rural population and prevailing small-farm agriculture would be more interested in establishing a well-balanced agricultural and rural policy, emphasizing structural change and regional development (reallocation between pillar I and II of CAP);
- differentiation of interests in particular forms of CAP or CARPE could be noticed also between groups of farmers or rural dwellers.

*Nota bene:* In the CEECs, little attention is placed on considering the future, alternative or desired type of agricultural and rural policy for the EU. The attention of the candidate countries is focused on preparations for the existing CAP. Following the publication of an EU proposal for agricultural and rural support for the CEECs after accession, the discussion has been dominated by the expected results of the EU proposal for the competitive position of agriculture in the CEECs and overall benefits for the agricultural sector and rural economy.

### **3 The experiences from the association and pre-accession periods**

Adjustment processes to the EU conditions during this period have been concentrated on trade issues and institution building, including *acquis communautaire* adoption. The CEECs signed the association agreement with the EU (Europe Agreement) in the first half of the '90s. This agreement was intended to build asymmetrical trade conditions favourable for post-socialist countries. In practice, it was quite the opposite, especially in the agro-food trade. Agro-food exports from the CEECs to the EU increased twofold between 1988 and 1998, while EU exports to CEECs increased almost tenfold. The net trade balance for the EU has changed from a negative € 1 billion to a positive € 2 billion

(SWINNEN 2001). In the case of Poland, agro-food exports from Poland to EU increased by 25% in the '90s, while exports from EU to Poland increased by 600% in this period.<sup>8</sup> The total EU trade surplus with Poland amounted to € 11.4 billion in 1999. Polish and other CEECs exporters have also faced growing competition from EU exporters on the markets of the former Soviet republics. This was a distorted competition since the EU exporters were supported with export subsidies while the CEECs exporters were not. This experience in agro-food trade between EU and CEECs in the '90s has caused fears among farmers in CEECs about their position on the Single Market after enlargement. The very low level of direct-payments support offered by the European Commission to the farmers from CEECs also contributes to their insecure position after enlargement. In such a context, it is not surprising that many farmers in CEECs are Euro-skeptics.

Since the beginning of 2000, all 12 candidate countries have been able to use the EU funds devoted to three pre-accession programs: PHARE, ISPA and SAPARD. The total amount of money available for implementation of pre-accession programs is almost € 3.5 billion annually. Poland, as the biggest state among candidate countries, receives € 920 million per year, out of which € 170 million is for the SAPARD program. Pre-accession programs should be devoted to supporting the candidate countries in their preparations for EU membership. All three programs are based on similar principles to the EU structural programs. They need the same institutions and procedures for their implementation as those existing in the EU. Pre-accession programs should support the institution building and experience accumulation necessary for the future utilization of the much bigger funds that will be available to CEECs after enlargement.

There is growing frustration in the candidate countries caused by the delays and difficulties in implementation of pre-accession programs, especially SAPARD. Necessary institutional arrangements for these programs are complex and costly. A delay of over two years in implementing the SAPARD program in some candidate countries (Poland, Romania, Hungary) has been caused partly by the late establishment of a legal framework and delayed decisions on the part of the European Commission. Complicated procedures as well as high and very detailed requirements related to the implementation of pre-accession funds have been criticized both by the candidate countries and by some EU bodies, including the Court of Auditors.

Implementation of pre-accession programs in CEECs – in my opinion – should be regarded, at least partly, as a missed opportunity. These programs have not achieved the major goals for which they were originally designed. It was assumed that in the years before accession (2000-2004) the flow of money under pre-accession programs would support the modernization of farms and food-processing firms, contribute to rural development by investment in rural infrastructure, by implementing village renewal and agro-environmental projects, and help in building a solid institutional basis for future EU agricultural, rural and regional programs. It has not happened yet, at least in some of the candidate countries. The failure of pre-accession programs threatens the successful adjustment of the new members after accession. The main consequences of the delayed implementation of pre-accession funds are as follows:

- the delay in institution building for future EU programs and funds will reduce the absorption capacity for these funds in the new members;
- a part of the EU aid offered to the CEECs will be lost;

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<sup>8</sup> An additional Protocol to the Europe Agreement concerning agricultural products entered into force in January 2001. According to this protocol, 91% of traditional EU agricultural imports from Poland are duty-free, while 43% of EU agricultural exports to Poland are exempted from duties. The negotiations concerning more sensitive sectors and processed agricultural products are ongoing (Regular, 2001)

- most pre-accession aid will be spent during two first years after accession and may “crowd out” the resources available under the EU programs (structural and rural) due to the co-financing problem;<sup>9</sup>
- dissatisfaction and demobilization of people involved in preparing pre-accession programs and projects during first years of the pre-accession period.

A report on “What went wrong with the pre-accession programs?” should be prepared as quickly as possible by EU authorities and the candidate countries in order to use these lessons and experiences to facilitate easier adjustment of the CEECs to EU conditions and for careful and profound analysis of these conditions. My personal – provisional – conclusion with regard to this aspect is: “The EU does not show the necessary flexibility and adaptability to the problems and specific conditions existing in the CEECs on its way to the enlarged Community. Eastward enlargement is treated by the EU as an accession process, not as real integration.”

An almost 10-year history of preparations in the CEECs for EU membership has delivered important lessons, which are instructive for the future adjustment of the CEECs to EU conditions:

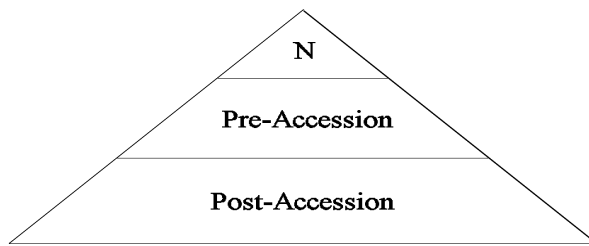
- There are many distances and disparities between candidate countries and present EU members; the most important one is related to institutional structures (“institutional gap”). Institutions matter, but institution building is expensive, takes a lot of time and also requires human capital of the best quality.<sup>10</sup>
- The conditions established for membership in the EU for candidate countries are aimed at the institutional compatibility of political, social and economic systems in CEECs with the system in place in the EU. Therefore, preparations for EU membership should concentrate on institution building.
- In the '90s, the CEECs entered “dual systemic transformation”: first, to the democratic system and market economy, second, to the specific institutional system of the EU. It is an extremely complex process of historical significance. There is a “synergy effect” in this “dual systemic transformation”.
- In the Agenda 2000 we can find the opinion that the first group of CEECs to be invited for negotiations on EU membership has built well-functioning market economies. There is no mention of their being poorly institutionalized market economies. Insufficient institutional support for agro-food producers and traders in CEECs has caused a growing imbalance in trade between CEECs and the EU.

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<sup>9</sup> The SAPARD program started in Poland in July 2002, instead of January 2000, i.e. with a delay of two and a half years. According to the financial rules applied to SAPARD, resources allocated for a particular year may also be utilized during the following two years. This means that in 2004 and 2005 Poland (and other CEECs) has to efficiently absorb a significant proportion of pre-accession funds, which need co-financing from domestic sources. This process will overlap with the beginning of implementation of the EU structural programs in new member countries.

<sup>10</sup> The “World Development Report 2002” is devoted to the significance of institutions in a market economy. “Markets allow people to use their skills and resources and to engage in the higher-productivity activities if there are institutions to support those markets. What are these institutions? Rules, enforcement mechanisms, and organizations supporting market transactions. Extremely diverse across rich and poor communities and nations, they help transmit information, enforce property rights and contracts, and manage competition in markets. All market-supporting institutions do one or more of these things. And in doing so, they give people opportunity and incentives to engage in fruitful market activity.” (World, 2001)

### Adjustment Triangle



While preparing for accession and full integration with the EU, one must remember that it is a long and complicated adjustment process. The core of this process is institution building in the accession countries, institutional change and institutional adjustments in other countries of the Community. The scope and timing of these adjustments is presented in the “adjustment triangle scheme”

There are three stages of the adjustment process to the conditions in the enlarged EU: first, within the framework of the negotiation period; second, in the pre-accession period, and third, after accession. Main aspects and features of adjustments in these stages are presented below:

#### **1. (N) Negotiations on accession (1999-2002)**

- Establishing general requirements and conditions for accession.
- The framework for “entry conditions” for new members is accepted.
- The concept of the future enlarged Community, mutual concessions and transition periods are discussed, and accepted.
- The negotiation phase involves a relatively small number of specialists and narrow circles of engaged societies; it is mainly a political and technocratic stage of enlargement.

#### **2. Pre-accession period (2000-2004)**

- The most intensive period of building formal institutions necessary for accession and integration.
- Pre-accession funds are available for candidate countries during this period. They are approximately four-times higher per year than the previous EU aid to these countries.
- Pre-accession programs, based on EU structural programs and their philosophy, serve as patterns and support for institution building, and as a training opportunity for constructing the “absorption capacity” necessary for future utilization of the Community support funds. It is also an important learning process and accumulation of skills useful for functioning within the EU structures.
- Hundreds of projects covered by pre-accession programs contribute to the diffusion of “know-how”, engage thousands of people at all levels of societal structures, and transmit information about many aspects of the EU economy and society to individuals and organizations in the candidate countries.

- The pre-accession programs contribute to the strengthening of the market economy and civil society in CEECs.
- Social dialogue on the costs and benefits of accession is conducted in the candidate countries, aimed at a better understanding of integration process, involving more people in this process and contributing to the positive outcomes of referenda preceding the formal signing of the accession treaty.

### **3. Post-accession adjustments (2004-)**

- Most of the adjustment processes in social and economic spheres necessary for full integration are made after accession of new members to the Community.
- Formal institutional structures, established during negotiation and pre-accession periods, are tested and put into action.
- Necessary corrections and additions to them are made.
- Formal institutions (law and organizations) are supplemented by informal institutions (social norms, behavior patterns, attitudes, ways of thinking, etc.) which support “real” integration. It is commonly accepted in the social sciences that much more time is needed to develop informal institutions than to establish formal institutions, a legal framework and organizations.
- Availability of Community funds (structural, agricultural, cohesion, etc.) helps to adjust economic and social structures to the new reality of an enlarged Community. The structures become more compatible and efficient.
- Part of this adjustment is the “catching-up” process of new members to the higher level of development prevailing in the Community.
- In this stage of mutual adjustment, accession is becoming a matter of real integration.

## **4 Evolution of agricultural policies in CEECs during the transition period**

The group of CEECs differs very much in their strategies of agricultural restructuring and in agricultural policies. The former Soviet Baltic republics (Estonia, Latvia and Lithuania) and Poland took the “shock therapy” approach at the beginning of systemic transformation. In this initial period of the transformation, agricultural support, including border protection, was drastically reduced, the national economies were opened to foreign competition, and farmers became taxed rather than subsidized. Producer Support Estimate (PSE) measured by the OECD dropped in some CEECs from a high level (75-80% in Latvia and Estonia) to negative values. After this period, the level of agricultural support started to grow and by the end of the '90s Estonia, Latvia and Lithuania had reached the level of PSE similar to other CEECs.

Czech Republic, Slovakia and Hungary have taken a more gradualist approach to agricultural-policy reforms. They reduced the level of protection and support gradually, from around 50% at the end of the '80s to a very low level (7-9%) in 1996-1997. Later the level of agricultural support increased as a result of the adjustment of their national agricultural policies to a CAP-like policy. Among the candidate countries, only Slovenia has a level of PSE comparable with the EU. Romania and Bulgaria have had very unstable agricultural policies with changing levels of support.

Table 1: Estimate of Support to Agriculture in CEECs, 1986-2001. Percentage PSE

Country	1986-1990	1993	1996	1999	2001
Czech Republic	57	28	13	24	17
Estonia	75	-32	7	7	13
Hungary	32	20	9	23	12
Latvia	80	-40	3	22	16
Lithuania	77	-37	5	16	11
Poland	-4	15	23	19	10
Slovakia	50	26	11	25	11
Romania	45	16	12	20	24
EU-15	43	44	35	39	35
OECD	38	38	30	35	31

Source: OECD, 2000, "Agricultural Policies in Emerging and Transition Economies", Paris. and OECD 2002, "Agricultural Policies in Transition Economies. Trends in Policies and Support", Paris. In the latest report, most of the indices were revised, in comparison with earlier reports, due to some changes in the methodology of PSE estimation.

Generally speaking, in CEECs in the late '90s growing convergence of the level of agricultural support could be observed both inside the group and between them and the EU. There are still differences among CEECs in relation to instruments of support. Most of them use market-price support (high tariffs) as a main instrument of support and, to a much lesser extent, other CAP-like means, especially direct payments. Direct payments play a significant role in agricultural support in Lithuania, Latvia and in Slovakia. Direct payments are not used on a greater scale in Estonia and in Poland. In CEECs other instruments of agricultural support which are not accepted in the EU are still used, especially subsidized credit.

## 5 Enlargement and the choice of agricultural support

Is eastward enlargement an opportunity and incentive to reduce agricultural support in the EU, or is it mostly a factor pressing for change in the structure of support and in the "repertoire" of instruments? Is it possible and justified to proceed with the implementation of "degressivity", "modulation" and "cross-compliance" principles in relation to direct payments or to convert this instrument into agricultural bonds? Is the budget constraint a major obstacle in accepting new members before 2006 (including their rights to CAP instruments)? These questions seem especially important in the discussion on enlargement in relation to agricultural and rural issues.

Eastward enlargement, which is the biggest enlargement of the Community since its creation, is not the right moment for a significant reduction in EU support for agriculture. New members of the EU will need agricultural support for modernization of their farms in order to make them competitive on both a European and a global scale. This support could be treated in a dual sense: as "transitional adjustment assistance" to the EU conditions, and as "transitional adjustment assistance" to world market conditions. In a proposal of CAP reforms submitted by the research group directed by A. Buckwell, the "transitional adjustment assistance" (TAA) should replace compensatory payments (BUCKWELL, 1997). Direct payments in their present form are an income-support instrument. Transitional adjustment assistance is future-oriented and

a modernization-support instrument.<sup>11</sup> Before changing direct payments in the present form into transitional adjustment assistance, it is necessary to define the goals of adjustment and the means for achieving these goals. CARPE was an outline of that kind of proposal. This proposal needs extension and concretization for the new conditions of the enlarged EU.

Eastward enlargement is a very strong factor pressing for the retention of agricultural support in the EU on a relatively high level (around 1.5% of GDP, measured in terms of the Total Support Estimate). It is also a factor mobilizing for a change in philosophy and the legitimacy of agricultural support. WTO negotiations additionally contribute to this pressure for change.

Why is it necessary to extend direct payments (gradually converted into TAA) for CEECs after accession?<sup>12</sup>

- *Non-discrimination argument*: all members of the EU should have the same rights. Direct payments are more an income-support device than compensatory instrument and no member of the Community should be excluded from the right to benefit from them.
- *Single-market and competitiveness argument*: since “old” and “new” members function on the same single market, and in the same competition environment, exclusion of CEECs from direct payments would significantly reduce their competitive position in the single market. This argument is linked to the next.<sup>13</sup>
- *Modernization argument*: direct payments or TAA are a source of investment and modernization for farms. Most of the post-socialist farms are under-invested or mis-invested. The financial situation of the farm sector in CEECs in the '90s has been generally bad. Only a small fraction of farms (in most of CEECs less than 10%) were able to invest, expand and modernize their equipment.
- *CAP democratization and fairness argument*: enlargement is a good opportunity to make public policy towards agriculture more accessible to small farmers and to make the support for farms more equitable. Today the prevailing principle is: the biggest take the most.
- *Total benefits from enlargement argument*: According to some estimations, the accession of CEECs, at least in the case of particular countries, without extending direct payments for them, would result in negative net benefits from enlargement for accession countries, especially in the first years after accession.<sup>14</sup>

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<sup>11</sup> “... transition or adjustment refers to the future, it is an attempt to reorganize resources (land, labour, management and capital) so that farms (and rural businesses) are capable of surviving unaided in the future. (...) Transitional adjustment assistance is forward-looking, offering at least the hope of change and adaptation to future conditions and future prosperity.” (BUCKWELL 1997: 80)

<sup>12</sup> When we started our project, the official position of the European Commission towards the CEECs was: “no direct (compensatory) payments for new member states”. This position was changed at the beginning of 2002, after starting official negotiations with the candidate countries.

<sup>13</sup> This argument is supported in the report of the CEPS Task Force: “A fundamental critique on the differential treatment of CEECs in terms of DPs is that this would clearly cause a distortion of competition between East and West European farms in a single market. With DPs paid per hectare or per animal, they are linked to production, and hence an unequal payment of DPs within a single EU market will distort competition between CEEC and EU-15 farmers.” (TOWARDS 2002b: 10).

<sup>14</sup> In “Horizontal Opinion”, submitted by Polish experts to the Polish Committee for European Integration, the scenario titled “EU scenario” (EU Common Position in negotiations not including direct payments for Poland), a simulation based on the Computable General Equilibrium model to the year 2010, shows that the net transfer to Poland in this scenario would be negative in 2010, while being slightly positive for farmers. This scenario also shows negative net results for Polish consumers and GDP growth (CZYZEWSKI, A.B.; ORLOWSKI, W.M. 2001). Another



There are several other issues discussed in the EU in relation to CAP reforms. The position of CEE countries toward these issues is not clear. Here are my comments on some of these issues:

*Degressivity issue* – Reduction of the costs of the direct payments can be achieved by simplifying the procedures related to them, by “modulation” and by limiting the amount per farm.<sup>15</sup> Due to the special needs for direct payments (or TAA) in CEECs, significant reduction of direct payments over time should be extended (for 7-10 years after accession). There is a rationale for considering partial conversion from Pillar I (including direct payments) to Pillar II (rural development supporting also agricultural development). Proposals aimed at avoiding an extension of direct payments into the new members from CEECs by converting them into bonds before enlargement, and granting them to the “old” members only, are unfair and dangerous for the successful integration of the CEECs with the EU.<sup>16</sup> There is one important argument presented by the CEECs against significant reallocation of direct payments to the rural-development measures: the direct payments are fully financed by the EU and access to these payments is relatively easy; rural-development measures (second pillar of CAP) need co-financing, are complicated and their results are delayed.

*Modulation issue* – This is a difficult and sensitive topic from the perspective of the CEECs. Poland and other candidate countries with a large small-farm sector are interested in finding appropriate ways for extending direct payments (or TAA) to the part of small-farm sector which has some potential for development and modernization. One of the new measures offered by the EU for the candidate countries, “support for semi-subsistence farms undergoing restructuring”, goes in this direction. The character of this instrument is mixed: similar partly to direct payments and partly to structural support. The small-farm sector is also growing in other post-socialist countries. In CEECs we can observe a polarization of agrarian structure (bimodal structure): besides many small farms, there is a growing big-farm sector. Some of the restructured and privatized farms (former state and co-operative farms) are very big by European standards and have thousands of hectares of agricultural land. As mentioned earlier, the concentration ratio in most CEECs is much higher than the EU average. In CEECs we have a new “landlords group” (or class) and this group could be a major beneficiary of CAP (mostly through direct payments). Many owners of agricultural land do not live in rural areas and do not participate personally in farming (absentee-owners). The concentration of CAP benefits in a relatively small group of land owners or land operators would raise the question of the fairness and equity of CAP. Unrestricted according to the size of a farm, direct payments would also increase significantly the price of land. In these circumstances, some forms of “modulation” of direct-payments distribution could be desired. Obligatory modulation proposed by the Commission in

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estimations, done by M. BANSE for Poland, shows that in “Agenda scenario” (no direct payments) net transfers from EU to Poland in 2005 would amount to € 1.79 billion with very small benefits to rural households and negative results for urban households, investments and GDP growth. In the scenario with direct payments, the net benefit for Poland is 2.5 times higher (BANSE, M. 2000).

<sup>15</sup> This direction of the direct payment reform is also presented in the Agenda 2000 mid-term review (TOWARDS 2002a).

<sup>16</sup> A. SWINBANK and S. TANGERMANN in their proposal for introducing a “Bond Scheme” instead of direct payments treat direct payments only as compensatory payments. As a consequence, they suggest excluding CEECs from the scheme: “To the extent that they do not suffer a reduction in price or income support, there would be no need to extend the payment scheme to farmers in the applicant states in Central and Eastern Europe and the Mediterranean. (...) The Bond Scheme would reduce the budgetary costs of Eastern Enlargement, for bonds would only be issued to those farmers adversely impacted by a withdrawal of support.” (SWINBANK, A.; TANGERMANN, S. 2001)

the Mid-term Review of the Agenda 2000 will not be extended to the new members from Central and Eastern Europe since these countries begin with a low level of direct payments (25% of the present EU level). It would be justified, however, to give new members from CEE the right to use the modulation instrument and establish an upper limit of direct payments below € 300,000 per farm.

*Co-financing issue* – Co-financing first pillar of the CAP would be unacceptable for the CEECs. On the contrary: enlargement provides an additional argument for the strengthening and continuation of a common character and for the solidarity of agricultural policy in the EU. Co-financing could also increase differences and disparities between agriculture and rural areas in richer and poorer member states and works against cohesion in the EU. Reallocation between CAP pillars I and II is often seen as a re-nationalization of CAP “by the back door”. The majority of measures included in the second pillar support farmers and are of a sectoral character. There is a co-financing requirement for these measures, which sets a minimum rate for national contribution. Richer countries can allocate much more resources for co-financing second-pillar measures than is required by the EC regulation. In reality, it is an additional farm-sector support which undermines the “common character” of the CAP.

*Cross-compliance issue* – This issue is mostly related to eco-conditionality and the “greening of the first pillar of CAP”. Enlargement is a good opportunity to extend eco-conditionality to both new and old members of the EU. Strengthening eco-conditionality of direct payments would be the right tool for reducing budget burden caused by direct payments. There are two major problems with implementing eco-conditionality: the first is linked to the standards or reference points for conditionality, and second is the transaction-costs issue. In the EU there is no common Good Practice Code (Good Farming Code) and the difficulties associated with constructing such a code are tremendous.<sup>17</sup> Difficult to estimate, but rather high, are transaction costs connected with eco-conditionality policy.

Eco-conditionality has been put into a set of requirements linked with the proposal package for CEECs. Execution of these conditions in the first years after accession would be very difficult and expensive for new members. First estimations of the costs and benefits of some measures offered by the European Commission for CEECs in January 2002 show that the costs of matching ecological conditions required by the regulation would absorb most or even all support from the EU (for example € 750 per farm for semi-subsistence farms). Eco-conditionality should be extended for the transitional period and more precisely linked with the level of support.

## **6 The Community budget constraints and eastward enlargement**

It is a very common opinion that in the present EU budget plan for 2000-2006 there is not sufficient money for the extension of CAP to the new members after enlargement. The cost of CAP extension to the CEECs is estimated at € 9-13 billion annually (SWINNEN 2001). In the EU proposal published on January 30, 2002, the Commission is offering the 10 candidate countries only € 2,048 million to € 3,933 million per year for supporting agriculture and rural development (both first and second pillar of CAP). Additional costs of accession are connected with the extension of structural programs to

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<sup>17</sup> “It is not possible now to build and European Good Farming Codes. The house has to be built on a solid basis, and those have to be local standards. Do not ask bureaucrats, even eurocrats, to build standards in their office without concrete knowledge of what is happening on the ground.” (URFF, W., 2001)

new members (€ 7-10 billion yearly). In the EU financial perspective for 2000-2006, there are some financial resources for CEECs:

- 1) € 3,120 million annually for pre-accession programs;
- 2) € 4,140-14,220 million annually for enlargement, beginning in 2002.

We should add the contribution of new members to the Community budget after accession to these amounts. Let us assume that the enlargement with 10 CEECs takes place in 2004. In this case, pre-accession funds can be transferred to other purposes (e.g. additional CAP expenses). Funds for enlargement predicted for 2002-2003 amounting to € 10.8 billion should be saved and added to amounts for enlargement after 2004. According to the estimations done by the Polish Section for Economic Analysis of Agricultural Policy (SEAPR), it would be possible to finance the full costs of extending CAP to the new members, including full direct payments, by increasing the EU budget to 1.27% of the total GDP ceiling. Similar estimations to this prepared by SAEPR (2002) were presented by M. Schreyer (SCHREYER 2001). It is not easy to explain to the candidate countries why the share of the EU common budget of Community GDP will increase to 1.15% in 2003 and, in the first year after accession of the 10 new members, will start to decline to 1.09% in 2006. In the EU budget proposal for 10 new members, the total amount of Community support for these countries is less than was predicted for accession of 5 CEECs in the budget accepted at the Berlin Council meeting in 1999. It is hard to accept the opinions presented by some EU officials that the proposal of the Community for new members from CEECs is “generous”. When three new members – Greece, Spain and Portugal, with a GDP per capita below the Community average – joined the EC, one of the reactions to this challenge was the first “Delors Package”, which resulted in a doubling of the common structural funds in the period 1988-1993. The challenge to EU social and economic cohesion after eastward enlargement is much bigger than after the Community enlargement in the 1980s, but the response to this challenge is much weaker.

In most of the estimations of the costs of enlargement there is an assumption that new members will take up their rights to common funds fully, from the beginning. This is a wrong assumption. The capacity for absorbing the EU funds for agricultural and structural policies will develop gradually after accession, especially when taking into account complicated procedures and institutional barriers in CEECs. It will be a relatively slow “learning-by-doing” process. Human capital and institutional barriers in CEECs for preparing, implementing and managing complex EU programs are probably much stronger than most people, both in CEECs and in the EU, imagine. Implementation of pre-accession programs in CEECs can be treated as a test for the human and institutional capacity and as a “training ground” for absorbing much higher funds after accession. This test so far gives little optimism for the quick extension of existing EU policies to CEECs after enlargement.

## **7 Eastward enlargement and the EU rural policy**

Eastward enlargement should be done together with the introduction of a new rural policy for Europe. There is little time left for preparing such a policy. The main ideas for this policy presented in the CARPE model (BUCKWELL 1997) and in the SARACENO proposal (see the contribution of SARACENO in this volume) are – in my opinion – well suited to the needs of an enlarged EU and new international conditions, including WTO recommendations. Most of the economic and social problems that the agricultural population faces cannot be solved by means of agricultural policies alone. Agricultural

policy will be more effective when it forms a component of a comprehensive rural policy. Even in the countries with highly productive and large-scale farms (e.g. USA), agricultural income is a shrinking part of the incomes of farm households (BLANFORD 2001). The introduction of the Farm Bill 2002 in the US adds new “ammunition” to the discussion about methods for solving the “agrarian question”. In most cases, rural development contributes to farmers’ well-being more than agricultural development. Rural development through institution building, human capital formation and the development of social and technical infrastructure also contributes significantly to agricultural development.

Rural unemployment in CEECs is one of the biggest and most complicated socio-economic problems. In rural areas of Poland unemployment, both registered and concealed, is higher than in urban areas. It is also more difficult to reduce unemployment in rural areas due to the less developed human and social capital, and to institutional constraints (KOLARSKA-BOBINSKA; ROSNER; WILKIN 2001). High rural unemployment is a major socio-economic problem in all CEECs.

Rural development should play an important role in strengthening the civil society, which is presently poorly institutionalized in rural areas in CEECs. It would be very useful for rural development to implement in accession countries LEADER-type programs as quickly as possible, even prior to accession. The LEADER program supports grass-root group initiatives and mobilizes local communities for collective actions. It is difficult to explain why the EU did not include LEADER-type measures in pre-accession support and almost eliminated LEADER+ from the rural development support package for the CEECs in 2004-2006.

CEECs will contribute to the greater diversity of the EU in all dimensions: environmental, social, cultural and economic. There are also big socio-economic differences and disparities across regions and social groups in CEECs which threaten the socio-economic cohesion of the EU. This requires the implementation of effective, decentralized structural and regional policies that are well suited to both regional and local needs.

It is a common phenomenon in rural areas, both in CEECs and in the West, that socio-economic exclusion or marginalization is stronger than in urban areas. Most CEECs face growing disparities between regions and social groups. Difficulties with the implementation of structural and rural development programs in CEECs – both those experienced up to now and those expected after accession – can contribute to a worsening of this phenomenon rather than improving the situation in this aspect.

## **8 Conclusions**

- Eastward enlargement of the EU is the biggest challenge to the Community since its creation. This challenge requires profound reforms of major policies, especially agricultural and regional policy. The reaction of the EU to this challenge has so far been insufficient. Enlargement of the EU by 10 new members is treated more as accession than integration.
- The candidate countries are concentrating on the adaptation of the *acquis communautaire* and on preparation for the implementation of existing EU policies. They are not sufficiently active in the discussions about future common policies for an enlarged EU which would better suit the needs of CEECs.

- Eastward enlargement requires large financial resources for a successful adjustment to EU conditions and for improving socio-economic cohesion in the EU-25. Enlargement is not the right moment for decreasing the share of the Community's common budget in GDP. In the face of challenges and needs connected with enlargement, the common budget should rather increase to the ceiling: 1.27% of GDP.
- In the long perspective, structural and regional-development support should absorb most of the common budget resources. Rural development can contribute more to the well-being of the rural population than traditional agricultural policy. A gradual shift from agricultural funds to structural funds and between the two pillars of the CAP seems justified in the light of past experience.
- Due to the high socio-economic diversity of an enlarged EU, more flexible, decentralized and less bureaucratic structural and regional policy is needed.
- The critical reaction of the CEECs to the EU proposal for budget allocation to the new members in the period 2004-2006 is understandable and justified. The proposed level of support to new members is low. It is lower than expected by CEECs and even lower than the possible financial framework established under the Berlin EC agreement in 1999. It seems to me that the EU is trying to implement a "cheap" enlargement strategy. This could be a threat to the successful and efficient integration of CEECs within the EU.
- In the first years after accession, new members from CEECs need strong agricultural support. This is required for the modernization of farm and food-production sectors and for strengthening the competitiveness of the agri-food economy in CEECs. The financial state of agriculture during post-socialist transformation in all candidate countries is very difficult. Without sufficient support, most of the agricultural producers from CEECs will be marginalized in the enlarged EU. Direct aid to the farms in new member states is necessary and justified. Implementation of *degressivity* and *modulation* of direct payments in the EU should be connected with the extension of this form of support to new members.
- Eastward enlargement of the EU is the right moment for extension of *cross-compliance* of agricultural support to old and new members. This may contribute to the greater legitimization of public support for agriculture. Fulfilling high standards of eco-conditionality, food safety and animal welfare is costly and complicated. These requirements could be accepted by farmers in CEECs only when sufficient compensation for them is guaranteed under new CAP rules applied to new members. This condition is not met by the proposal from the EU submitted to CEECs in January 2002.<sup>18</sup>
- There are important lessons for the future adaptation of new members to EU conditions coming from the pre-accession period. Utilization of pre-accession funds

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<sup>18</sup> In the final stage of negotiations on accession conditions in Copenhagen (December 2002), the candidate countries from Central and Eastern Europe achieved some significant concessions in comparison with the initial proposal submitted by the Commission. The most important is linked with the direct-payment issue. New members from CEECs can reallocate part of the Pillar II money to increase direct payments during the first years after accession. They can also top up direct support from the EU budget with additional money coming from domestic sources. As a result of this agreement, in Poland, for example, direct payments for farmers can reach 55% of the EU level in 2004, 60% in 2005 and 65% in 2006, instead of the previously proposed 25%, 30% and 35% respectively in first three years after accession. In the new conditions accepted in Copenhagen, the phasing-in period for reaching 100% of direct payment was reduced from 10 years to 7 years. Poland and some other countries have also gained higher than initially proposed milk quotas and longer transition periods for adjustment to the EU requirements in relation to particular products, food-processing and market regulations.

and implementation of pre-accession programs has been much less successful than expected before starting these programs. Connected with this failure are long delays in program implementation, relatively small amounts of available money spent, a lot of dissatisfaction among potential beneficiaries, etc. There is a real threat that a similar failure may be repeated in the first years after accession in relation to structural funds and rural-development programs applied to CEECs.

- To safeguard the more efficient and just utilization of EU support, there is a need for more transparency, better “user-friendly” procedures and stronger involvement of those social groups who are the targets of support.
- Enlargement of the EU in May 2004 should accelerate a social dialogue in the Community on a new philosophy and a new policy for integrated development of rural areas in the EU-25.<sup>19</sup> “Policy Vision for Sustainable Rural Economies in an Enlarged Europe”, prepared by the ARL West-European Working Group, provides a good reference point for this dialogue.

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<sup>19</sup> The first positive sign of the beginning of such a dialogue is the result of the Council meeting in Luxembourg in June 2003, with the participation of 10 candidate countries, on the reform of agricultural policy. The reforms generally run in the directions proposed in the “Policy Vision” paper.

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# Food Safety, Food Quality and the CAP

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- 1 Introduction: what is the connection to the CAP?
- 2 Definitions of Food Safety and Food Quality
- 3 Market failures and public actions for food safety and quality
- 4 Conclusions

## **1 Introduction: what is the connection to the CAP?**

As a reflection of the concerns of the time, the Treaty article defining the purpose of the CAP makes no reference to food safety or food quality. The CAP started its life as a set of cross-border economic and political arrangements for the signatories, concerned with raising productivity and, it was hoped, living standards of those engaged in farming. It arose from a period of food market instability and insecurity, and its prime purpose was quantitative – raising output of Europe's food sector, with passing but contradictory reference to a desire for 'reasonable' (consumer) prices. At the time of creation of the CAP food safety was under member state, not EC, competence. If food quality was a concern at all it was considered a commercial issue. The strongest accusation is thus, perhaps, that the CAP has failed food quality and safety by ignoring it.

From this beginning, over the years, a mythology has grown up that food safety and quality have been big 'missing factors' in the CAP which must now be rectified. The idea is that the high, and relatively stable, price regime of the CAP has been responsible for a massive intensification and industrialisation of agriculture and this in turn has reduced safety, diminished food quality and also been responsible for large-scale environmental damage. Both links in this argument are more false than true.<sup>1</sup>

First, the so-called intensification of agriculture (actually a substitution of capital for labour and land) is a world-wide phenomenon seen under a wide range of agricultural policies; some which subsidised agriculture some which taxed the sector. It has been brought about by general economic and technological factors and has only very slightly been modified by agricultural policy. The very fact that the sectors where this process has gone furthest in European agriculture, (pigs, poultry, horticulture and field scale vegetable production) are the sectors least protected by the CAP illustrates the point.

Second, it is far from proven that food safety and quality have been poorer as a result of this so-called industrialisation, and they are poorer now than in former decades. Given the definition of quality (paragraph 9 below) it would seem a safer conjecture that there is a greater range of differentiated food products available daily to the bulk of the European population now than at any other time in our history. There is greater variety, consistency and purity within all the main product lines available, a greater proportion and volume of produce moving through these differentiated lines, and great many more lines than there ever has been. Likewise no systematic evidence has been offered to show that the incidence of food safety and hygiene breakdowns have been

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<sup>1</sup> There is a case to be made that the CAP has had a systematically negative environmental effect. This too is invariably overstated, but it is not the subject of the current paper.



more frequent or caused more damage in recent years than formerly.<sup>2</sup> The quite different issues of nutritional standards and health (obesity, the over consumption of salty, sugary and fatty foods) has nothing to do with agricultural policy. If anything, the high prices of EU agricultural produce (particular sugar and animal fats) will have, *ceteris paribus*, inhibited consumption of some of these foods rather than encouraged it.<sup>3</sup>

The changes observed in the technology and structure of primary production, the huge growth of the intermediary food processing, distribution and catering sectors, and the dramatic changes in household economic and social behaviour, are the major determinants of the large changes in food consumption patterns. In turn, the underlying causes of these changes go far wider than agricultural policy. It appears that, because of its other short-comings, a false debate has been created in which the CAP has been accused of neglecting an area in which it was never designed to operate and in which it has, even today, only a marginal role. After the current hyperbole has settled, in which it is argued that the CAP should be a policy for quality and not quantity, we will still find that the bulk of the expenditures and actions under the policy have little directly to do with food safety and quality. Indeed, this is as it should be. Food safety and quality are far too important to be left to the CAP.

## **2 Definitions of Food Safety and Food Quality.**

Food safety refers to human health.<sup>4</sup> Public policy on food safety is, or should be, an objective, science-based concern in which opinions carry zero influence. For public policy, what matters primarily is whether a food product or process is safe to eat, not whether the chattering classes in the media think it is or is not. Science itself is fallible, but the scientific process and criteria provide ideals to be constantly striven for. Food safety is most easily defined in term of negatives, the absence of natural or man-made toxins or allergens in food, or their appearance below thresholds of danger for the majority of the population in the context in which they are likely to consume.

As in most fields involving biological variation, it is not possible to arrive at a definition based on absolutes. Tolerance to harm from food ingredients varies according to age, gender, body mass, activity, physiology, genetic disposition, the processes employed in food preparation, consumption patterns and a host of other factors. In addition, food safety policy has to contend with the fact that there is no control possible over the hygiene, storage and preparation of food at the final stage in the home, nor is there control over consumption levels and mix.

In this field, in the presence of such variability and the absence of certainties, a great deal of policy will boil down to the assessment, communication and management of risk. Cautious safety levels with wide margins of error will characterise this area.

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<sup>2</sup> These are extremely complex issues to analyse given the large changes in public health protection measures, in life styles, food preparation and eating patterns and the changes in food consumption.

<sup>3</sup> The debate on the CAP and food quality is not helped by the confused way in which phrases like 'cheap food policy' are used. There can be no doubt that at both farm gate and retail levels, Europe is a high food price area compared to all of the rest of the world with the exceptions of Norway, Switzerland and Japan. Yet there are persistent accusations that food safety and quality have been sacrificed by cheap food policy. This usually refers to the effects of highly competitive behaviour in the food processing and distribution sectors who fight to provide cheap, mass produced (= low quality in the eyes of the critics) food for the poorer sectors of society.

<sup>4</sup> It is not sensible to intermix animal welfare and environment with food safety as is often done, these are separate concerns and must be treated separately.

Food quality, refers to the totality of characteristics of the food, that bear on its ability to satisfy stated or implied preferences. Quality implies variety and is a multi-dimensional concept, most of which are subjective. One way of characterising some of the dimensions of food quality is to distinguish:

- Measurable features – purity; consistency; moisture content; chemical composition; physical characteristics, microbiological character; and keeping quality.
- Consumption preferences – choice, smell, taste, colour, size, shape, texture, eating characteristics, after taste.
- Environmental characteristics – association with desired environmental impacts or their lack.
- Animal welfare characteristics – association with desired animal welfare impacts or their lack.
- Social characteristics – association with desired social outcomes or their lack.

Some would add ethical characteristics (considerations of what is good) to the above list, but it is suggested this would be double counting, that the above five exhaust the possibilities.

These categorisations are defined in terms of the food product itself. However, they also apply to the process in which it has been produced. This introduces further dimensions of quality. As more and more food is sold in a processed form, as convenience ready-prepared meals and food eaten in catering establishments, a large set of further quality traits enters the picture. These include a range of food additives (e.g. colourants, preservatives, stabilisers) and process agents. They also, importantly for the consumer, include packaging, presentation and promotion. In a different dimension, the nature of certain stages of the production process can take on great significance for quality in the eyes of the consumer. For example, there is no reliable way of detecting in an egg, or a pork product, whether the chicken was caged, or the pig tethered. Yet some consumers have strong preferences for these products.

As this paper is offered in the context of public policy, the above definitions partition safety and quality. It is asserted that food safety and food quality should not be conflated. The former is not considered an aspect of the latter. For policy purposes, food safety must be considered an ‘on’ or ‘off’ phenomenon, not a matter of degree. The food is safe to eat or not. Within the tolerances mentioned, and subject to storage and preparation instructions, all consumers must be safe to assume that *all* food legally on sale is safe to eat. The fact that we are all free to ignore instructions or to over-consume, for example alcohol, raises quite separate issues of consumer, nutritional, and public health education and policy.

### **3 Market failures and public actions for food safety and quality**

In a pluralist, liberal market democracy, public interventions may be justified when there are identifiable or predictable occurrences of market failure, market imperfection or missing markets. That is, in the absence of such failures we would start with the presumption that private interactions are sufficient to deal with the issue at hand and there is no need for public regulation or intervention. It will now be argued that food safety is an area where there *are* conditions of pervasive market failure and regulation will be expected to be the norm. For food quality it is suggested that market failure is not normally the case and private market or commercial behaviour should be expected

to be the norm, although there is still an important public role for ensuring the necessary infrastructure and regulatory apparatus are in place so that product differentiation and quality can flourish.

Lapses in food safety will normally have lagged, geographically diffuse and difficult to predict, effects. That is the problem often shows up removed in time and space from its source. If a meat 'processor' has a lapse in microbiological hygiene the food poisoning symptoms occur hours, days or possibly even weeks later over an area which depends on the structure of the food chain. A failure in one country can appear in another. This can make it extraordinarily difficult to trace the source of the problem. In these circumstances, even for the reputable firms in the food chain, self interest would not be considered a sufficient safeguard to rely on self-imposed health and hygiene standards. Because these very circumstances also provide possibilities for the unscrupulous to take short cuts it is inevitable that a system of public regulatory control is put in place.

At a less practical and more conceptual level, food safety can be said to have the characteristics of market failure. If food ingredients are free from infectivity or poison all consumers benefit from the absence of contamination. The enjoyment of freedom from 'disease' of each consumer does not diminish the enjoyment of others. Also it is difficult if not impossible to exclude the non-payers (non-consumers) of this freedom. Thus, safe food processes leading to safe food can be argued to involve a degree of non-rivalness in consumption and non-excludability, the hallmarks of market failure. We can therefore expect the market to supply too little food safety. That said, and in contrast to some other classical areas of market failure there is no tendency to understate the demand for food safety. Indeed because we all consume food every day of our lives, and because any costs of over-provision of food safety are so dispersed and thus shared, there is probably a tendency to overstate the demand for safety.<sup>5</sup> Indeed if we add the modern feature of the full glare of publicity, and the blame culture, given to each and every failure of food safety, there is a strong incentive for government to be super-precautious. Again the apparently slight, and dispersed, costs of higher standards are thought by government to be easily assimilated.

The conclusion is that food safety will be an area of strong regulatory control. This is achieved through the definition of standards of cleanliness, purity and hygiene at all points in the food chain, backed up by: monitoring; sanctions for abuse; a liability regime with a presumed duty of care. Many aspects of these regulations are expressed through the licensing of processes, premises and operatives. The appropriate administrative level to operate these controls should be a matter of technical effectiveness. Because of the dispersed nature of food preparation, catering and retailing most of the regulation and monitoring is carried out by local authorities, under national legislation paid by the Member States (MS) or in systems of decentralised governance, at a regional level. There are no doubt differences between EU member states whether these functions are under the ministry of health, agriculture, environment or consumer affairs. The series of well publicised food safety failures in the last decade has resulted in many countries in the creation of Food Standards or Food Safety Authorities.

The creation of the single market brings these issues to the EU arena. Given the free movement of goods in the market, there is a process of gradual harmonisation of food safety standards and regulations, plus mutual recognition of Member States' procedures,

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<sup>5</sup> Which means there is over-cautious regulation. This inevitably imposes additional costs in the food chain, and makes it more difficult for local production to be internationally competitive. This in turn usually leads to trade disputes. There are several current examples of this in the EU.

plus harmonised consumer information and labelling. At times of breakdowns in food safety, the maximum good is deemed to be served by the isolation of the country or region with the problem. Free trade within the single market is thus usually partially and temporarily suspended. The locus of power on the trade aspect of food safety is still being tested. In principle, as with all trade matters, it is at the EU level, although the reality as illustrated by the prolonged French ban on UK beef which had been cleared by EU veterinary authorities, shows that this principle is not universally accepted. In addition the EU has now set up a European Food Safety Authority with powers to provide scientific and technical advice, to collect and analyse data, identify and communicate risk, and communicate with the public on all food safety matters.

Food safety is pre-eminently a food chain issue not an agricultural issue. The bulk of the significant threats to food safety are likely to arise either in farm inputs manufactured up-stream of farms or in the transformations after products leave the farm gate. This means that traceability of product through the entire chain is vital. This in turn calls for agreed procedures and labelling techniques. These will have to be agreed nationally and co-ordinated supranationally and internationally. It is in this area of traceability and the means of bringing it about that food safety and quality can come together.

Once systems are set up for tracing food ingredients for reasons of food safety, it is cost effective to use the same systems and mechanisms for food quality too. Quality assurance systems therefore take on some of the functions for ensuring food safety. This can give rise to confusion in the minds of consumers.<sup>6</sup> The classic case of this is exemplified by organic food. The licensing and assurance systems for organic production is now well established, and the organic marque or label is extremely well recognised. It is however a food quality and not a food safety indicator. There is no scientific basis at all for asserting that organic food is safer than inorganic (or conventional) food. If this statement were not true, it would imply that there is some risk (however slight) to good health from consuming non-organic food.<sup>7</sup> This in turn could only mean that the conventional food production systems including inorganic fertilisers, crop protection chemicals and animal health products encouraged and indeed licensed by the member states has embraced some public health misjudgements. No Minister or Commissioner responsible for food safety could sleep easily if this were the case.

The regulation of food safety therefore involves a complex series of licensing and control procedures. It starts with the licensing and registration of crop protection and veterinary and animal health products. It licenses processes, premises and people in the chain from farmers and downstream: first stage and subsequent stage food processing and manufacturing; transportation; storage; distribution; retailing and catering, and at points of import and export. It involves health and safety at workplaces, offices and advice on these matters in homes. It also has associated large-scale public information systems to help explain the measures in place, to provide information on products and the principles of home hygiene and family nutrition and health.

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<sup>6</sup> It would be highly dangerous to allow purveyors of high quality food to use food safety as any part of their marketing strategy. If premium food products, sold at higher prices to niche markets, can be marketed as 'safer' it undermines confidence in the lower priced general products. If a process used in the production of the latter can be demonstrated to pose a threat, then it should not be licensed.

<sup>7</sup> The author can hear the howls of disapproval of these statements from, for example, those who feed organic food to their children. Food safety authorities are right to ignore such emotion, their concern must be to protect the safety of the non-organic food fed to babies and children of all, and perhaps especially those of the less articulate in society.

In short there is considerable area of market failure concerned with food safety and thus a highly developed set of EU, MS, regional and local regulatory procedures. But emphatically, this is not, and should not be conflated with, agricultural policy. The CAP should be consistent with food safety policy, and some of its funding streams might contribute to the achievement of the aims of food safety regulations. But whether there is an EU agricultural policy or not, food must be safe.

Generally speaking food quality is not a matter of market failure. What is felt to be of high quality is subjective.<sup>8</sup> Bringing about the process of product differentiation which is an intrinsic aspect of producing higher quality is done through commercialisation and marketing to define premium products. It is done by careful packaging and presentation. The purpose is to segment the market. By realising that some consumers have the income and preferences to purchase (usually lower quantities) at higher prices than the average, this offers producers the chance to sell a higher value product, and also, depending on the costs of delivering the higher quality, to achieve higher returns.

Many aspects of quality are a matter of plant or animal variety or production process and they are intrinsically not capable of being tested or measured at the point of consumption. This applies for example to organic food, free-range eggs, charollais beef, and specified vintage quality wines. There is no test possible on the final product to demonstrate that these products are what their label says they are. Consumer trust is placed in the traceability system which delivers the quality. This in turn has mostly been established by commercial practice and by firms' reputations for high quality which would evaporate if they were found out to have been cheating. To this extent self-interest is the best guarantor of honesty. The very process of defining quality is one for private sector initiative, imagination and flair. The creation of sustained quality products requires immense attention to detail, the creation of brands and promotion. These processes require considerable investment and involve a great deal of risk. Many new food products, e.g. recipes or particular types of pre-prepared convenience foods fail. Precisely for these reasons the development and promotion of quality is therefore principally a private sector activity.

Despite this presumption that the production and creation of quality food products must be a private sector affair, there are a number of rather pragmatic grounds for some degree of public involvement in stimulating and maintaining quality. As the number and variety of quality marks proliferates government has taken on, broadly, two roles: stimulating producers to produce variety, and consumer protection. The first role is justified by the fact that with small-scale and geographically dispersed producers, there is insufficient information, incentive, expertise and resource to develop new products and processes. These structural failures justify public assistance to stimulate the creation of producer controlled businesses to perform these quality-raising roles. Second, for consumer protection it is necessary to have in place the mechanisms for overseeing the institutions that set up and run assurance schemes, and performing periodic checks to ensure that the traceability systems are operated with good consumer information and without fraud. The roles for public policy for food safety are therefore as follows.

To offset the disincentive effect of the CAP. For four decades, under the CAP, farmers of certain major products have been encouraged to produce, not for the market but for publicly determined intervention 'quality' standards. This especially applied to cereals, oilseeds, beef and dairy produce. It encouraged uniformity, a commodity

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<sup>8</sup> English speakers are brought up on a nursery rhyme illustrating this. "Jack Sprat could eat no fat; his wife could eat no lean". This beautifully illustrate the power of individual tastes and preferences and thus the difficulty of defining 'quality' in meat products.

mentality and all too often lead to an indifference towards product differentiation and finding out what the consumer wanted.<sup>9</sup> Marketeers would argue that having been responsible for creating such problems in the first place, then the last instrument which perhaps should be used to encourage the opposite attitudes is the CAP! However the processing and marketing article of the Rural Development Regulation (1257/99) provides funds to encourage and assist the setting-up of schemes or farmers' organisations devoted to raising quality and improving marketing. To some extent this support can help provide capital investment, but rightly, the bulk of such investment is regarded as a matter for private credit not public subsidy.

To provide consumer information. There are undoubtedly failures in the availability of information. One is the asymmetry of information. The seller knows much more about the conditions of production and the real quality than the buyer. This has spawned a great deal of public activity in the form of nutritional labelling, use-by dates on perishable products, and harmonisation of information in the single market – developing symbols to help overcome the existence of multiple languages.

To assist the creation of the infrastructure for quality. Almost by definition quality means multiple lines each with smaller throughput than undifferentiated commodity product. At least in the first instance, this can involve higher costs. It is currently fashionable to argue that locally and regionally denominated foods, speciality products e.g. from rare breeds or produced using traditional processes, have intrinsic value and can also provide welcome support for the communities which have traditionally produced them. Unless the processing, transportation and marketing of these products is co-ordinated and supported e.g. by co-operatives or other forms of producer or community organisations, these initiatives may not get off the ground. Public support may therefore be justified to provide the stimulus and co-ordinating role. The support may take the form of institution building (producers groups or co-operatives), information, advice, training, initial start-up credit or loans. Note, this list does not include on-going annual subsidies.

Some of the collective actions may be to act as a counterweight to the power of the highly concentrated food processors or retailers. Thus national (or EU) supermarket chains may be required to maintain a certain proportion of shelf space for local or regional produce. Public support may be given for the establishment of farmers' markets, or in support of the organisations who have been set up to assist farm retailing and farmers' markets.

To ensure suitable location and scale of livestock processing capacity. This particularly applies to abattoirs. There are large private economies of scale in these operations. A prime example of this is in regard to the need to have qualified veterinary inspectors to oversee such difficult operations as the removal of BSE-related specified risk material from cattle. If small abattoirs are required to pay for the time of these meat inspection services, the costs can put them out of business. The smaller the number of abattoirs, the longer the distance to be travelled by live animals and the greater the total transportation of product, and the greater the commensurate externalities of pollution and road congestion. Many MS see in these arguments sufficient justification for schemes of sharing the costs of expensive veterinary meat inspectors in small abattoirs and meat processing plants to ensure that some of this value-added is maintained near

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<sup>9</sup> This is the conventional wisdom repeated by politician after politician at conferences for years. It is no doubt partially true, but it can be overstated, for is also the case that the recent decades have seen a huge increase in the variety of grain, oilseed, meat and dairy products on sale throughout the community.

the points of production rather than concentrated in cities nearer the centres of population.

Training, education and market information. These roles are usually supported by public funds. It is generally accepted that the private sector will under supply such training as they are unable to capture the benefits of their trained staff who can walk away at the end of the training. In addition, these market failure arguments seem to carry more weight given the small and micro business structure which characterises at the very least the rurally-based part of the quality food chain.

## **4 Conclusions**

Governmental institutions have an essential role to play in food safety, they have a less central, but nonetheless important, role in assisting the development of food quality.

It is vital that consumers have confidence that their food is safe. For this reason it is equally vital to separate food safety from considerations of food quality both in policy and in public discourse. There is a crucial role for the state to guarantee food safety. This is done by having the capacity for research, monitoring and testing, licensing and inspection, and sanctions for non-compliance, to earn this consumer confidence. These matters are mostly dealt with at the member state level and below, but there is an important role for EU co-ordination. Also, increasingly, with globalisation, the co-ordination involves a stronger international element – requiring actions from, inter alia Codex Alimentarius, WTO and the OIE. Continual development in the work of these organisations is necessary to match the proliferation of traded products, including regimes for inspections abroad and in transit.

This vital work is a matter for public policy, but is not directly a matter for the CAP. There should be nothing in the CAP which in any way restricts the above tasks for ensuring food safety and all CAP support regimes should be food safety-proofed. This means there should be a periodic and quite explicit consideration given to test that there is nothing intrinsically in each CAP support systems which could compromise food safety. The main food safety related role for the CAP occurs when there is a food safety failure. It is the corresponding commodity regime which provides the framework and mechanisms for co-ordinating the response. This usually involves some emergency trade arrangements, and invariably some market stabilisation arrangements. It is important that such arrangements operate smoothly. Rebuilding consumer confidence requires that they are sure no contaminated food is reaching the food chain. The smooth working of these arrangements and the minimum disturbance to consumer confidence are also vitally important for producers. Outside the remit of this paper is the issue of who should pay for the market stabilisation when there is a breakdown as for example caused by the BSE crisis.

Achievement of higher food quality is a matter of differentiation, imagination and innovation. This can only be brought about by private sector activity. The government can play an important role in creating the framework for this to take place. This involves facilitation – by encouraging producer groups and co-operatives, and by overseeing quality assurance schemes. There is an education and training function, both for consumers and producers in the food chain. Government can help the creation of the infrastructure for quality and by ensuring necessary regulation is implemented in a proportionate way. It also has an important role in holding the ring to ensure fair terms of competition given the big imbalances in market power in the food chain.

Many of the public sector actions to encourage diversity and quality will lie with the member states. For example the planning and tax systems have a big influence on the freedom of initially land-based firms diversifying into food processing and retailing. The most important set of instruments influencing food quality at EU level are those in the Rural Development Regulation. This is where funds can be available for the functions listed above. The actions and funding will generally take the form of specific once-off investments, rather than a continuous stream of annual payments. Farms, and increasingly other rural businesses who have access to the RDR schemes can seek support under this regulation. The scope for this has been increased by the additions to the RDR in the June 2003 CAP reform, although there has only been a small (5%) shift in funding from the agricultural market policy to enable this. In time these actions should be a much more important part of the agricultural and rural policy.

A more problematic area is the extent to which quality associated with environmental, social and animal welfare is handled in the ways described to this point. It may be argued that higher standards under these three headings constitute improvements in food quality – or at least improvements in the quality of production conditions. The market is likely to be ineffective in paying for many if not most of such quality attributes. In such circumstances, if the market does not pay for the additional costs of delivering these ‘services’ then they should be paid through annual payments to the producers concerned. For environmental services of biodiversity, landscape, resource protection and cultural heritage it is argued that there is enough separability between these aspects and the quality of the food itself that the most efficient delivery of the non-market services is indeed achieved by custom-built agro-environment schemes. Such schemes do not prevent specific environmental attributes being captured in high quality foods. The point is that society would be unwise to depend on this connection for the delivery of the desired rural environment.

The social dimension is even more difficult to deal with. There are examples where it is possible to attach support for specific communities to products and thus achieve economic return through the market. An example is honey or other products sold by monasteries. The public buys the product to support the monastery. Arranging annual public payments for such elements in society is also possible. The hill farming payments, less favoured allowances and payments to producers north of parallel 62 are all examples of a mix of environmental and social payments. The problem with such schemes is to explain why the farmer in such areas receives annual financial support and the, equally poor, garage mechanic does not. This is an area where rhetoric has a habit of overwhelming cool analysis in separating justified payments associated with environmental or social quality and elements of pure political subsidy.

Finally, the issues of standards of food quality and the method chosen by society to support it can often lead to problems of international trade. This is the subject of the so-called non-trade concerns in the WTO, but is a subject in its own right and is not opened here.





## Should risk management tools play a role in the CAP?

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### **1 Introduction**

Support of farm incomes and stabilisation of prices have always been very important objectives for the CAP. The ongoing process of the CAP reform i.e. weakening and possible future removal of some of the instruments that have contributed to income and price stability raises the issue whether instruments such as income insurance, safety nets or some other stability-providing tools should be introduced instead? The issue of using risk management tools as agricultural policy instruments has been intensely discussed in recent years, see below. This short paper, which draws very strongly on the existing literature, especially the below mentioned reports, raises some questions concerning income/price stabilisation instruments in relation to the CAP. Should some risk management tools be added to the existing CAP measures? Or should they rather replace some of the currently applied policies facilitating the process of the CAP reform? Which options would be preferable in such a case? What is a proper division of responsibilities between the Member States and the European Union with respect to use risk management tools? Will the enlargement affect pros and cons of using stabilisation instruments and a choice of a preferred method to do so?

There has been a considerable interest in the tools for risk management in agriculture in recent years. In May 2002, the Spanish presidency organised a conference on agricultural insurance and income guarantees. A year before a workshop on income risk management was held at OECD, (2001). In January 2001, the Commission has produced a report on the issue of risk management tools in relation to EU agriculture focusing especially on insurance (CEC, 2001). A report on income insurance for European agriculture was also published by DGII (European Economy, 1999). LEI (2001) has published a report on alternative instruments for the CAP, focussing especially on risk instruments.

Within agricultural policies as applied at present in many countries, in particular in the EU, stabilisation of prices and incomes is strongly connected to price and income

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<sup>1</sup> The author would like to thank GIOVANI ANANIA and ALLAN BUCKWELL for valuable comments.

support. This paper will focus exclusively on the issue of stabilisation i.e. on variability of incomes and not of the level of the incomes as such. Income instability is defined as excessive or unexpected departure from the normal trend of income growth. The issue of permanent support to unprofitable but socially desirable production will not be discussed. This is a highly relevant question but it falls beyond the scope of the paper. Income stabilisation can be achieved by various measures such as price stabilisation, crops insurance, income safety nets etc. A short evaluation of those measures will be provided in the paper.

Markets and incomes could also be stabilised by use of supply management measures such as long term set-asides, pre-pension schemes, herd-buy-outs. Those are not traditional instruments used for the purpose of dampening of variability of relevant variables but stabilise market by reducing supply. Use of such instruments could be justified in the process of reforming agricultural policy to facilitate a removal of resources that are deemed to leave agriculture but where the adjustment process may be slow. The paper will not cover this type of policy. It is not to deny the crucial importance of such or similar measures. Any substantial reform of the CAP may imply restructuring of agriculture, downsizing of some activities, regional reallocation of production etc. This could involve social hardship for the affected producers and should be avoided by an appropriate combination of economic and social policies.

## **2 Will agriculture be a more risky business in the future?**

The recent surge of interests in risk managing tools for agriculture is to a large extent explained by the fact that it is believed the risk exposure the sector is facing will increase in the future. Several arguments are advanced to support this claim. Liberalisation of the CAP is expected to increase price variability and more restriction on the acceptable methods of production, e.g., ban of certain pesticides, may result in higher yield variability. Climate change will have an impact on production risk as well since volatility of weather and ensuing crop failures may increase. In addition, increased trade flows in animal products and growing mobility of people and movement of animals can result in an increased spreading of plant and animal diseases across national borders. Structural change in agriculture contributes also to an increased risk exposure. Specialisation in European agriculture is increasing which raises both producers' production and price risks (compare below).

The predicted increases of risk mentioned above are basically of two kinds. Some refer to exogenous changes of climate or travel patterns. Others connect to future policy changes, some of them yet to materialise, such as a more radical market liberalisation and more stringent environmental policies. Needless to say, increase of risk will depend on the extent such policy changes will take place.

## **3 Risk and agriculture - how much different?**

How different is agriculture with respect to risk from other type of economic activities? Agriculture face many different risks (see below). However, all risk will ultimately affect income. Hence it may be useful to focus on income risk. Are farmers' incomes much more prone to variation than income from other firms and businesses that can be found in rural areas or in the economy in general?

Risk can be classified by its origin and its consequences. Agricultural enterprises face many types of risk. Several of them are common to all businesses such as risk linked to family situation, health, personal accidents or macroeconomic situation, financial and business environment. In addition, agricultural businesses are faced with number of

risks due to nature of production. Those include production risks as a result of plant or animal disease, natural damage as a result of drought, floods, frost, hail or storms, ecological risk caused by climatic change, pollution etc. Price and market risks as well as institutional risks could be added to the list. This paper will focus on price risk and yield risk. Those risks have major impact on farm income.

Risk in farming is often considered as having specific characteristics. Dependence on climate and biological processes makes it more difficult to control than mechanical processes. Inelasticity of supply and demand contributes to fluctuation in commodity prices. It can, however, be argued that risk is an inherent part of any business activity and some risks are taxed rather than subsidised (OECD 2001). Risks related to changes of demand are higher in other sectors and risks in agriculture are known. Unfavourable weather may ruin incomes in several branches of the economy especially in tourist industry including small businesses in rural areas.

The preceding section raised a question whether risk in farming will increase in the future. It can be observed that it is not only farming that may face a prospect of increased economic vulnerability in the future. The process of globalisation contributes to increased risk in many other spheres of economic life. For instance, small towns/communities that strongly depend on one single industry for income and employment face considerable risk in a globalised market.

The question whether farm incomes tend to vary more than incomes of other comparable groups (small enterprises) is an empirical matter. To some extent differences in income risk can be assessed by comparing relative frequency of bankruptcies in sectors dominated by small enterprises including farming. Swedish data for 1989-1990 indicate that the frequency for agriculture, forestry and fishing was considerably lower (0.16) than for other sectors (1.09-2.43), (MOLANDER 1993).

To summarise, the comparison between agriculture and other sectors with respect to risk is not easy to make especially as the relevant comparison relates to risk exposure in the future. On balance, one could argue that agriculture may in the future face somewhat higher risk than comparable sectors in the economy.

#### **4 What can farmers do about risk?**

Risk has always been present in economic activities of human kind and some of the strategies to handle it, such as saving surplus from periods of plenty to periods of scarcity are, indeed, very old. Farmers can either reduce the risk or cope with it by sharing risks with others. Farmers can achieve reduction of risks by measures on the level of household or by choosing less risky farm activities. Keeping low debt to asset ratio and a certain level of liquidity are examples of financial management that farm households can engage in. Diversification through increasing the share of incomes from other sources than agriculture contributes also to a reduction of an income risk of the household. On farm measures include reducing exposure to production risk by plant protection and disease control or diversification by selecting a mixture of agricultural activities that have net returns with low or negative correlation. Price risk can be reduced cultivating crops where prices are guaranteed by the government. Coping with risk involves sharing and shifting of financial and production risk to those for whom bearing risk is less costly. Strategies to share risk with others include buying insurance, engaging in contract marketing, leasing equipment, joint purchasing of inputs and marketing of products and hedging on futures markets. Finally, farmers may rely on existing social, fiscal and agricultural safety nets or count on public disaster aid.

## 5 Justification of state aid and insurability of risks

A standard argument for state intervention in the market rests on the existence of market failures. Other rationale for the intervention can be a desire to redistribute income to producers especially if welfare of the producers would be seriously affected otherwise. Besides having a negative effect on welfare of farm families, high fluctuation may, moreover, have negative impact on rural areas. The latter justification involves value judgement and is a matter for political opinions and preferences. Those vary considerably between different countries. Substantial differences exist even between Member States in the EU. This paper will focus more on economic aspects.

The economic argument for state intervention is based on missing markets. If uncertainty affects farmers' decision regarding production and use of resources and lead them to produce below profit maximising level of output and to avoid production of riskier commodities social welfare will decrease. Farmers could cope with uncertainty by relying on contingency markets to neutralise risks. In reality contingency markets are not always available and they have a cost. In addition they may not be sufficient in case of natural catastrophes. Moreover, unpredictability can lead to misallocation of resources. Excessive risk can make access to credit more difficult and may threaten the survival of the enterprises.

Market failures, contributing to difficulties in establishing contingency markets, can be significant due to human cognitive limitations related to low probability, high-magnitude risks, systemic risks and asymmetric information. People tend to underestimate or even ignore low probability risks. Furthermore, people tend to underestimate risks of natural disaster but overestimate man made risks. People are generally optimistic and think that their own risk is lower than risk for other people. Asymmetric information results in adverse selection because it gives the insured better possibilities to determine the soundness of premium rates than the insurance provider has. As a result level of risk of the insured population is higher than of uninsured population. Additional problem that is caused by the asymmetry of information is that of moral hazard which occurs when the insured is able to increase his or her indemnity by altering their behaviour after buying the insurance and without the knowledge of the insurer.

The CARPE report (EUROPEAN ECONOMY 1997) argued that justification of governmental assistance comes from the scale of the problem of risk management in relation to the size of the business involved and producers' capacity to act.

The aforementioned report by the European Commission has identified several market failures related to the risk management in agriculture. On demand side there is a lack of knowledge on behalf of farmers how to use risk management tools, cognitive failures that make farmers to underestimate the risk they face especially for events with low probability and high potential losses. Farmers may moreover rely on ad-hoc disaster aid, off-farm income and the demand for risk management products is therefore low. On the supply side, insurance may not be supplied, as a result of violating of the conditions for insurability (see below), catastrophic risks may be difficult to be insured at reasonable costs. Establishment of future markets requires a fulfilment of a number of conditions.

The most efficient method of correcting market failure is to facilitate the establishment of missing market for risk coverage. Public policy can intervene by setting the necessary legal framework for the creation of such markets or/and provide incentives for development of markets or lower the costs of such tools (by providing subsidies for insurance premia). If the establishment of missing markets is not possible,

the second best solution is to bridge the missing market. Income safety nets can perform this role.

However, even if presence of market failures can justify government intervention, it has been criticised because it prevents development of market solutions, transfer support to farmers and leads to rent seeking behaviour. In some cases government provided insurance may create an insurance market where none market existed, but this insurance does not necessary eliminate problems. Pooled insurance premiums and subsidised premiums can provide the wrong incentives to farmers. Excessive subsidisation of risk may easily result in “overcorrecting” of market failures with too much, not too little risky production taking place. Subsidisation can also encourage use of risky methods of production such as cultivation on marginal lands susceptible to drought or other natural disasters, high density of livestock, which contributes to spreading of animal diseases.

All risks cannot be insured. Moral hazard and adverse selection inhibit, as mentioned above, establishment of insurance markets. To avoid moral hazard, only accidental or unintentional losses can be insured, i.e. insured parties must not be able to affect damage or possible claim. Insured parties cannot have more information about their risk than the insurers. Insurance is based on aggregating similar independent risks into a single insurance pool for the purpose of reduction of variability of the loss. This presupposes existence of large number of roughly homogenous, independent exposure units and no catastrophic losses. The last mentioned can, however, be dealt with by re-insurance. In addition, conditions for insurability of risk include availability of statistical information enabling to establish extent and frequency of damages. Furthermore, premium rate for the participants must be acceptable and economically feasible (EUROPEAN ECONOMY 1999).

For the insurance contract to be financially viable for the insurer revenues from premiums must at least equal the cost of indemnities. In addition, if the insurance company is to stay in business administrative costs and normal profits must be covered as well. As a result the expected cost of buying the insurance is negative. Hence, unsubsidised insurance will usually be attractive only for risk averters i.e. to those who prefer a certain outcome to an uncertain outcome with the same expected value. Insurance is, accordingly, applied for risks that could threaten the continued existence of farm business or that could seriously damage the welfare of the owners, (EUROPEAN ECONOMY 1999).

## **6 Risk management tools in use in Europe and elsewhere**

Many tools are available for managing risk in agriculture. While the ultimate objective is usually to reduce large farm income variations, in particular to avoid large income losses, various parameters are targeted. Some tools such as various insurance schemes or futures market are exclusively designed for the purpose of risk management. In other cases stabilisation is an element of a broader arrangement or even a by-product of a scheme designed for performing other functions. Below a short overview of major instruments that directly or indirectly contribute to stabilisation of incomes is provided. The reason for doing this is that the objective of this paper is not to provide a general discussion of risk management but to raise a question whether risk management tools should be added to pre-existing CAP measures or replace some of them in the process of agricultural policy reform. This question can only be answered taking into account the totality of existing measures.

- Price insurance

Market support in the framework of the CAP has major impact on farmers' price risk. Price stability provided by market regimes varies, however, between different commodities. Price variability for leading prices on European markets is illustrated below. Table 1 shows coefficients of variation for the same commodities. Considerable differences in the variability of prices can be observed. Diagram 1 and 2 illustrates development of prices for major agricultural commodities 1973-1993.

Table 1: Coefficients of variation for major agricultural commodities

Commodity	Mean	Var.	Stand. Dev.	Coeff. of Variation
Wheat (soft)	14,97	6,75	2,60	17,35%
Barley (feed)	13,52	4,90	2,21	16,37%
Maize (grain)	15,28	7,67	2,77	18,13%
Rapeseed	26,63	25,53	5,05	18,98%
Beef	287,18	1609,63	40,12	13,97%
Pig meat	134,14	365,32	19,11	14,25%
Lamb Meat	121,65	1715,23	41,42	34,05%
Broiler	138,88	337,60	18,37	13,23%
Butter	323,89	2049,62	45,27	13,98%
SMP	169,23	2482,90	49,83	29,44%

(Source: calculated by ANDERS BÄCKSTRAND (SLI) based on AGMEMOD Database)

Price risks can be covered to some degree on futures and option markets, i.e. an exchange in which futures contract and options are traded.<sup>2</sup> These instruments are efficient for systemic price risks. Hedging price risks on future markets reduces risks from price declines within a given year but provides little or no inter-year income stability. Besides reducing short-term risks, future markets increase price transparency. In Europe, futures can be traded on five exchanges. Traded volumes are low. Use of future markets in Europe is hampered by CAP-induced price stability. Uptake is, moreover, slow because use of futures requires considerable investments in know how and infrastructure. However, even when futures and option markets are well-developed farmers are reluctant to use them (EUROPEAN ECONOMY 1999).

#### ▪ Exchange rate insurance

The agro-monetary system introduced in 1960 provided for a long time insurance against exchange rate volatility by allowing for differences in institutional prices between different MS thereby avoiding price reductions in countries with appreciating currencies. The completion of the internal market in 1992 resulted in equalisation of institutional prices and removal of MCAs. MS could, however, still compensate farmers for currency revaluations and ensuing reduction of prices by other means such as direct subsidies, partly financed by the Union. The completion of the third stage of EMU and the introduction of the Euro made any such arrangements redundant for the participating countries. The agro-monetary system has been eliminated in January 2002 even for those countries that do not participate in the EMU. Of the three countries, Denmark participates in ERM2 keeping its currency within 2.25 % band making the impact of monetary variability on farm income minimal. Sweden and the UK do not participate

<sup>2</sup> A futures contract is an agreement priced and entered on an exchange to trade at a specific future time a commodity with specified attributes. An option is a contract that gives the holder the right to, without obligation, to buy or sell futures contract at specified price within a special period of time regardless the market price of the future (OECD 2001).

Diagram 1: Livestock commodities

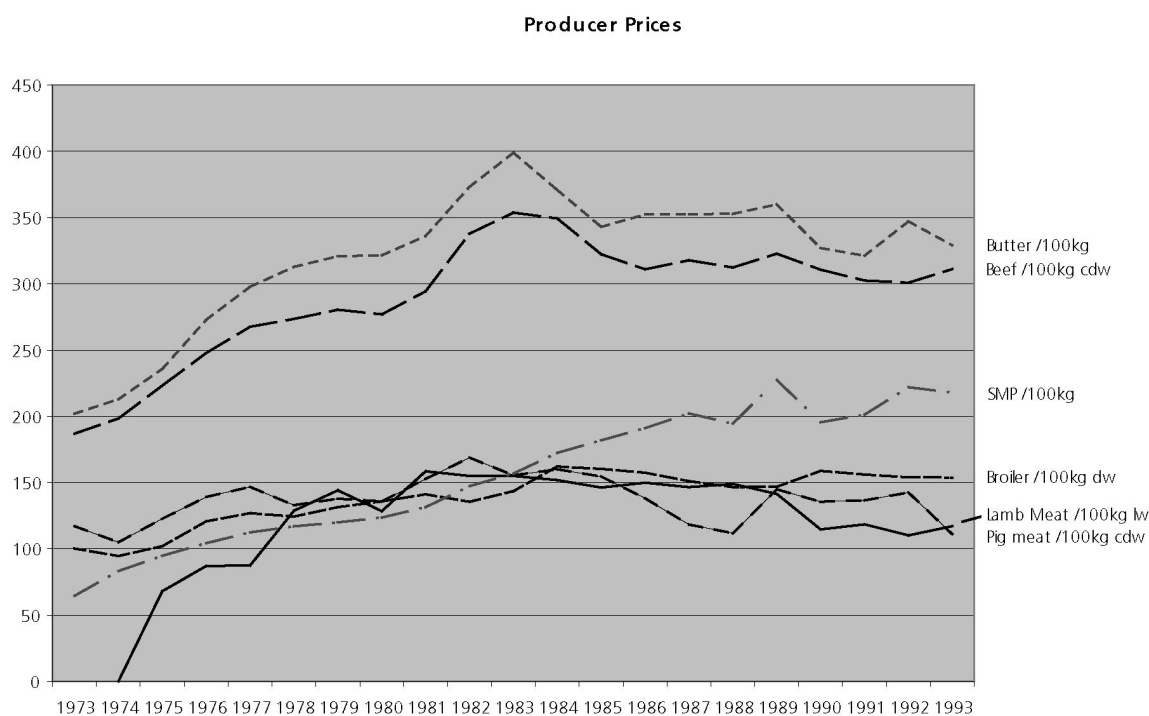
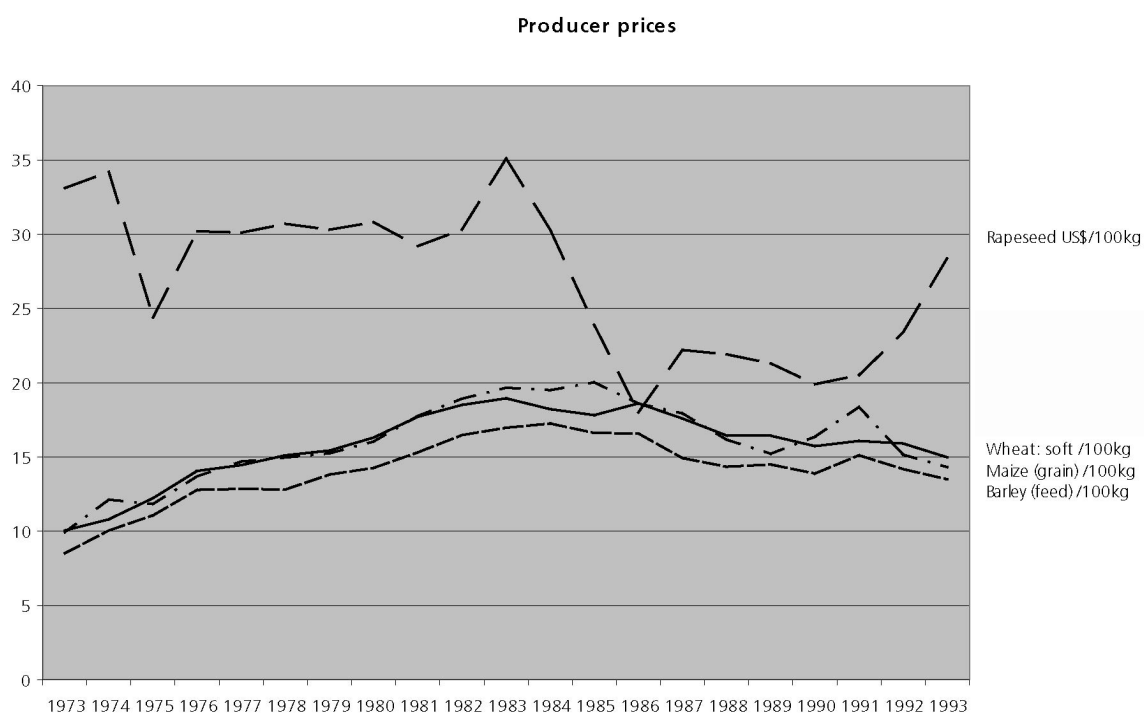


Diagram 2: Crops



(Source: prepared by ANDERS BÄCKSTRAND (SLI) based on AGMEMOD Database)



in the ERM2 and follow similar monetary regime based on inflation targets and floating currencies. A strong devaluation of pound sterling in 1992/3 and an equally strong revaluation since 1995 contributed significantly to massive instability of incomes in the UK agriculture.

The issue of coping with monetary instability may re-emerge after the enlargement. The new member countries will not join the EMU at the accession. The extent of the problem will depend on the monetary arrangements followed.

- Crop and yield insurance

Yield insurance is available in several countries, (see below for examples). Any field crop is subject to variability of yield. In reality, however, only the main commodities are covered. There are special problems in devising yield insurance for speciality products, intermediate commodities and livestock products (EUROPEAN ECONOMY 1999).

In the US a comprehensive system of crop insurance is in place with state involvement in subsidising insurance premia, covering administration expenses, reimbursing acquisition costs of private sector and providing reinsurance. In addition substantial “emergency aid” has been paid since 1998. In Spain there are numerous insurance companies which offer coverage for almost every agricultural risk. Premiums are subsidised by the government (between 20% and 40%). In addition the state provides reinsurance. In France agricultural calamity funds exist which covers perils such as excessive rains, flood, frost, drought, windstorms, epidemics and parasites (CEC 2001).

- Other type of production risks

For livestock products where epizootic diseases are eradicated by stamping out, full compensation is paid to the farmer for capital lost. The EU reimburses 60% of the costs. Only farmers that have their animals slaughtered are entitled to compensation. Farmers who suffer income loss due to restrictions on movement of animals are not compensated. Neither are other rural interests compensated.

The reimbursement from the EU is supposed to come from the Veterinary fund. The Veterinary Fund is, however, not a fund in proper sense of the word but rather a budget line in the agricultural budget. This is clearly demonstrated by the fact that the total spending exceeded allocated means several times. The issue of reforming of the fund has been raised during the Spanish presidency but not resolved as yet.

- Direct payments

Direct payments (DP) have now emerged as a major instrument of the CAP. Those payments account now for a substantial share of the budget. Roughly speaking two types of payments can be distinguished. The payments that originated as compensations in the process of reforming of commodity regimes, MACSHARRY and Agenda 2000 and various environmental payments. The switch from price support to area and livestock based payments has contributed significantly to an increased stability of farm incomes in the relevant sectors. Those payments are very unevenly distributed among commodities. Livestock, in particular, is less dependent on direct payments than the crop sector.

- Income and revenue insurance

It could be argued that the real problem of instability is income risk. Price and yield correlation determines the need for insurance. If the correlation is strongly negative

there is little need for insurance and if price (yield) only is insured farmers will be over-compensated, (EUROPEAN ECONOMY 1999). However, it should be observed that on large, well-integrated markets with varying natural and climatic conditions for agriculture, prices and quantities will not necessarily move in opposite direction for all farmers. Some producers may face low prices and below average yields at the same time. However, yields for some bulk commodities seem to be correlated across large geographic regions.

Different measures for income stabilisation exist. Those include gross revenue insurance, income stabilisation accounts, business continuation assurance or anti-bankruptcy assurance and allowing for different social security eligibility criteria for farmers when incomes are low. It is not possible to provide any detailed description or evaluation of the available measures here. The purpose is only to indicate what options exist.

*Gross revenue insurance* has an advantage over price and yields stabilisation by allowing for the fact that most farms are multi-product businesses and it is unusual that all markets fail simultaneously. Farm revenue insurance will, furthermore, be cheaper since low revenues from one enterprise are likely to be partly offset by high revenues from another enterprise. Moreover, insuring whole farm revenues will not distort market for any particular commodity.

An attempt to introduce a gross revenue scheme for pork production in the EU in spring 2000 failed. The scheme did not include any element of subsidy and basically did not offer the pork producers anything that they could not do better by themselves.

A *net income stabilisation fund* is an instrument with which producers can stabilise their income in the long term. The fund is set up by producers in good times and used for withdrawals in bad times. The government can stimulate participation in such a fund by granting a subsidy, guaranteeing an attractive interest rate or offering tax relief. The advantage of the scheme is that it supports income security and is principally suited to all businesses. The scheme does not offer a compensation for structurally declining prices and incomes being thus a pure stabilisation measures (LEI 2001).

Several variants of stabilisation funds are or had been in use around the world. The Australian scheme allows farmers to transfer money into income equalisation deposits in high-income years with funds so transferred being treated as deduction from income tax. When bonds are encashed, the funds are added to the taxable income that year. Canadian NISA subsidises and assist farmers in building savings for low revenues years. Farmers contribute and receive dollar-for-dollar match from the government. Farmers are allowed to contribute up to 2% of eligible sales. Withdrawal is allowed when gross revenue falls below a minimum income level. An another Canadian measure is anti-cyclical income support (AIDA). In this system, payments are made if individual farm incomes fall below 70% of their historical three-year average. The provisions for calculating the trigger for payments ensure that newcomers, high debt and low-debt are treated equitably.

*Anti-bankruptcy assurance* was part of the Swedish reform of agricultural policy of 1990, but more as an exit than as a stabilisation measure. (The intention was that new entrants and farmers who made large investment prior to the reform decision should not go bankrupt because of the reform. The option was not used in practice due to accession to the EU). This option has obvious merits from the social point of view since farmers are often personally responsible for their losses but can be very tricky to implement in practice due to difficulties to distinguish between the impact of “bad luck” and bad business practice. The risk for moral hazard is obvious.

Applying different social security eligibility criteria for farmers when incomes are low could be motivated by the fact that farmers cannot temporarily leave their business and look for other occupation in bad years (EUROPEAN ECONOMY 1999). The same applies, however, for many other businesses.

- Experiences with insurance schemes

Agricultural insurance systems that are in use vary considerably with respect to coverage, degree of subsidisation and degree of government involvement in the provision of the insurance. Greece relies on predominantly public system involving compulsory contributions and guarantees coverage of losses. In Spain and Portugal government plays a key role by providing both premium and subsidies and re-insurance. Italy, France, Austria have predominantly private systems of agricultural insurance but differ considerably with respect to subsidies for insurance premia. Italy grants considerable amounts. Germany is not providing any subsidy (CEC 2001).

Experience with multi-peril crop insurance indicates that governments are subsidising them to a great extent. Thus, coverage of a wide range of perils at a level of protection that is interesting for farmers seems to require considerable state involvement. However, even insurance systems benefiting from considerable public support do not have universal uptake rates, the coverage in terms of products and participants remains limited, 30 % in Spain, 20% in the US but more than 60% of eligible acreage is covered (CEC 2001).

Questions that can be raised with respect to insurance whether existing arrangements provide enough social returns to justify high costs indicated above. Questions arise also as regards efficiency of public-private partnership (CEC 2001). Since subsidies are normally set as percentage of premia, farmers facing highest risks receive highest subsidies. This may contribute to more risky production taking place.

## **7 Mid-term review**

Since a decision to reform the CAP has been taken on 26 of July, the relevant question is whether the post-reform CAP should be amended. The studies that are available analyse the reform proposal by the Commission rather than the final outcome of the process. All studies indicate that production, in particular beef, will decrease. The question relevant to this paper is whether the reform will produce less or more stable farm incomes? It is beyond the scope of this paper to offer an in depth analysis what kind of impact further decoupling of direct payments, implied by the reform, may have on the variability of prices and yields. It could be hypothesised, however, that a joint effect of decoupling, modulation and cross compliance may result in lower use of farm inputs such as fertiliser and pesticides. This in turn could increase variability of yields.

Introduction of direct payments had a major impact on increased stability of incomes, especially in countries participating in ERM, i.e. with stable currencies since part of the farm income was replaced by a payment with zero variance being based on fixed yield and fixed remuneration per output unit. Since, according to the reform decision, only 5% of payments will subject of modulation, the stabilising effect of direct payments will remain more or less the same.

Hence, it may be concluded that, by and large, post midterm review CAP could be quite similar to previous CAP with respect to the stability i.e. the reform would probably not significantly increase instability, if at all. Hence, previously formulated conclusions should, on the whole, apply.

## 8 Is there an added value in common risk management policies?

One of the key issues raised in this paper is whether a case can be made for amending the CAP (present or post midterm review) with risk managing tools and if so which tools would be appropriate. From the presentation above follows that the CAP has, albeit indirectly, played a major role in reducing risk from farming activities but that the involvement of the Community in direct risk management is limited. The CAP contributes substantially to price stability, but there are considerable differences between different commodities. Some sectors operate already almost on market conditions. With exception of epizootic diseases, production risks are insured, at the MS level, if at all. Direct payments contribute substantially to income stability by being independent on current prices and quantities but have not been explicitly designed for that purpose.

A report on the insurance by the Commission, quoted before, states that the present CAP performs quite well in stabilisation of farm incomes. The report argues, furthermore, that there is no need to add insurance schemes to the present CAP since existing rules allow MS to introduce such schemes on the national level whereas adding insurance policies on top of the existing common regulations would only result in a very complicated policy.

What role should the EU play in providing stabilisation instruments? This question could be more suitably approached using the concept of subsidiarity. The principle of subsidiarity implies that the Commission, Council, or another EU body should not try to do things that national governments can do equally well, or better, by themselves. The major criterion of judging what is “better” for the purpose of our analysis is economic efficiency. Additional criterion that could be invoked relates to accountability of the policy, i.e. possibility of the citizens to exercise a democratic control over policy making. Accountability is basically a political economy argument. The underlying question is whether a common policy is less or more prone to be captured by special interests than it would be the case with national policies. Furthermore, common policies may include an element of income redistribution between countries, making it possible for the poorer members to afford policies which they otherwise would not be able to apply.

Existence of spillovers and economies of scale and scope are common efficiency arguments in favour of centralisation. Policy spillovers arise when the policy measures adopted at national level have economic effects that cross national boundaries and may in some cases have negative implications for living standards in other countries. Where actions of each national government have consequences which are felt outside its territory, it is unlikely that the policy decisions taken by national governments will fully reflect all the costs, and benefits of particular policy choices, in particular of non-residents are unlikely to be given adequate weighting. In such a case, independent national policies will produce inefficient results.

Some public goods cost less or are more effective if provided by the centre than by several separate states. Economies of scope may emerge when the Community is involved in several disciplines. Centralisation allows more specialisation and, hence, more gains from division of labour. Problem of communication and control will, however, generally increase more than proportionally with size. Hence, there are also likely to be *diseconomies* of scale with centralisation. Common decision-making *per se* may be associated with costs. Speed and easiness of making corrections and alteration may be impaired. Centralisation may require large bureaucracies (high

transaction/administrative costs), detailed regulations and far-ranging administrative controls in order to ensure that policies really are common.

An advantage of decentralised decision-making is that Member States may be better informed about conditions that affect the local implementation of policies, and have better knowledge about local preferences. Better knowledge about the effects of policies may also give an advantage to the state authorities. Decentralisation implies that policies can be more flexible and responsive to local conditions, while centralisation relies on rules on equal treatment of states/localities, and central authorities tend to prefer simple and relatively uniform policies.

Below, the aforementioned criteria will be applied to different type of risk (price, yield, income) and risk management instruments that are used or could be used in the EU. Efficiency arguments are better analysed separately for different types of risk. Political economy and equity considerations will be discussed jointly.

*Price risks* are at present mitigated by common instruments operating on the market. All stabilisation instruments that operate in this way must be a common responsibility. Different countries cannot independently intervene in the same market. Market-driven stabilisation tools such as futures markets are gaining some importance but volumes are still small. Active encouragement of development of such instruments (through provision of information, education etc) could be a joint responsibility of the Commission and MS.

With exception of epizootic diseases, where some financial support is provided, *production risks* are mainly a responsibility of MS. The EU plays only a limited role at present in setting the overall framework. In situations where national governments rely on ad hoc disaster aids, insurance could increasingly replace them. This would increase predictability, stabilise expenditure and reduce negative effects of disaster aid. Would it be efficient to centralise the provision of insurance against crop failures and other perils? In principle, insurance is based on pooling independent risks. The system works better the bigger the pool is. In addition, economy of scale in administration could provide arguments for a common scheme. However, implementation at the EU level may be problematic due to the fact that insurance schemes are susceptible to fraud which may be more difficult to control at EU level.

Moreover, crop insurance schemes that exist in different MS vary considerably with respect to the degree of subsidisation of premia. This reveals differences in policy preferences between the MS as far as desirable redistribution of income to farmers is concerned. In such a situation, a decentralised policy performs better (compare the discussion above). Insurance should, hence, be primarily developed at MS level. Spanish experience shows that a comprehensive system of agricultural insurance can be developed within common framework of state aids. As long as national schemes are compatible with this framework, there is no danger of distortion of competition and no negative spillovers.

Veterinary Fund as designed at present provides an example of common “insurance” that is not working very well. Veterinary Fund could be argued constitute a free of charge insurance for epizootic diseases with “re-insurance” provided, again free of charge, by the EU budget, (HOWE and WHITTAKER 1997). In reality such a scheme contributes to a substantial redistribution between regions and MS, to the advantage of MS facing high risk to regions facing low risk as well as encourages an inefficient, i.e. too risky production. A study of the impact of foot and mouth disease conducted in Sweden and based on the CAPRI model compared EU-budget financing of a hypothetical outbreak with financing based on the number of susceptible animals and

the stocking density coming to a conclusion that redistribution is considerable (NORELL et al. 2002). The same study came also to the conclusion that a risk based on the financing of the cost of the outbreak, if paid by farmers as an insurance premium or a fee to a fund, would affect allocation of production. Regions with highest stocking densities would lose competitiveness.

Accordingly, the EU should play a role only when production risk is to large extent systemic since in such a case either no insurance is being offered or is not commercially viable due to high cost. EU could facilitate re-insurance of risk by providing a proper legal framework. Providing re-insurance would address one of the most important obstacles for development of insurance systems, i.e. potentially catastrophic losses. If such re-insurance were provided, more insurance companies would offer the coverage of risks potentially resulting from catastrophic losses. Re-insurance should, however, not imply pooling all risk and subsidising high-risk areas. Annuality of the EU budget constitutes a problem if re-insurance payments were to be provided directly from the budget.

*Income and revenue insurance* schemes are at present not used in the EU. Since such schemes could constitute a future option for agricultural policy it may be of interest to analyse whether, in the case such tools were introduced, they should be a part of a common policy. Introduction of income and revenue insurance involves several issues, both technical and more principled ones. Income insurance schemes resemble socially motivated safety nets raising the questions of compatibility with existing national social security systems. Moreover, social policy is not a competence of the EU and it is doubtful whether this should be the case. Especially if only one sector of the economy is covered. The concept of “fair income” which is invoked in the Treaty has never been clearly defined. Moreover, in the Treaty, achievement of farm incomes is connected to raising productivity of farm labour rather than to providing social assistance.

Additional problem connects to co-ordination of taxation policy. Some income insurance schemes are based on tax concessions. Since tax policy remains at national level such policies would be difficult to implement as common policies. Schemes that do not rely on tax concessions but on public subsidy could more easily be implemented at EU level but differences between tax systems applied in different MS could pose problems with respect to identifying income. The issue is, however, how efficient would such a system be. As it is the case with crop insurance, the bigger the pool the easier it is to reduce variability. This would be the case if all countries and all commodities were involved. However, this type of measures are very demanding as regards information requirements, especially AIDA type solutions, (individual income histories are needed) and administrative provisions. Risk for fraud seems considerable. For farm level insurance, significant investment in monitoring and acquiring information must occur to connote moral hazard and adverse selection. Income insurance schemes seem, thus, more appropriate at national level.

Revenue insurance schemes would escape some of the problem of co-ordination with social and taxation policy that was discussed above. However, even in this case introduction of a common scheme may involve considerable bureaucracy. It could be noted that the proposed insurance scheme for pork was envisaged as a voluntary measure at the MS level.

Moving to political economy consideration, lobbyists and rent seekers who risk losing subsidies generated by price and income support programmes may switch their attention to obtaining rent from risk management and insurance programs. Centralisation of decision making may facilitate this process. Albeit not universally

agreed in the literature, it has been argued that the centralised bargaining process inherent in the CAP has increased the strength of the farming lobby and has created a bias in favour of farmers. An advantage of common schemes could be that this would make it possible for poorer farmers to participate.

## **9 Risk management tools and liberalisation of the CAP**

The discussion above focussed on the present CAP. The question that emerges is what role risk management tools should play on a liberalised market. It is not easy to know how such a liberalised market would look like in details. The author of this paper has for obvious reasons some bias for a reform along similar lines as suggested by CARPE. Long term reform proposal advanced by CARPE envisaged a gradual elimination of market support and introduction of environmental support (landscape payments) as well as rural development support, which was suggested to include a broader range of measures, beyond present extend of the regulation.

The measures that are presently included in the CAP are designed to support farm income. By pursuing this objective stabilisation is achieved as a by-product. Risk management tools cannot reverse long income trends and hence accomplish this dual objective. Neither should they do so. Any serious liberalisation of the CAP presupposes a removal of the income objective. CARPE proposals argue that the purpose of granting payments to farmers is to remunerate them for provision of public goods that otherwise would not be produced.

With liberalisation of agricultural markets in the EU, price variability of products currently supported will tend to rise; though effect will be less in large, highly integrated markets. Annual income in agriculture can vary vastly in the absence of government intervention.

Should risk be primarily responsibility of farmer as manager or should farmers be offered some assistance for managing the risks? Removal of market regimes could stimulate development of futures markets. However, as pointed out before, even when such instruments are well developed, farmers are reluctant to use them. On the other hand, farmers that are facing most risks, i.e. large, specialised commercial farmers are best suited to use such instruments.

It is not likely that liberalisation will significantly increase yield risks. Hence, the issue is whether prices or incomes should be stabilised. Stabilisation of prices could be achieved by relying on existing CAP instruments and using them only as “safety nets”. This could imply keeping the level of border protection at a level implying zero protection at an average or trend value of world market prices and only to be activated when the price falls below a trend level. A variable levy system, which operated in this way, has been eliminated and replaced by bounded tariffs. However, as long as tariffs are fixed at a high level, the applied tariff can be varied. An alternative method would be the use of safeguard measures. Such measures are already available in the UR AoA and allow increasing tariffs if domestic prices fall too much or import volumes increase too much according to agreed formulas. These measures would imply a simple protection of farmers against low world market prices. A possible complication is “political sustainability” of safety measures. Historical experiences show that it is difficult to separate stabilisation of prices from supporting prices.

Income stabilisation could be achieved by different measures. It is beyond the scope of this paper to argue for a particular choice. Such measures, as argued before, are better suited to be designed and administered at the national level. The main issue is who should be a subject of income stabilisation policies?

In section three it was argued that farmers' incomes after the liberalisation may be more prone for variation than incomes from other comparable sectors but that risk may, due to globalisation, increase in other activities as well. If the difference would be considerable, which cannot be known for sure at present, the argument can be made for designing of farm-specific insurance schemes. Otherwise, a more appropriate solution could be general insurance schemes open for other businesses in rural areas or small firms in general. A related issue connects to choice of relevant policy variable for stabilisation of incomes of farm families namely whether a focus of stabilisation should be farm income or total income.

Risking an oversimplification of the case, future farm structure of Western Europe will consist of two types of farms. On one hand specialised commercial farms, often large ones, and on the other hand smaller farms deriving their income from multiplicity of sources: agricultural production, provision of environmental amenities, rural businesses which may or may not be related to farming, off-farm employment etc. A vast majority of farms have already multiple income sources with farming accounting only for a share of total income. This development has continued for a long period of time and is probable to become even more accentuated with a CAP reform.

The first category of farmers will face much higher income risk than the other one since both price and yield risk increase with specialisation. Risk management by means of diversification is hardly an efficient option for larger farmers who are fully occupied on their farms. Dividing their machinery, time and managerial capacity between several different activities impairs efficiency and hinders exploitation of economies of scale. Existing evidence indicates that farmers are not applying this strategy now and are not much likely to do so in the future. Income insurance schemes could be justified for this group.

The farmers who rely on many income sources will face a much smaller risk, as it is most probable that income changes will not be correlated. For those farmers, stabilising farm income only may be somewhat pointless, if the share is small. Opting for the total income raises again the issue whether farmers should be the only group that is offered income insurance or whether this type of policy should only be offered to other rural households or other small firms.

## **10 Enlargement**

The enlargement will magnify market failures that inhibit establishment of insurance markets in agriculture. In particular establishment of individual income insurance schemes such as AIDA will face tremendous transaction costs in countries where fragmented farm structure prevails.

## **11 Concluding comments**

The OECD (2001) has argued that to evaluate the need of government intervention, it is important to:

- i) assess extent to which there is a market failure and a lack of adequate risk management options,
- ii) assess how costly this failure is in terms of social welfare, and
- iii) calculate the cost and benefits of government intervention.

This paper has only addressed the first of the above-mentioned issues, namely market failures. The issue was raised in relation to the CAP. The main focus of the paper was



the question whether markets for risk reduction are missing or incomplete and risk not sufficiently reduced by existing stabilisation policies. Only in such a situation a case can be made for more government intervention. To justify that such an intervention should take place at the EU level, a common intervention should, according to the principle of subsidiarity, create an added value compared with national policies.

The paper has examined two cases. The first one related to the existing CAP, the second to a future, more liberalised CAP. The present CAP contributes substantially to stability of prices and incomes. This is achieved mainly as a by-product of policies that aim at income support. With exception of epizootic diseases, the CAP does not include insurance schemes against crop failures or other perils. The MS provides such insurance, to varying degree and under different institutional arrangements. It is difficult to find convincing arguments for centralisation of crop insurance. The conclusion that emerges from the analysis is that the EU should only play a limited role in risk management focusing mainly on provision of legal framework and possibly on re-insurance.

Income insurance schemes are at present not used in European agriculture. Such schemes could play an important role in the future agricultural policy. However, insurance schemes may be difficult to apply at EU level. The MS seem more equipped to deal with this type of policies. Incomes could also be stabilised by a common policy, safety nets operating on prices. By relying on safeguard measures within the framework of the WTO, excessive variability of prices could be prevented. The paper has not provided an evaluation of the relative merits of income insurance compared to price stabilisation as measures to stabilise incomes. In fact, those two measures do not exclude each other and could even be used as complements.

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## GREENING THE CAP: THE FUTURE OF THE FIRST PILLAR

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- 1 Introduction
- 2 An overview of CAP reform mechanisms
- 3 Greening the first pillar: why and how
- 4 Concluding comments

### **1 Introduction**

This paper has emerged from discussions in an ARL working group<sup>4</sup> which has met on five occasions during 2001/02 pooling ideas for the next phase of CAP reforms. The two authors and three other members<sup>5</sup> of the ARL group were also participants of the Commission's 1995/96 working group which produced the so-called CARPE concept for a more integrated rural policy. Earlier versions of this paper entitled 'Greening Pillar 1' were written before the Commission produced its "Mid Term Review of the Common Agricultural Policy" (henceforth MTR). A condensed version of what we mean by Greening Pillar 1 forms section 2 below, a fuller discussion of the idea is in SUMPSI VIÑAS and BUCKWELL (2002). The argument of the earlier paper was that if moving funds from Pillar 1 to Pillar 2 by voluntary or compulsory modulation, or by degressivity was so difficult politically, then we should consider the option of achieving the objective of greening the CAP by greening the first pillar. In the light of the more radical than expected MTR, the paper has been restructured to aid the discussion of the further evolution of the CAP which will be publicly debated over the coming months.

There is little disagreement that the present CAP does not fulfil what Europeans want from their prime rural policy (see the contribution of VON URFF in this volume). At the same time the agricultural chapter is the most difficult in the enlargement negotiations with the applicant states in Central and Eastern Europe (see the contribution of WILKIN in this volume). Also the CAP is a continuing source of tension in international relations (see the contribution of ANANIA in this volume). We contend that there is, within the EU-15, a broad consensus between many groups representing consumers, the environment, and the rural economy – and even some representing farmers and land managers<sup>6</sup> – about the shape of the Common Rural Policy which would better deliver what European citizens want. This in turn defines the direction in which reforms should take place, namely to move more of the support offered by the CAP from its existing connection to agricultural production towards a system of more effectively dealing with

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<sup>3</sup> This paper is the opinion of the authors alone and is not to be interpreted as the position of their organisations.

<sup>4</sup> This paper was prepared as a contribution to the Working Group on "The Future role of Agriculture in Europe of the AKADEMIE FÜR RAUMFORSCHUNG UND LANDESPLANUNG (ARL) Hanover, 2000-2002.

<sup>5</sup> EWA RABINOWICZ, JAN BLOM and TOMAS GARCIA AZCARATE

<sup>6</sup> For example the ELO, the European Landowners Organisation and Condiretti, the Italian Farmers Union.

the pervasive market failures surrounding rural land management.<sup>7</sup> To bring this about means continuing the MACSHARRY and AGENDA 2000 reform processes, involving the further decoupling and reduction of production related subsidies and switching support to the delivery of public environmental and cultural landscape services and assisting rural development. Moving the policy in this direction is what we mean by 'Greening the CAP'. We do not go into the details of the environmental issues in this paper. A comprehensive analysis of what greening the CAP means is discussed in BALDOCK and DWYER (2002).

In the present paper we focus attention on what we consider are the most important structural aspects of the next reforms, focussing particularly on Pillar 1. Even within Pillar 1 this paper says nothing about the residual commodity-linked parts of the CAP, which (following CARPE) are, mostly, transformed into the safety net or stabilisation instruments. RABINOWICZ (in this volume) discusses these risk management issues. Neither do we deal with the future of the unreformed sectors such as dairy and sugar, or the detailed adjustments to other commodity regimes (wine, tobacco, olive oil and fruit and vegetables). These are, of course, critical issues, but we argue they are secondary to the structural questions about the future logic and justification of large-scale public support to agriculture and rural areas. As these lagging regimes are reformed they will have to fit in with the new architecture of the Policy. In our view the essence of the debate is how to get more of the CAP support into Pillar 2-type measures. We do not examine the nature and purpose of such measures, this is provided by SARACENO (in this volume), especially with regard to the rural development (as opposed to the agro-environmental) measures.

## **2 Greening the first pillar: why and how.**

The prime aim of future CAP reform is to achieve a better harmony between the conflicting aims of different strands of public policy. The stated aims of the CAP enshrined in Article 39 of the Treaty of Rome made no mention of environment. It was not until the Single European Act (1986) that environmental policy was introduced in the Treaties. In the process the environmental goal became an overarching objective with which, in principle, sectoral policies such as the CAP have to comply. This raises a question of whether it is better to achieve (rural) environmental objectives with suitably modified agricultural policy or to start again with purpose-built environmental policy. Practical politics rules out the second option.

There is a corresponding debate *within* agricultural policy itself. It seems rational to suggest that rural environmental policy aims would be best achieved using explicit agro-environmental instruments whose sole objective is the achievement of the

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<sup>7</sup> Two styles of rhetoric have been used to describe these concerns. Some refer to multi-functional agriculture in which many outputs beyond food and fibre production are deemed important. The list of components of the outputs claimed for multifunctional 'agriculture' is very long indeed: landscape, habitat protection, biodiversity, flood protection, water purification, leisure, recreation and sport, heritage features, vernacular architecture, social structures and practices, diet, costume, as well as food safety and security, and animal welfare. However because there is no agreement on which of these non-food goods and services are included in this term and even less agreement about which of them are associated with sufficient market failure and jointness in production to justify public payments, this term will not be used. The rhetorical style currently in vogue in the Commission is to refer to a policy for quality rather than quantity. The more elaborated version of this then refers to many of the same list as above, mentioning specifically, environment, animal welfare, food safety and quality and occasionally the safety of farm workers. BUCKWELL (in this volume) discusses specifically the public roles in food safety and quality, so the rest of this paper focuses on the environmental and rural development market failures justifying public assistance.

environmental goals.<sup>8</sup> This follows the Tinbergen principle of matching policy instruments and targets. It suggests that the first best solution is to expand the agro-environment programmes under Article 24 of the Rural Development Regulation 1257/99. Why then consider the greening of pillar 1 instruments which patently have had the prime purpose of farm income support?<sup>9</sup> Four reasons are offered.

First, there must be coherence between agricultural and environmental policy. European environmental law exists in the form of the nitrate, habitats, birds, waste and water framework directives. In addition, Member States have their own environmental law. Agricultural policy should, at the very least, not induce behaviour which undermines these directives and laws. This is enshrined in the environmental protection requirements in Article 3 of the Horizontal Regulation 1259/99 of Agenda 2000.<sup>10</sup> Second, there should be policy coherence between the 1<sup>st</sup> and 2<sup>nd</sup> pillars of the CAP. Steps should be taken to ensure that environmental services supplied at public expense through pillar 2 are not undermined by the (currently) six-times-greater public expenditures on pillar 1 measures. The third argument concerns hearts and minds. By introducing environmental requirements into Pillar 1 measures, this could raise consciousness of all concerned about the need to switch the purpose of public supports. This alone has the potential to induce more environmentally benign performance. The fourth is a dynamic argument. Suitably redefined commodity payments might be seen as providing financial assistance to farmers to enable them to adapt their farming system and practices to be less environmentally damaging.

Bringing these together, the important point, and main objective of Greening the CAP is to restore its legitimacy. The thrust of the current paper is that whatever the outcome of the debate on the MTR, the likely rates of implementation of change will still leave, at the end of this decade, the majority of public support being provided within the first pillar. Given European society's high level of concern for environmental goals, the legitimacy of the CAP demands a more conscious effort to ensure that its principal instruments are applied in such a way as to better contribute to the environmental objectives of rural policy. Added to this, and given the volume of protection under discussion, a mere decoupling of pillar 1 support from production, with only a limpid re-coupling to environment or other social goals by cross-compliance, may prove insufficient defence in WTO of the Commission's proposed decoupled payments.

There are a number of ways in which environmental greening can be achieved, they are *not* mutually exclusive. It is most likely that progress will be made by utilising several of these approaches, although this risks complication of the policy.

The first and most obvious is to try to ensure there are not CAP market measures which directly undo or diminish the environmental achievements of the agro-

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<sup>8</sup> It might also be helpful if the language were changed to speak of rural environment schemes rather than agro-environment. Although such is the defensiveness of agricultural interests in 'not losing our money' that this might be seen as unhelpfully provocative.

<sup>9</sup> The most usual interpretation of the price support system of the CAP, and the direct payments which were introduced to compensate farmers when support prices were reduced, is that their purpose is to raise farm incomes. In turn, it would seem reasonable if there is such a goal, then the objective would be to raise the incomes of those who were poorest. It is a curious feature of the CAP that of course, price policy and direct payments help most those who produce most. In addition, as a large proportion of European farmers have non-farming sources of income, it might be expected that an income policy would pay some regard to the total income of agricultural households. In fact the payments are made with reference only to eligible crop areas and livestock numbers. Thus the claim that the CAP is an income support policy is, at best, a crude approximation.

<sup>10</sup> This regulation has not, to date, been implemented with much rigour. It is well known that most member states have a long way to go to fully implement all the environmental directives.

environmental programmes and the environmental directives. Thus, as a general principle of policy coherence, it can be argued that environmental conditions should be attached where feasible to all Common Market Organisations (CMO) supports in first pillar.

In fact, this is already the status quo for direct payments. The environmental protection requirements, article 3, of the common rules for direct support schemes (1259/99) requires MS to “take the environmental measures they consider to be appropriate... These measures may include:

- support in return for agro-environment commitments,
- general mandatory environmental requirements,
- specific environmental requirements constituting a condition for direct payments.”

The article then goes on to require that MS decide on the penalties “that are appropriate and proportionate to the seriousness of the ecological consequences of not observing the environmental requirements... They may provide for a reduction or, where appropriate, a cancellation of the benefits accruing from the support schemes...”

Interestingly, almost all discussion of this issue interprets the whole Article 3 as a ‘cross compliance’ measure, yet, strictly, this only refers to the third indent, attaching specific environmental conditions to direct payments. At present, there is a fairly relaxed interpretation of the cross compliance conditions amongst the Member States. In SUMPSI VIÑAS and BUCKWELL (in this volume), section 3.1, we discuss how more meaningful environmental conditions could be attached to the receipt of direct payments. This is certainly one way of improving the environmental performance of the CAP. Another way of achieving this goal is to attach environmental conditions to investment plans – this is particularly relevant to sectors, e.g. fruit and vegetables, where there are no direct payments. A third method is to achieve some greening by requiring all farmers to conduct an environmental audit. An important principle here is that the first, and vital, step towards changing behaviour is to raise awareness of the environmental effects of the current farming system. It is interesting to note that this latter idea forms part of the Mid Term Review proposals.

The more radical suggestion for genuinely Greening Pillar 1 is to make full use of the first indent - “support in return for agro-environment commitment”. The fundamental principle of this approach – as for all agro-environment schemes – is that society has effectively defined as private the property ownership and use rights for land, above the statutory levels embraced in environmental law. Therefore, if society wishes to induce users of the land to provide certain public environmental and cultural landscape services, then society must pay land managers to do so. The strongest version of our idea for Greening Pillar 1, is to launch a base, tier zero, agro-environment scheme within the first Pillar. Suitably adjusted higher tiers of agro-environment schemes remain in the second pillar.

The core idea is that all member states would agree to a schedule for segregating the direct payments into two parts. The greened part would involve switching, say 20%, of their total current Pillar 1 direct payments into an entry-level agro-environment scheme involving flat-rate area payments. It is for the member states to decide precisely how to operate the scheme within the principles explained in paragraphs 15 to 17 below. The fate of the non-greened remainder of direct payments is then subject to further negotiation – part will be switched to Pillar 2 for rural development schemes, it is likely that the remainder would be subject to a schedule of cuts (i.e. degressivity).

The rationale for a base tier agro-environment scheme follows from the observation from environmental NGOs that applications of the current approach to custom-built agro-environment schemes have been generally conceived to achieve significant environmental improvements on a minority of the agricultural land area.<sup>11</sup> This gives rise to two problems. First, the ecologically rich pockets may be too small and isolated to survive, so the strategy may fail biologically. Second, it encourages the idea that once these pockets of environmental richness are preserved then it does not matter what goes on elsewhere (a segregation approach). An alternative concept is therefore to try and achieve smaller, but still significant, environmental improvements on the majority of the land area (an integration approach), but above the reference level dictated by existing environmental regulation and minimal environmental standards (Codes of Good Farming Practice).

One way to do this is to require recipients of the arable and livestock direct payments to enrol in a base-level, entry tier, land management scheme in return for a suitably scaled part of their direct payments.<sup>12</sup> Such a base-level stewardship scheme would define the parameters of the farming system which have the potential to bring about significant improvements in biodiversity, landscape and heritage conservation, and resource protection. This would include the following sorts of elements:

- specification of management of field margins, and margins along water courses,
- requirements of a proportion of non-cropped habitat on the farm,
- management of certain aspects of water on the farm,
- specific practices to provide food supplies for bird species, and habitat for other fauna and flora, e.g. beetle strips,
- cutting dates for grassland, and (maximum or minimum) stocking densities,
- care for heritage and other valued man-made features.

The details of such schemes would be drawn up within an EU framework, but with flexibility for regional and farming system-specific adaptation. The key principles are that the scheme is kept administratively simple, with non-competitive entry, applicable to all recipients of direct payment and paid regionally-defined, flat-rate, per hectare payments (which would be part of, i.e. not all, existing direct payments).<sup>13</sup> The contracts should be multi-annual, and the scheme would be integrated into the regional programming approach introduced by the Rural Development Regulation.

Greening Pillar 1 through a Base Stewardship Scheme in this way adds a new tier of agro-environmental achievement. Conceptually, it delivers higher environmental standards than achieved by cross compliance (on any remaining payments) and below those of most of the existing higher-level environmental schemes. Figure 1 summarises the interrelation between these schemes in terms of the areas involved (along the horizontal axis) and the scale of environmental performance and thus payment levels

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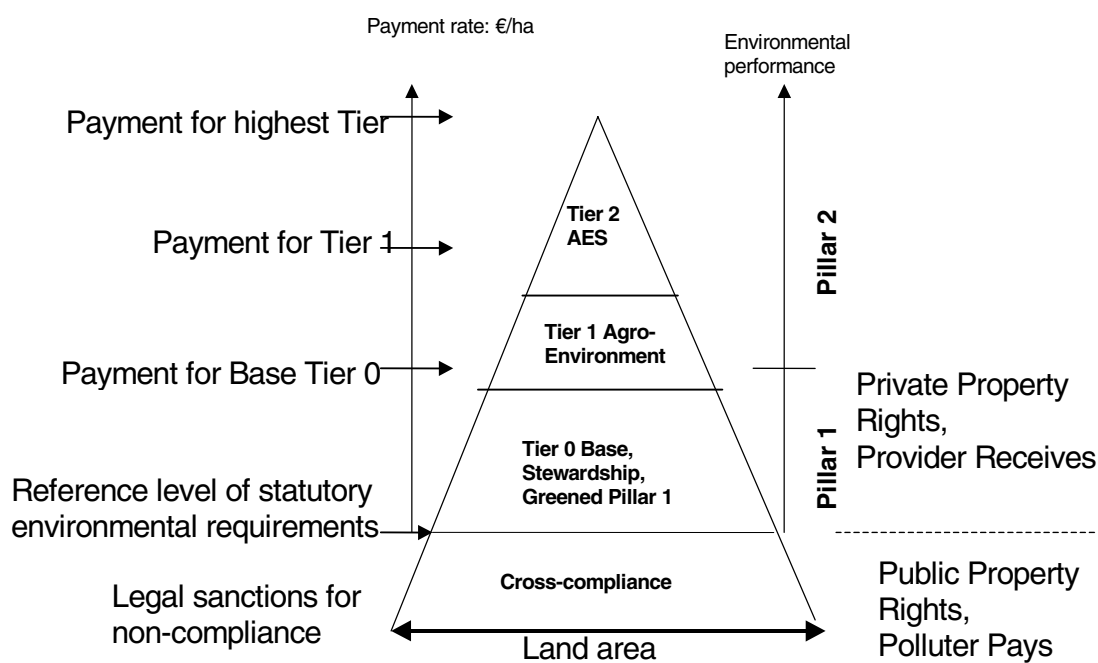
<sup>11</sup> This applies to the Member States where the agro-environment schemes only encompass a small minority of the land area and there are quite demanding environmental conditions and consequently quite large payments. This has been the approach in the UK. At the other extreme is Austria where a majority of agricultural land comes under such schemes, the other member states range in between.

<sup>12</sup> Our proposal here is that the base stewardship scheme should be compulsory. In practice because there is a significant administrative task to get all eligible land enrolled in such a scheme in a single year, it may be necessary to allow it to be optional, but with strong financial incentives for enrolment within a very few years.

<sup>13</sup> Note that this basic land management scheme is identical in concept to the, so-called, entry-level, broad and shallow stewardship scheme proposed by the Independent Policy Commission which recently reported on the Future of Food and Farming in England (the so-called *Curry report*).

(up the vertical axis). It shows the cross compliance conditions applied at the legal reference level, and progressively higher environmental standards, and thus payments, for the new base level or tier zero, stewardship scheme and higher tier schemes.

Figure 1 Interrelationship between Agro-Environment Schemes



The figure is purely illustrative and is not drawn to scale. Some conceptual difficulties of the present and prospective schemes are evident. The first concerns the cross-compliance conditions for remaining direct payments. DPs are sure to continue for many years given politically feasible rates of reform. If the conditions are really no more than the legal reference level, then it is hard to justify any payment at all.<sup>14</sup> Second, in reality, for many years to come, the size of direct payments (whether decoupled or not) will actually greatly exceed the base-tier environment payments which are associated with a higher level of environmental delivery.<sup>15</sup> Third, the intention of a base stewardship scheme is that it should ultimately embrace the whole farmed area. At present the cross compliance conditions can only be enforced on that part of the farmed area subject to existing or future direct payments. A further difficulty with the diagram is that environmental performance is not a simple uni-dimensional scale as depicted here, although for practical administration the payment has to be.

There would be three key decisions required to implement this Greening of Pillar 1:

<sup>14</sup> The logic of paying farmers to respect the law is doubly difficult. From non-farmers point of view it seems to contradict the polluters pays principle. From the farmers' point of view they face a double jeopardy that they get punished once for breaking the law by the normal sanctions, and again by loss of established payments.

<sup>15</sup> Note that a difficult debate is looming on how environmental payments, are related to the (declining) scale of production or decoupled payments. Budget controllers will no doubt argue that smaller decoupled payments means smaller environmental payments (based on the principle of opportunity costs within farming). Farmers will argue that smaller decoupled payments necessitates higher environmental payments (based on their non-farm opportunity costs).

- (i) the amount of current expenditure on direct payments to be devoted to base stewardship within Pillar 1,
- (ii) the amount (of Direct Payments) to be switched to Pillar 2 for other rural development measures – including new measures for improving quality and meeting standards,
- (iii) whether to decouple and reduce the remaining non-greened Pillar 1 Direct payments.<sup>16</sup>

Such a proposal would have six significant benefits:

- (a) The main attraction of implementing base stewardship in Pillar 1 is that the EU's prime instrument of agro-environment policy is then implemented in its 100% EU funded Pillar. This helps to overcome the reluctance of some Member States to switch payments towards the environment as it removes their co-financing obligation. For the core delivery of good basic biodiversity and resource protection, it seems reasonable that this should be taken as a community-wide environmental, and thus financial, responsibility. Higher tiers of environmental delivery are, correctly, a shared responsibility.
- (b) It would reduce the volume of Direct Payments which are only very weakly linked through cross-compliance to the delivery of environmental, or other non-market, services. Thus it would strengthen the claim to have truly 'greened' part of the Pillar 1 Blue Box payments.
- (c) It would enable changes to the current distribution of direct payments which is determined by the historical agricultural production in the EU, as a bigger part of direct payments would be determined by demands for public environmental services in the EU.
- (d) Some of the problems of Eastern enlargement could be eased as during the transition period any reductions of direct payments would only apply to the part which is independent of base-level stewardship scheme.
- (e) A base-level stewardship scheme as proposed would help increase the cost effectiveness of achieving environmental objectives. The agro-environmental schemes of pillar 2 spend a significant part of total budget assigned to RD Regulation and have high transaction costs on a small part of territory. In contrast, the base-level stewardship scheme would spend (initially) a small part of total budget assigned to direct payments and would be designed to have low transaction costs on a major part of the territory.
- (f) This could help achieve a rather quicker switch in the objectives of the CAP payments from income support to supply of environmental services. This would help legitimise the CAP faster than relying on the drip-by-drip approach of fund switching from pillar 1 to pillar 2.

Of course there would be significant costs and an administrative challenge to enrol, monitor and enforce most current recipients of direct aids into such a scheme. The ideal approach would be to switch the purpose and functioning of the IACS data base, from its socially redundant role of monitoring production payments to be an integrated land use and environmental information system - preferably in electronic form. This could

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<sup>16</sup> The remaining Pillar 1 non-greened direct payments – whether decoupled or not-would, of course, be subject to cross compliance conditions – with all the same logical difficulties as discussed above.



enable the information system to become a comprehensive land management tool for the benefit of the land managers as well as the administration<sup>17</sup>. The audits proposed in the MTR would be an important contribution to this, and it is realistic to acknowledge (as the MTR does) that there is an initial investment required setting up the systems.

### 3 An overview of CAP reform mechanisms

The ideas for greening Pillar 1 were developed in the months preceding the publication of the Commission's Mid Term Review. Broadly, we share the Commission's vision for the future shape of the CAP. The task of the next few months is to decide how best to set off towards this vision. The MTR indicates the Commission's suggested route. The purpose of this section is to examine how this fits with Greening Pillar 1 and other suggested routes for the next stage of reform.

The CARPE report summarised the process of changing the balance of objectives and therefore instruments of the CAP in a diagram depicting the shares of the budget devoted to four broad categories of measures. The robustness of this analysis is demonstrated by the fact that the same four categories of support are still relevant although time and fashion results in slightly different labels for them. The four categories identified by CARPE and their current equivalents are:

- |   |   |                           |
|---|---|---------------------------|
| ▪ Market Stabilisation                          | - | Safety Net                |
| ▪ Transitional Adjustment Assistance            | - | Decoupled Direct Payments |
| ▪ Environmental and Cultural Landscape Services | - | Agri Environment Schemes  |
| ▪ Rural Development Incentives                  | - | Rural Development schemes |

The essence of CARPE was that the importance of the Commodity Market Organisations (CMOs) would continue to decline and be transformed into Market Stabilisation measures. Whatever remained of the direct payments would become Transitional Adjustment Assistance, and much of the existing Direct Payments would be switched into Agro-Environment and Rural Development. The principal deficiency of this analysis was the absence of discussion of the mechanisms to bring about these changes. Agenda 2000 provided the policy vehicle of the Rural Development Regulation (1257/99) to receive more of the funds and the Horizontal Regulation (1259/99) was supposed to provide a mechanism to shift the funds between Pillars. However the voluntary Modulation mechanism has proved an insufficient instrument to bring about a real shift in resources.<sup>18</sup>

The thrust of the MTR proposals is to decouple direct payments and move more resources into agro-environment schemes and rural development. The main questions are how to do this, and at what rate. This paper focuses on the mechanisms: The complexities of doing this and the quite different characteristics and impacts of

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<sup>17</sup> It has been observed (MARTIN HAWORTH of the UK National Farmers Union), that the IACS system really is a missed opportunity. It provides no service beyond administrative control. Even for this purpose it was found wanting; for example, it turned out to be of no assistance at all in tracing animals during the UK, Foot and Mouth Disease epidemic in 2001.

<sup>18</sup> The principle reasons for the 'failure' of voluntary modulation have been cited as the problem of finding match funding, and the risk to a Member State of exposing its own farmers to unfair competition from those in other Member States where the direct payments are not cut.

available mechanisms. The rate of change under the chosen mechanism will be decided by political negotiation. The mechanisms have acquired unusual and difficult names with no generally agreed definitions. Tables 1 and 2 represent an attempt to define these mechanisms and their properties. The tables show five adjustment mechanisms.<sup>19</sup> Of these, only the first currently exists.

- **Voluntary Modulation** was proposed as part of the Agenda 2000 package. It is defined in Article 4 of the Horizontal Regulation 1259/99.<sup>20</sup> It allows member states to reduce direct payments by up to 20% and switch the funds into certain Pillar 2 measures. It is in play in the UK, rising to 4.5% by 2004. Until the French Presidential elections in June 2002, it was in play in France at a similarly modest level.
- **Decoupling and Compulsory Modulation.** These are the core elements of the MTR.<sup>21</sup> The essence is that most direct payments are to be converted into historically-based decoupled direct payments (DDP), and these are to be cut by a small amount per year which rises cumulatively to 20%.<sup>22</sup> The smallest farms are to be exempt from the payment cuts, and largest farms are to have a ceiling in their payments.<sup>23</sup>
- **Greening of Pillar 1 (GP1)** is the suggested alternative approach in which part of the production linked direct payments is converted to environmental payments within Pillar 1. This leaves to be decided the fate of remaining Pillar 1 payments.
- **Degressivity** was debated in the final stage of the Agenda 2000 process but not adopted. We are not aware of the existence of a definitive statement on degressivity. The most common interpretation is that involves the progressive reduction of Pillar 1 direct payments. Most proposals suggest differentiating the rate of cuts by farm size, and the presumption is that some, but not all of the funds saved are switched to Pillar 2 schemes. It is not clear if the recycled payments remain with the Member State or are 'returned to Brussels' for redistribution.
- The **Bonds** idea has six components: decouple payments from crop and livestock production, further decouple them from land, fix the duration and extent of the payments and transform them into bonds. These ideas have been promoted for many years by TANGERMANN and his collaborators. The current version is described in SWINBANK and TANGERMANN (2000).<sup>24</sup>

The jargon introduced by this discussion is the invention of Euro-imagination and gives rise to considerable confusion. We therefore summarise our interpretation of what these

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<sup>19</sup> We note in passing that another mechanism for achieving some of the objectives of further CAP reform seems to have gone off the agenda, namely re-nationalisation of the direct payments. We choose not to discuss this as it is a pure financing mechanism rather than concerned with adjusting the purpose of the policy.

<sup>20</sup> Note the voluntary refers to the member state's choice of whether to implement the scheme. Given the decision to implement, it is compulsory on farmers in that MS.

<sup>21</sup> There are of course many other important proposals in the MTR not considered here because we are concerned in this paper in the mechanisms of bringing about reform and not the details of the reform.

<sup>22</sup> Of the total direct payments of € 26.3b (excluding accompanying measures) the COPs, Beef and Sheep payments due to be decoupled account for €22b (83%). The direct aids omitted from the decoupling are for olive oil, dried fodder, textile plants, fruit and vegetables, tobacco and others.

<sup>23</sup> The criteria for defining the size of farm and thus whether they are exempt from payment cuts or have their payments capped, is the size of CAP direct payments and the farm labour force.

<sup>24</sup> In this analysis we do not explore all aspects of the Bonds idea, particularly the debate on whether they are attached to land or seen as entitlements for individuals.

terms mean in Table 1. This shows the presence or absence of six features of the five mechanisms. Further explanation is given in the following paragraphs.

**Decoupling** the pillar 1 direct payments means removing the direct connection between the receipt of a payment and the current (or future) areas, animal numbers, production or prices of agricultural products. It is a defining feature of Bonds Scheme, it is a core part of the MTR. It could be part of the Greening Pillar 1 idea, although the necessity to do this depends on how much of these payments are Greened and how much switched to Pillar 2. It was not part of the Agenda 2000 modulation, but it could be part of degressivity.

A prime reason for decoupling the production-linked, and thus trade distorting, direct payments is to make them more legitimate, and specifically, eligible for the WTO Green Box. It might be thought that part of the purpose of doing this (as seen by EU rural interests) is to render payments exempt from reduction commitments. However, avoiding reduction commitments cannot be the aim of decoupling. Proposals to decouple the payments, such as the MTR and the Bonds Scheme, also propose cutting them!

Table 1: Adjustment mechanisms for the CAP (N = no; Y = yes)

<i>Features</i>	<i>Adjustment mechanisms</i>				
	<b>Modulation Agenda 2000</b>	<b>MTR Dynamic Modulation</b>	<b>Greening Pillar 1</b>	<b>Degressivity</b>	<b>Bonds</b>
<b>Decouple the pillar 1 Direct Payments (DPs)</b>	<b>N</b>	<b>Y</b>	<b>Y in part</b>	<b>?</b>	<b>Y</b>
<b>Decrease the payments annually and cumulatively</b>	<b>Y</b>	<b>Y</b>	<b>Y</b>	<b>Y</b>	<b>Y</b>
<b>Phase-out the payments, Allow capitalisation</b>	<b>N, N</b>	<b>?, N</b>	<b>?, N</b>	<b>?, N</b>	<b>Y,Y</b>
<b>Switching payments into second pillar</b>	<b>All</b>	<b>All</b>	<b>Little</b>	<b>Some</b>	<b>Little</b>
<b>Convert Pillar 1 DPs into AEPs<sup>25</sup> within Pillar 1.</b>	<b>N</b>	<b>?</b>	<b>Y</b>	<b>N</b>	<b>N</b>
<b>Differentiate payment cuts by farm size</b>	<b>Y</b>	<b>Y</b>	<b>?</b>	<b>Y</b>	<b>N</b>

Indeed, once payments are divorced from production (and anything else) it is even more difficult to explain what they are for and to avoid such cuts. The Commission's proposals to impose cross-compliance conditions will not protect these payments for long. First, the notion of cross-compliance has always implied that the payments have some primary purpose, but at the same time it is reasonable to ensure coherence with other objectives of policy such as respect for the environment, food safety and animal welfare.<sup>26</sup> When the payments are divorced from the compensation principle and from

<sup>25</sup> AEP = Agro-Environment Payment

<sup>26</sup> The inclusion of food safety in this list is a particular example of pure political rhetoric – it implies that there is no need, or less need, to worry about the safety of foods not covered by decoupled payments, like pig and poultry products, olive oil or fruit and vegetables! This is, of course, nonsense. *All* food is, and should be, subject to food safety regulation and sanctions for non-compliance.

production, the primary purpose has evaporated.<sup>27</sup> Second, the cross-compliance conditions proposed are existing statutory EU and Member State environmental, food safety and animal welfare regulations. The public are entitled to ask why compliance with these laws is not already expected without the bribes of DPs. Likewise, producers are entitled to ask why they are to be doubly punished, first by the normal legal sanctions resulting from non-compliance with the law, and second, by loss of their long-established payments. Third, a big part of the policy changes (in all options except Bonds) is to put significantly more money into agro-environment schemes. The reference level for environmental performance in all these schemes is certainly well above the statutory legal requirements. If, as many propose, the new agro-environment schemes are rolled out to cover most of the agricultural area, then the Pillar 1 cross-compliance conditions become redundant, covering a smaller part of the total area at lower environmental standards (see Figure 1 above).

***Reducing the direct payments*** in Pillar 1, whether decoupled or not, is a core part of *all* five mechanisms. The main distinction between the mechanisms is that in the case of GP1, the main idea is to convert the purpose of part of the direct payments to payment for basic environmental stewardship, the non-greened part is either switched to Pillar 2 or would be subject to gradual reductions. This means that at similar rates of policy change over all options, Pillar 1 expenditure will fall by less under GP1 than the others.

***Phasing out DPs and allowing capitalisation*** of payments is the main idea of the ultimate component of the Bonds proposal, though, curiously, its authors suggest that failing to complete this final step does not demolish their idea.<sup>28</sup> Agenda 2000 mentioned neither of these ideas. Whether decoupled payments (which are not tied explicitly to environmental, or other public good, delivery) can persist indefinitely is not addressed by the MTR, GP1 or degressivity. None of these three mechanisms mentions ‘phasing out, i.e. ultimately eliminating, direct payments. Neither do these three suggest capitalisation of the payment streams.

***Fund switching*** is one of the two defining features of so-called Modulation (see footnote 29). The interpretation in Agenda 2000 is that all funds cut from direct payments are switched, within the same member State, into Pillar 2 agro-environment and rural development schemes. The purposes to which the switched funds can be put in Pillar 2 are also restricted: they can only go to schemes directed at farmers under the so-called accompanying measures. Under degressivity, it is generally assumed that only part of the ‘savings’ on direct payments is redirected to the Rural Development Regulation. The authors of the Bonds idea are mostly concerned with finding an exit strategy for the mainstream direct payments and have been rather sceptical about the necessity to bolster the second pillar. However, more recent versions of their proposal acknowledge that the Bonds would be part of a more comprehensive reform allowing some fund switching into Pillar 2 as an option. Converting Pillar 1 direct payments into environmental payments is the essence of GP1. The logic of this approach is that if there is political reluctance to switch funds from Pillar 1 to 2, then why not seek to convert some of the Pillar 1 payments to their more justified purpose without shifting them between pillars? It is interesting to note that the Commission’s MTR proposals

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<sup>27</sup> The reference in the MTR to direct income payments is not very convincing either. There is no attempt now, and there is no proposal in the future, to discover the income of the recipients of DPs or DDPs. With a very wide range of degree of dependence on farming amongst recipients, and evidence in many MS that rural households are financially better off than urban households, this is at best an extremely blunt instrument of social policy. In any case it has always been difficult to explain why one particular occupational group (*some* farmers) deserves a special and additional category of social payments compared to all others in society.

<sup>28</sup> A Bond Scheme which does not offer a bond seems contradictory!

contain elements which could be interpreted partly as Greening Pillar 1 – specifically, the proposals for cross-compliance and set-aside. The MTR proposals also, understandably, abandon the notion that funds recycled through Modulation necessarily remain in the same Member State. Furthermore, the MTR proposals widen the range of actions for which switched funds may be directed, but not beyond farmers.

The sixth characteristic of the mechanisms is the *differentiation or modulation of the payment cuts by farm size*. This sounds as if it ought to be a defining feature of Modulation schemes. However, linguistic confusion was sown when the UK interpreted the Agenda 2000 Modulation mechanism as not requiring any differentiation amongst farmers in the payment cuts.<sup>29</sup> In the UK a flat percentage rate of cut has been applied to all direct payments irrespective of the size of the recipient. The MTR proposals, and also proposals for degressivity, contain strong elements of modulation. If politically desired, some modulation of any cuts in the non-greened portion of DPs could figure in the GP1 proposal. The Bond scheme, as an exit strategy for direct payments, does not bother with modulation.

The debate on the merits of these schemes, as seen by the Member States and interest groups, has been intensified by the publication of the MTR. It may help this discussion to elaborate further on some of the most important properties and impacts of the five mechanisms. These are summarised in Table 2, and explained in the following paragraphs.

Table 2: Properties and some Impacts of CAP Adjustment Mechanisms

<i>Properties &amp; impacts</i>	<i>Adjustment mechanisms</i>				
	Voluntary Modulation	Decoupling and Compulsory Modulation	Greening Pillar 1	Degressivity	Bonds
<b>EU Budgetary Cost</b>	=	=	= or ↓	↓	↓
<b>Member State Budget Cost</b>	↑	↑, ↓ or =	=	↓ or =	↓
<b>Redistribution between Member States</b>	N	Y	?	Y	N
<b>Redistribution between farms</b>	?	Y	N	Y	N

*The EU budgetary cost* of the proposals is of great interest for all member States.<sup>30</sup> The net contributors to the budget, (especially Germany, UK, Sweden and the Netherlands), are mostly concerned that the mechanism should provide a route for cutting this cost.<sup>31</sup> Other member states are more concerned with preserving the current level of support to farmers. Table 2 shows that fund-switching mechanisms of Modulation are designed to maintain (EU) “budget neutrality”, although in the MTR paper this is only specified for the period of the current financial perspective, until the

<sup>29</sup> It is important to note that this interpretation has been accepted by the Commission, thus Modulation need not imply modulation! To try and rescue the integrity of the English language we denote the mechanism of Modulation as a proper noun, and the act of differentiating payment cuts within this mechanism as a common noun: modulation.

<sup>30</sup> Note that in most of what follows the discussion is confined to the EU-15, and not to the applicant states.

<sup>31</sup> This is based on reported statements of Ministers at the open, televised, Agriculture Council of 15/7/02.

end of 2006. An important purpose of both degressivity and bonds is to reduce FEOGA costs. The GP1 mechanism could do either.

***The Member State budget costs*** here refers only to the MS co-financing of CAP expenditures. Since the publication of the MTR this is more difficult to analyse. Until this document appeared, the logic, and indeed appeal to farmers, of Modulation was that not only did it preserve the level of EU expenditure, but it required additional Member State expenditure.<sup>32</sup> This came about because funds switched from (the 100% FEOGA financed) Pillar 1 required on average the same amount of extra Member State match funding from their finance Ministries to implement the co-financed Pillar 2 measures. The proposed Dynamic Modulation in the MTR apparently breaks this link. The Commission asserts that “no additional budgetary effort” will be required from the Member States to implement the proposals.<sup>33</sup> This relaxation of co-financing requirements arises from the proposal that Member States will, apparently, have the option to avoid co-financing new funds switched into Pillar 2, and from the proposed reductions in MS co-financing rates for certain existing, and new, measures. Thus the outcome for MTR Modulation, and one assumes also for degressivity, is that the Member State budgetary impact is indeterminate. It depends on the outcome for co-financing rates in Pillar 2, on the extent of Member State discretion available for this, and on the share-out of the additional Pillar 2 funds. For any MS, under the MTR and degressivity, their co-financing responsibility could rise, fall, or stay the same. The purpose of Bonds is to reduce both the EU and MS financial burden. This is not explicitly a purpose of GP1, though it could be.

***Redistribution of support between the Member States.*** This is quite explicitly one of the objectives of the MTR proposals. Again, it must be assumed that it would also apply if degressivity is pursued as an active option. Redistribution is explicitly ruled out by the existing Agenda 2000 Modulation, and it is not part of the Bonds proposals. It could be part of any cuts in remaining DPs in the GP1 proposal. The redistributive effect of the MTR derives from two sources: the way Pillar 1 payments are reduced, and the explicit redistribution of these funds to Pillar 2. If the reduction in DPs was applied as a flat-rate percentage cut, it would contribute funds in proportion to the current distribution of the direct payments (which is uneven). If in addition, the payment cuts are modulated, the redistributive effect will depend on the modulation formula.<sup>34</sup> Countries with more, larger and more capital intensive farms would contribute more. Some countries would hardly contribute at all, as the majority of their farms are below the cut-free franchise.<sup>35</sup> The Commission’s proposed criteria for redistribution of additional Pillar 2 funds will inject a welcome element of objectivity into the allocation of Pillar 2 funds.<sup>36</sup> The criteria proposed are agricultural area, employment and general

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<sup>32</sup> It was also part of the appeal to farmers that Modulated funds remained within the Member State and could only be spent on farmer-oriented measures. The MTR proposes to change both of these features.

<sup>33</sup> It is not completely clear if this refers only to the period until 2006.

<sup>34</sup> The Commission’s formula comprises a no-cut franchise of € 5000, plus € 3000 per additional annual work unit on the farm, and a ceiling of € 300K in DDPs. Numerous other formulae are of course possible. French modulation had a € 30K franchise and progressively larger cuts in successive higher bands of DPs with allowances for labour employed.

<sup>35</sup> The modulation parameters of the MTR proposals are calculated to exempt 75% of farms accounting for 20% of payments. In the scale of fund switching proposed, the ceilings of € 300K are a distraction. They move relatively few funds, and in any case the Commission has proposed that they should remain with the affected MS so do not affect the distribution argument. This proposal also removes the possibility of cutting part of the total payments, which, unfortunately, affects most the two countries keenest to bring about cuts in total expenditure (Germany and the UK).

<sup>36</sup> It prompts the thought whether such redistribution should not also apply to the existing RDR funds.

prosperity levels, ideally the criteria would be the demand for agro-environment services and rural development, these factors are probably the most workable proxies.

**Redistribution between farms** is an essential part of the MTR Modulation proposals. It is escapable under Agenda 2000 Modulation as demonstrated in the UK. It is likely to be part of degressivity, and could be part of GP1. Note that modulation is only partly based on Robin- Hood-principles, it takes from the large, but it gives no more to the small. The other way in which funds can be redistributed between farms is in the way that the additional Pillar 2 funds are deployed. Non-competitive entry schemes such as broad application stewardship (see paragraphs below), or less favoured area payments, are accessible to all farms meeting the eligibility criteria (which could be wide). On the other hand, other schemes for agricultural development (improving marketing, encouraging producer groups, training etc) are generally operated through competitive entry and tend therefore to accrue to the more alert farmers who are engaged with officialdom. Such schemes are often criticised by small farmers as too bureaucratic and thus inaccessible.

**To summarise.** The debate facing the EU over the coming years, concerns the choice of how to bring about a CAP which is less distortive of commodity markets, and more capable of delivering the non-market services by land managers and encouraging wider rural development. This has to be done at a rate acceptable to the recipients of the existing support regimes. The rate at which these mechanisms could be put in place and the timing are political decisions. However it helps consideration of the options and their effects to illustrate the implications of the sort of changes under discussion. This is done in Figure 2.

The figure updates and amends the diagrammatic representation of the broad reform options in the style shown in the CARPE report. The figure shows the budget distribution by function in 2002 and in 2020 for three reform options. The vertical axis is scaled in billions of Euro (i.e. the absolute budget allocations not just the shares as in the original version of this diagram). In 2002 about 86% of EU budgetary resources were allocated to the pillar 1 (light shaded) Commodity Market Organisations (CMOs) and Direct Payments (DPs). The remaining 14% of funds (darker shaded) were devoted to the second Pillar Agro-environment Schemes (AES) and Rural Development (RD) actions.<sup>37</sup>

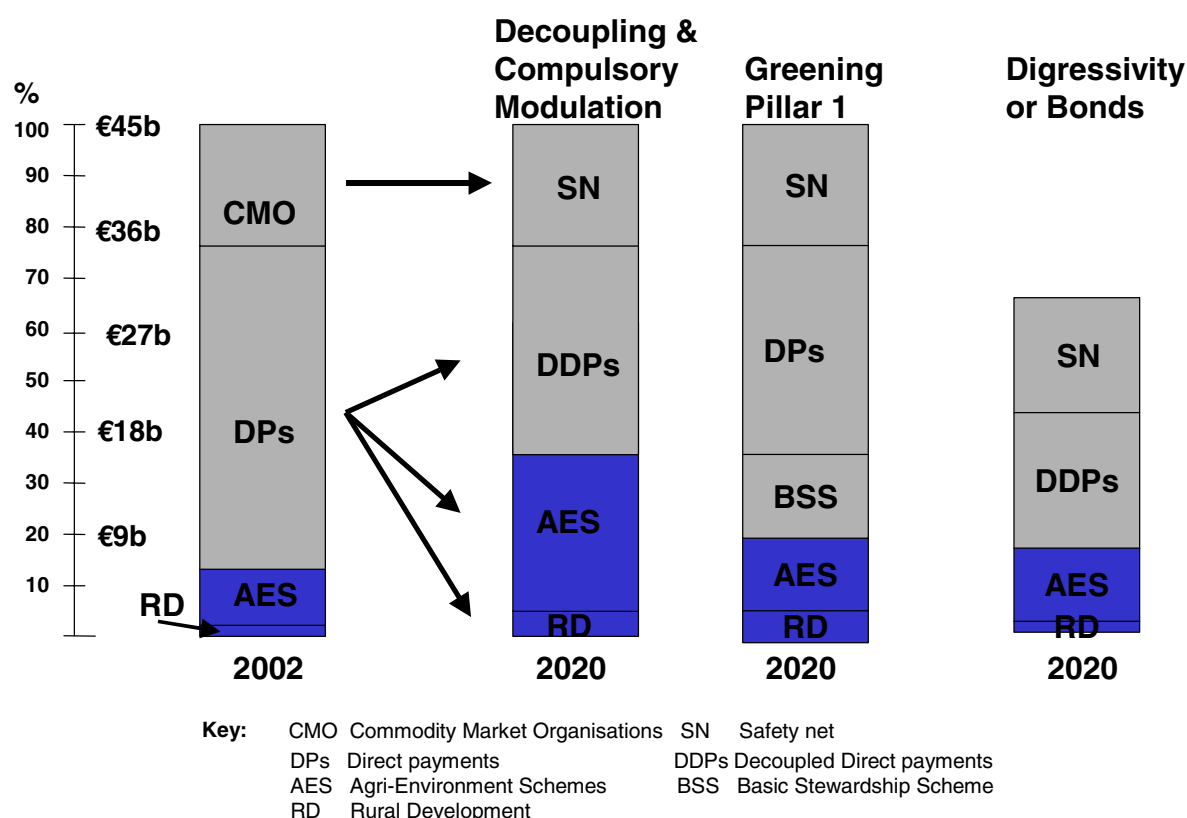
To simplify the presentation, only three of the above five adjustment mechanisms are shown: Decoupling and Compulsory Modulation, Greening Pillar 1 and Degressivity. The intention is to illustrate the broad orders of magnitude, and therefore the schemes are shown way out into the future in 2020. We have not analysed the specific commodity market issues and the conversion of milk, sugar and other unreformed sectors to the new approach. For this reason it is assumed that the non-direct payment part of Pillar 1 (€ 11b) changes only in name to remind us of its main future *raison d'être*.

Under the option of **decoupling and compulsory modulation**, the assumed rate of cut in direct payments is 3% per annum, starting in 2004 and rising to 20% in 2010, this is projected forward rising to 50% in 2020. It is further assumed that 20% of the DDPs are exempt from cuts, and for simplicity the ceilings are ignored. The outcome is that by

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<sup>37</sup> Including the accompanying measures, even though these are financed from FEOGA guarantee.

Figure 2 Reforming the structure of the CAP (EU-15)



2020 Pillar 2 has grown to € 17b (37% of the constant FEOGA total of € 45b.) and DDPs have declined to € 17b. We have shown the shares of Pillar 2 funds between Agri Environment Schemes and Rural Development as remaining in their current proportions.

In the **degrossivity option**, the same rates of reduction in Direct Payments, and exemption from cuts are assumed, but in addition it is assumed that only 25% of the funds saved are switched to Pillar 2. The result is a decline in total FEOGA expenditure from € 45b to just under € 30b, of which about € 12b is DDPs, and just under € 7b is Pillar 2 measures.

The illustration of the **Greening Pillar 1** option assumes the same rate of transformation of Pillar 1 payments into environmental payments as the MTR. Thus the Direct Payments decline to the same level. The main difference is that all the growth in Agri Environment Schemes is achieved within Pillar 1 under what we have termed a Base Stewardship Scheme. For simplicity the existing Rural Development and Agri Environment Schemes are shown not to evolve from their 2002 levels. Taking this extreme case is enough to demonstrate that in reality Greening Pillar 1 would have to be accompanied by some fund switching from Pillar 1 to 2 to enable more RD activity.

#### 4 Concluding comments

**Political cost effectiveness.** This is the essential argument to be judged. How can the social performance of EU land management, and thus the internal EU political legitimacy of the CAP, be strengthened most quickly and effectively? The case for Greening Pillar 1 is that it offers the possibility of achieving more gains in this direction



across a larger part of the rural territory, and faster, than the alternatives. The alternatives are strengthening the purpose-built agro-environment schemes under pillar 2 by fund switching using Modulation or degressivity. Part of this judgement must be the real effectiveness of the greening. There is a danger that the most politically acceptable way of greening the CAP is the one which offers the least demanding real change in practices and thus minimal real environmental delivery. Emphatically, this is **not** our purpose. There should be no reason to assume that Greening Pillar 1 offers to farmers' organisations the hope that they will get less demanding schemes than under Pillar 2. Whether a base stewardship scheme is implemented in either pillar it should have the same restrictions and same sanctions for non-compliance. The difference lies in the, far from trivial, financing arrangements and ease of bringing about the policy change.

More analysis is required to make judgements about the relative institutional and administrative ease of engaging a large proportion of farmers into delivering environmental services through schemes delivered under pillar 1 or 2. It is not obvious that there would be any fundamental difference at all. The practical challenges of defining the 'rules' of the entry level, base tier land stewardship scheme, for example, would be no different whether they are implemented under either pillar of the CAP. The argument essentially boils down to the scale of what we have in mind, in particular, whether the objective is to have agro-environment schemes embracing a minor part of the land area or the majority.

There remains a feeling that Greening Pillar 1 is an opportunistic, supply-driven approach to policy change. Production payments exist, how can we legitimate them? There is truth in this, but it is unavoidable. It is in the nature of the provision of public goods that there is no market place to establish the demand, therefore the political market place is used to agree the funds available to fulfil the social needs. Schemes to deliver the service are then devised within this budget. The current debate can therefore be seen as an exercise in establishing the budgetary limits for public environmental and cultural landscape schemes and rural development.

**EU budgetary considerations.** This is an extremely important factor. The fact that Pillar 1 payments are obligatory expenditures from the EAGGF guarantee section and are 100% EU financed, offers, possibly, a more secure way of publicly funding environmental payments. This is how the issue might be seen by environmental NGOs, net FEOGA beneficiaries, poor countries and the applicant countries. The contrast is that Pillar 2 agro-environment schemes rely on non-obligatory, co-financed expenditure.<sup>38</sup> To combat this differential attraction of Pillar 1, perhaps there could be a greater range or flexibility of co-financing arrangements for second pillar measures in relation to environmental demands and ability to pay amongst the regions.

**Wrong starting point?** On the other side of the balance it might be argued that achieving environmental benefits by Greening Pillar 1 is starting in the wrong place. Why should the recipients of direct payments be the most important target group for environmental amelioration? If public money is to be devoted to producing an incremental improvement in resource protection and biodiversity would we choose to start from those areas which are recipients of arable and livestock direct payments? Actually, the rational answer is indeed, yes. These are the farmers who have been led, by the previous support system to focus more on agricultural output rather than on the environmental outputs (quantity rather than quality). If European society really wants

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<sup>38</sup> Although the Commission has proposed raising the EU co-financing from 50% to 60%.

(and is prepared to pay for) better environmental performance over most of its managed territory than what better place to start with the areas engaged in some of its most intensive production? Because recipients of direct payments occupy, it is estimated, in the region of 60% of the agricultural area, then much, perhaps most, if not all, of this territory *would* be the target for environmental improvement in purpose-built agro-environment schemes. The complaint is just as likely to be why *only* the present area subject to direct payments is subject to the proposed reform? Why not the land presently occupied in dairy farming, sugar, wine, olive oil, tobacco and horticultural crops too? To answer this we must answer another question, how much of these landscape and biodiversity goods does the public wish to buy? We don't require the road system or industrial parks to supply biodiversity or landscape, so why the glass house or field-scale vegetables area? Second, we can only work from existing policy thus to achieve the switch in payment justification over the area occupied by COPs, beef and sheep would already be a significant advance.

**Overlap, confusion and duplication with second pillar.** If the first-best solution to deliver environmental and cultural landscape services is from custom-made agro-environment schemes, then trying to achieve the same objectives via Pillar 1 may further confuse and complicate the CAP. Whilst true, it may be unavoidable. However another view is that the bulk of existing support can be justified on environmental grounds therefore sooner or later the whole CAP has to be greened. It does suggest however that policy makers keep a very clear strategic view of the way the CAP is evolving so that there can be a route through which, temporarily distinct programmes in pillar 1 and pillar 2 which produce related outcomes can, ultimately, be re-united. This was illustrated in Figure 2. It should be noted that the Commission's MTR proposals do not avoid muddying the water. The MTR appears to contain four new agro-environment ideas: (i) to continue set-aside as an environmental measure in Pillar 1. (ii) The suggestions for environmental cross-compliance of Pillar 1 decoupled payments. (iii) The proposed new 'Meeting Standards' and 'Quality' chapters of the RDR involving temporary payment for higher environmental standards. (iv) The extra resources for Pillar 2, much of which presumably will be allocated to agro-environment schemes. This does not sound much different, and is certainly no simpler than the ideas presented here.

It will be difficult to avoid **effects on competition** between the EU member states if the determination of the environment conditions is devolved to national or regional level. Whether these will constitute serious market distortions is difficult to judge as a general point. The question is the intra-EU equivalent of the non-trade concerns argument currently being discussed under the WTO. If, in each member state, there were a perfect match between consumers purchasing behaviour and citizens willingness to impose environmental requirements and costs, then there would be no distortions. However this seems an unlikely coincidence. It is more likely that MS whose citizens and NGOs have the taste for the strictest environmental conditions and whose consumers are the least discriminating are likely to see their market shares of affected production fall most. However these considerations will apply whether environmental schemes and their restrictions are implemented in Pillar 1 or Pillar 2. In fact as the latter are co-financed, and consequently less controlled from Brussels, this might be a greater problem for Pillar 2 schemes than those in Pillar 1.

At the very least some greening of Pillar 1 direct payments is essential for reasons of policy coherence. The EU can not justify spending significant public money through agro-environment measures under the RDR and take no action to ensure that this effort is not undone by the much greater sums of public money spent on direct payments. This

and the Treaty requirement that all policies must pay due attention to the respect of EU environmental directives, were the motivating forces for the Article 3 environmental requirements in the Agenda 2000 Horizontal regulation.

In addition to the internal political motive for greening Pillar 1 payments we also consider the international, WTO, motive to green these supports. Under this heading our conclusion is that a *token* environmental greening is not likely to satisfy international pressures to reduce the trade-distorting effect of these domestic supports. To achieve this would require a more fundamental decoupling of the payments, for example by linking payments to past and not current levels of eligible crops and animals, and releasing farmers to determine their crop areas and livestock numbers in accordance with market demands. It is worth noting that fully decoupling Pillar 1 payments, in itself, has the capability of providing environmental benefits as if it were achieved it would open even greater possibilities of environmental linkage. This is because it would be very hard to explain to European taxpayers what the decoupled payments were for, unless they were then tuned to the delivery of environmental services.

This paper has considered taking these ideas much further. We do not support *token* greening. Having explained some possibilities and virtues of Greening Pillar 1, we compared this idea with other ways of achieving a socially more defensible CAP. It has not been our intention or expectation to find a conclusive set of arguments in favour of one of these approaches. Our hope is that setting out the possibilities and some of their advantages and weaknesses is a contribution to the debate.

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# Rural Development Policies and the Second Pillar of the Common Agricultural Policy

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## **1 Introduction**

The debate about rural development and rural policies is relatively recent in the EU (late Eighties) in relation to agricultural policies, which date back to the origins of the European Community. This fact complicates the discussion because it is never clear whether rural policies are being developed because of the specific problems of rural areas (as territorial policies) or because of the specific problems arising from the need to reform the CAP (as sectorial policies). At present these two “visions” of rural development exist side by side in the “second pillar”<sup>2</sup> of the CAP.

This paper tries to bring together the various arguments that make a reform of rural development policies desirable and useful for the stakeholders involved. The policy implications of a desirable reform are also considered. CAP, in its long story has established powerful interest groups in the administrations, in the sector and even in expert's circles. Past shortcomings of reform attempts suggest that a consensus on reform is difficult to achieve and requires a clear and shared outline of what will agricultural and rural policy look like after the reform process. A transition period, the inclusion of wider interest groups than those directly concerned by the policy, the possibility of regionally adapted versions rural policy appear to be important components for insuring a strengthened support and a more effective policy.

In current documents and literature, a shift from the “first” to the “second” pillar, implying a reduction of the funds allocated for market support and an increase of the funds available for the second pillar, is often presented as a strengthening of rural

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<sup>1</sup> ELENA SARACENO is presently working in the Group of Policy Advisers, in the European Commission. This contribution reflects her personal views on rural development, in her expert capacity in this field. The contents of this paper do not reflect the opinion of the Commission services and in no way prejudge the Commission's official position on this matter. She is extremely grateful to the working group for the very useful discussions and comments made to previous drafts of this paper.

<sup>2</sup> The “second pillar” in EU terminology and within the framework of the Common Agricultural Policy includes different forms of direct support for farmers (less favoured areas compensation allowances, environmental payments, investment grants) and rural areas (local development, services, crafts, patrimonial heritage). While the “first pillar” has provided support to the agricultural sector through price support (common market organisation), the second pillar provides payments or grants to farmers for specific investments, situations, services or activities.

policy. However, as will be shown below, such a shift maintains unchanged the sectorial objective of the policy, would have the same beneficiaries (farmers), while changing “only” the rationale and instruments used for the transfer of resources. As farmers are imagined having similar needs across Europe, measures are the same for all areas. This approach is a good example of rural policies developed in response to the need to reform the CAP.

There is also a different understanding of rural areas, present in the Structural Funds programmes, in EU initiatives such as LEADER, and in the definition of objective 5b areas during the Nineties. These rural areas have been considered in a spatial dimension (regional or local) as an integrated whole, covering all sectors of the economy and benefiting all actors living and operating in rural areas, including, of course, farmers. There might be complementarities between the territorial and the sectorial rural policies, but the aim is usually not the same. Instead of farm structures and incomes, or agro-environmental concerns, the aim is the development of the rural-local economy with its peculiar mix of resources, on the basis of perceived strengths and opportunities. The instruments of such a policy have a development rationale, proactive rather than compensatory. The programmes have common guidelines but the actions undertaken vary from one rural area to another and are adapted to meet local/regional needs. This approach is a good example of policies developed to meet the specific problems of rural areas.

Both approaches to rural policy are currently found in EU policies. A second pillar that responds predominantly to one or the other function would mean quite different things and aim at different results. There are also important implications of policy management and implementation since the sectorial function has been traditionally a horizontal one (common for all farms) while the territorial function has been defined in its contents at regional or national level, and is different from area to area.

This paper will argue that both rural visions respond to existing policy needs and are therefore legitimate and relevant. The issue should not be to choose one or the other but rather to address each of these needs explicitly and distinctly. From this perspective, the “second pillar” should become the container of two different policy objectives: the first addressing the structural needs of the agricultural sector in a reformed CAP (the sectorial function); the second addressing the development of rural areas with a multi-sectorial, integrated approach (the territorial function). Environmental concerns need to be included both within the sectorial function for matters related to agriculture (water, soil, production practices) as well as in the territorial function for matters related to the sustainability of the rural area as a whole (impact of tourism, industries, energy production and consumption, infrastructures, services, etc.).

Distinguishing between these two functions of rural policy does not imply that there are no linkages between them. Quite the opposite: in the past it was thought that there was no need for such a distinction because farming was the main activity of rural areas and the two coincided. Empirical evidence has proven that this assumption was not accurate to start with, and is increasingly not so. Rural areas have modernised not only in its farm structures but also by becoming mixed economies, often competitive and dynamic, thus reducing the imagined overlap between agricultural activity and rural space. It is this growing differentiation, as will be shown, that largely explains the “take off” of some rural areas, rather than the specialisation in farming activities.

In the future these two functions should be expected to diverge rather than to converge. The relationship between the territorial and the sectorial also needs to be reformulated conceptually: diversified modern rural areas become attractive and viable

areas providing advantages both for professional farmers and their families, as well as for other activities. This reduces the need for an indefinite support of the agricultural sector<sup>3</sup> or at least makes it more limited and circumscribed. The sustainability of rural areas does not depend on the farming sector alone but on the diversity and attractiveness of the rural resource base in relation to other types of areas, both rural and urban.

A brief summary and assessment of current EU rural policy is our starting point, providing a framework of reference, a sort of baseline of the policy supply today. To understand it, however, some explanation and critical assessment about its evolution is necessary. This will show the strengths and weaknesses of the current policy set up and give a preliminary indication of a desirable evolution (section 2). A review of recent trends in rural areas indicates a process of growing diversification of activities and of differentiated responses to spatial restructuring challenges. The result is an increased attractiveness in some cases and a continued decline in others. Acknowledging the different dynamics of rural areas implies a change in the original CAP assumptions and should influence the strategy of desirable policy adjustments (section 3). Some of the policy reform options that have been considered recently are reviewed in order to assess whether they meet the weaknesses of present policies and recent trends in rural areas (section 4). The arguments of each section are then drawn together to indicate the broad components of a desirable rural policy for the future, both in its sectorial as well as in its territorial functions, making explicit the inter-relationship between the two and the political-institutional options they imply (section 5).

## **2 An assessment of current EU rural development policy**

This section reviews current EU rural policy from the perspective of the sectorial and territorial functions identified above and its evolution over time.

### **2.1 Today's components of EU rural policy**

The present framework of rural policy within the European Union was defined in Agenda 2000 in 1997<sup>4</sup> and in 1999 in Berlin, with the final decisions on the financial allocations for the period 2000-2006. A set of regulations<sup>5</sup> establishes the norms and procedures for the utilisation of those allocations by Member States. The first and most important one is the Regulation for Rural Development (Reg. 1257/99). A second form of intervention in rural areas is also possible with the Structural Funds either in objective 1 (lagging behind) and objective 2 (conversion of areas facing structural difficulties) areas. A third instrument is the LEADER + Community Initiative.

The Rural Development regulation has reassembled under one single heading already existing measures, established at different times. The “menu” of measures available has been classified according to broad categories of factors addressed and their sectorial or territorial function, based on the economic sector or actor benefiting from the support.

The table shows the heterogeneity and variety of rural development measures available for the current programming period. A number of observations can be made:

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<sup>3</sup> The US farm bill, recently approved by Congress, increases the support for large farms and is a good example of the failure of agricultural policies alone to produce competitive farm structures of any size (not depending on support), as well as their inability to generate viable rural areas based exclusively on agricultural activities.

<sup>4</sup> EUROPEAN COMMISSION: Agenda 2000, for a stronger and wider Union, Com (97) 2000.

<sup>5</sup> Reg. n. 1260/99; Reg. 1261/99 on the European Regional Development Fund; Reg. 1262/99 on the European Social Fund; Reg. 1263/99 on SFOP; Reg. 1257/99 on the support for rural development with the Guarantee section of the European Fund for Agricultural Orientation and Guarantee; Reg. 1750/99 and Reg. 2603/99.

- They cover both the sectorial and territorial functions mentioned. Very few of these measures are really new. In fact they represent the historical accumulation of direct interventions since the CAP was launched and reflect different rationales of policy intervention in successive programming periods rather than a coherent overall design.

<b>Rural Development Measures (Title II of Regulation n. 1257/99)</b>		
<b>Function (aim of measure)</b>	<b>Category</b>	<b>Measure</b>
<b><i>Sectorial function</i></b> (for the agricultural sector only)	Investments in farms	Investment in agricultural holdings
		Processing and Marketing of agricultural products
		Marketing of quality agricultural products
		Land improvement
		Re-parcelling
	Services and infrastructures for farmers	Restoring agricultural production potential damaged by natural disasters and introducing appropriate prevention instruments
		Setting up farm relief and farm management services
		Agricultural water resources management
		Development and improvement of infrastructure connected with the development of agriculture
		Financial engineering
	Human resources in farming	Setting up of young farmers
		Early retirement
		Training
	Income support for less favoured areas and areas with environmental restrictions	Compensation to farmers (by hectare)
		Compensation to farmers in environmentally sensitive or protected areas
	Environment and Forestry	Agro-environmental schemes
		Afforestation of agricultural surface
		Other forest measures
<b><i>Mixed sectorial and territorial function</i></b>	Environment and Forestry	Protection of the environment in connection with agriculture, forestry and landscape conservation as well as with the improvement of animal welfare
<b><i>Territorial function</i></b> (for the population at large and/or the rural population and non-farm activities)	Promoting the adaptation and development of rural areas	Basic services for the rural economy and population
		Renovation and development of villages and protection and conservation of the rural heritage
		Diversification of agricultural activities and activities close to agriculture to provide multiple activities or alternative incomes
		Promotion of tourist and craft activities

- The measures responding to the sectorial function are well articulated and cover a wide range of farming needs. They have different intervention rationales: to accelerate and facilitate the modernisation of farms through investment aid and infrastructure provision, to compensate perceived handicaps in particular areas through income support, to make available services through subsidies, to facilitate the turnover of farmers and capacity building through capital and training, to pay for environmental practices. There is both a structural adjustment objective as well

as assistance for what is perceived as less competitive farming conditions. The actions contemplated by these measures are the same for all rural areas; they are horizontal measures (formerly included in the 5a objective).

- The measures with a territorial approach appear less articulated in relation to the sectorial ones and, since they are quite recent, have a more coherent rationale that supports the diversification of activities in rural areas. This is justified in terms of the need to create services and sources of alternative employment and income for farmers who will have “to adapt to market evolution, market policy and trade rules, consumer demand preferences and enlargement” (rather than the development of rural areas per se). The territorial function is perceived as responding to the constraints influencing farming. The actions covered by these measures may be different in each area and are therefore adapted to specific rural conditions (former 5b objective).

Members States and Regions may draw up rural development programmes. Their implementation procedure varies according to the type of area. In objective 1 areas rural development measures should be integrated with other measures promoting their development and structural adjustment. In objective 2 areas, they should accompany the other measures supporting the social and economic re-conversion of areas defined as rural.<sup>6</sup> Rural areas not included in either objective 1 and 2 areas may also submit programmes. In this way *all rural areas of the EU are eligible for the measures indicated above*. These measures are financed by the EAGGF through its guarantee or guidance section, including the diversification measures in rural areas outside objectives 1 and 2.

These type of rural development programmes are not the sole instruments available: the European Regional Development Fund (ERDF) and the European Social Fund (ESF) may finance interventions in objective 1 and 2 areas in other sectors of activity such as infrastructure, tourism, small and medium enterprises, the environment, human capital through specific programmes. Therefore a large part of what we have called the territorial function (integrated, multi-sectorial development in sectors different from agriculture) is included in the intervention of the other Structural Funds instead of in the rural development programmes. Where this is not possible however, is in rural areas outside the objective 1 and 2, where the only measures for diversification available are limited to those indicated in the Regulation and may be financed with the EAGGF, Guarantee Section.

The programming documents of the Structural Funds in objective areas, respectful of the subsidiarity principle that must characterise their intervention, are defined at sub-national level. This decentralised procedure implies that the strategy and actions chosen in each programme are adapted to regional contexts, involve consultation and partnership arrangements that should insure broad participation of different interest groups and concerted practices for decision making. They are expected to be multi-sectorial, integrated and to have development (territorial cohesion) objectives that will reduce disparities between regions. This is not true of rural development programmes that contain a “menu” of standard measures. National authorities may choose between

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<sup>6</sup> Rural areas are defined as NUTS level III territorial units which have either: a) a population density of 100 people per km<sup>2</sup>, or a percentage share of agricultural employment which is equal to, or higher than, twice the Community average for any reference year from 1985; b) an average unemployment rate over the last three years above the Community average, or a decline in population since 1985.



them, but are not required to integrate them and or show that the structural difficulty addressed will be overcome as a result of the support received.

A third form of EU intervention in rural areas is the LEADER + initiative. This is the continuation of an innovative approach to rural development, already experimented with LEADER I (1991-1993) and LEADER II (1994-1999). It is a Community Initiative, financed through the Structural Funds, which started as a pilot, experimental approach. It is based on a method for establishing a strategy and actions adapted to the area rather than a particular list of standard measures offered for implementation. This innovative approach has the following features:

- The area based approach. The geographical area for the intervention is small and homogeneous. In this way social, economic and institutional actors know each other well and also know what are the strengths and opportunities, the weaknesses and constraints of the area.
- The bottom up approach. In order to arrive at the actions that will be realised the local actors need to be mobilised through participation and involvement in the formulation of a strategy and the contents and priorities of the business plan.
- The local action group. This is a partnership between private and public actors, relevant at local level, which becomes the agent for stimulating a participatory approach, defining the strategy and the actions, the costs, the financing and manages the implementation of the plan.
- Innovative, multi-sectorial, integrated actions. All sectors of activity are eligible, actions must be coherent and integrated, and new for the area (not already financed by other programmes). They may choose to specialise on a particular theme or type of measure, or to diversify the interventions. Emphasis is put on resources that are unique and specific to the area and may increase its competitive advantage (rather than imitating what other rural areas do). Complementarities and synergies between sectors should be sought.
- Networking and transnational co-operation. Local action groups do not operate in isolation but are interacting with each other either directly or through regional, national or European networks, funded by the initiative, and provide technical assistance, training, circulation of information, study visits, agreements, facilitate exchanges of experience and transfer of innovative actions.
- The financing. Local Action Groups receive a global budget for the realisation of their business plan, decide the allocation of funds to actions and have a certain degree of flexibility in shifting funds from one action to another. They are subject to financial controls by the relevant authorities.

This approach to rural development is a good example of a policy responding exclusively to the territorial function. Even if its cost has been extremely modest in relation to other Structural Fund expenditure (see below) and it has maintained its pilot and experimental character, it has proven an extremely popular and adapted approach. In terms of outcome, it has provided modest but tangible alternatives (employment, entrepreneurship, attraction of resources, empowerment of local actors). All rural areas, even those not included in objective 1 and 2 areas, may be eligible for LEADER +. The initiative is financed entirely by the EAGGF, Guidance Section.

The three forms of intervention analysed in this section represent quite differentiated approaches to rural development. Together they represent the policy “supply” at EU level, certainly complex in its design and not necessarily coherent as a package. The

rural development programmes have substantially a sectorial function and appear weak as instruments for diversification, still perceived and legitimated as a sort of undesirable but necessary alternative for “inefficient” farmers who might be pushed out of their activity. The Structural Fund Programmes in objective areas and the LEADER + initiative address the territorial function with a multi-sectorial and integrated approach, perceive the diversification of activities as a positive strategy for economic development. Since interventions are fragmented in different types of programmes, the co-ordination among them is weak and mostly left to Member States’ preferences. Although apparently Member States can pick and choose among the “menu” of measures available within Rural Development Programmes, these measures are rigid and standardised and do not allow for any adaptation to local conditions. This is only possible with the LEADER initiative and the Structural Funds’ Programmes.

One way of assessing the relative importance attributed to the different functions is to consider the financial allocations for the various forms of intervention. For the period 2000-2006 the agricultural sector receives appropriations of between 41.7 and 45.6 billion Euros per year (at 2001 prices). This represents around 45% of total EU expenditure: 40% for market support (the common organisation of markets, the first pillar) and a little less than the remaining 5% is for the Rural Development Programmes and the LEADER + initiative (the second pillar). Another 32% goes for Structural Funds expenditure. It is no news that both in absolute and relative terms the agricultural sector is the largest beneficiary of EU spending with almost half of the total resources available. Rural development receives a very modest share of agricultural expenditure and diversification measures (the territorial function) have an even more modest share (about 10% of rural development funds, 1% of agriculture expenditure and 0.5 of the total). However, because the total expenditure is significant, in absolute terms the funds for rural development objectives (around 4.7 billion Euros per year) is substantive, especially when matched by national co-financing and other additional resources available at national and regional level. When Structural Funds Programmes are included in the picture, although it is not known what portion goes to rural areas, the big disproportion between allocations to the sectorial and the territorial function of rural development is certainly reduced but remains significant.

The policy supply here described is managed and implemented at national or regional administrations on the basis of the subsidiarity principle and it is subject to co-financing by the EU, Member States and regions. The programming instruments are quite different in each case and may involve different administrations, according to the Member State allocation of competencies. For example, Regulation 1257/99 is usually managed by Agricultural and/or Rural or Regional Ministries at State or regional level. Regional policies with the Structural Funds are usually implemented by industrial, infrastructure or treasury ministries at the level of competence established for the specific intervention within the Member State. LEADER + is managed by very different administrations in the different member states, not coinciding necessarily with the first two forms of intervention. The result is that rural development policies are not managed or implemented as a package of integrated measures and there is little co-ordination between the different administrations involved.

## **2.2 How did we get to the present situation?**

The situation just described is the result of an historical addition of successive rationales and measures that were introduced without undoing or revising substantially previous approaches. Until the late Eighties there was not even the claim that the EU had or needed a rural development policy. However, since Agenda 2000 and the inclusion of

farm structures' support within the framework of rural development programmes, it has become current practice to consider traditional forms of support for the farming sector as part of rural policies, thus blurring a clear distinction between the territorial and the sectorial functions, although in fact expanding the latter.

The European policy for rural development was conceived since its origins as an accompanying policy to the CAP rather than as a policy with its own autonomy and objectives. Three periods or "waves" of policymaking may be distinguished, each with its own peculiar philosophy and instruments.

- The first generation of measures was intended as an accompanying policy for market support, addressed the modernisation of farm structures (from the mid Sixties) and had a clearly defined sectorial function. Its most original aspect was the transformation of a structure of peasant farms into one of professional family farms, of medium size, well equipped and connected to markets. It was meant to facilitate the exit of small subsistence farms and compensate farms operating in marginal ("disadvantaged" areas). This policy, coherent in its design, played only a marginal role in the modernisation of farm structures, especially in the less developed Member States. It was based on a compensatory approach. Its original design did not contain any limitations on the duration of the policy, did not contemplate a system of substantial checks and balances, the possibility of changes and adaptations over time, was never systematically evaluated in its efficiency or effectiveness.
- The second set of measures, in the second half of the Eighties, introduced the territorial function in agricultural policy. The integrated Mediterranean projects tried firstly to link different forms of agricultural interventions between themselves, adapting measures to particular contexts; then the specific needs of rural areas were more openly addressed (with "The future of rural society",<sup>7</sup> the LEADER Community initiative). These changes coincided with the reform of the Structural Funds that allowed more flexibility to Regional authorities in their programming and in the implementation of multi-sectorial approaches. It became clear then that the modernisation of farm structures and a sectorial approach were not sufficient to promote viable rural areas. On the other hand the limits and excesses of market policy were becoming visible. A new set of accompanying policies was conceived together with the MACSHARRY reform (agro-environmental measures, extensification and afforestation). The territorial function and the sectorial function both expanded significantly but were kept distinct as policy instruments: the new accompanying measures were not considered part of the rural development policy and were explicitly intended to address the problems of CAP reform. The overall expenditure for both functions increased.
- The third period, initiated with the preparation of Agenda 2000 in the second half of the Nineties, consolidated the sectorial and territorial interventions under what has been called the 2<sup>nd</sup> pillar of the CAP, introducing Rural Development Programmes at national and regional level. This implied re-labelling previous sectorial interventions as rural development policies, and the creation of a new "container" (the 2<sup>nd</sup> pillar) for all measures not included in market support (the 1<sup>st</sup> pillar). This new package was extended to all rural areas, with the above-mentioned differences for objective and non-objective areas. No new measures were introduced, and all the old ones were included with modest changes. The effect of putting them all

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<sup>7</sup> CEC, 1988

under the same rural development label made more visible the predominance of the sectorial function.

Furthermore Agenda 2000 introduced a clear separation between the expenditure for market and first pillar support on the one hand and the rural development measures of the second pillar on the other, as separate components of the Guarantee section of the EAGGF, to be indicated in separate sub-headings and not allowing any internal shifts between the two. This was meant to keep distinct the two types of expenditure for accounting reasons, because of the different co-financing arrangements that they implied and also to block any flexibility between the two pillars.

Agenda 2000 also established a budget ceiling for agricultural expenditure. This meant that any change in priority between functions or measures could only be achieved by shifts in the allocations (and no longer by an increase in the overall expenditure). The agricultural interests were stronger and better organised in defending their share of the budget and, as a result, the territorial function lost visibility and relevance (or did not grow as expected) in relation to the “success” that it had achieved in the previous period. Agenda 2000 did also address the problem of enlargement by creating a separate pre-accession appropriation for candidate countries, without however making clear the future of CAP after accession.

The integration achieved between the three Structural Funds since the end of the Eighties was partially set back by the possibility of preparing national or rural development plans with EAGGF funding separately from the other programming documents with the other funds. The degree of integration that is now possible depends on the type of area: it is potentially higher for objective 1 and 2 areas, but no longer required by the Commission and left to the decision of national policymakers and interest groups; it is not possible for interventions in non-objective areas since rural development plans should be the only instrument operating in these areas. The possibility of making national plans run counter to the area based approach that prevailed in the second period.

This short reconstruction of how the EU arrived at the present rural development policy supply makes possible some general observations, useful to keep in mind for future policy reforms.

The rural policy of today is the result of successive additions of measures with different rationales. It is no longer clear what kind of structural farm adjustment is desirable or what kind of farming practices are recommended in terms of the common policy. The income problem is not perceived in relation to the actual needs of particular categories of farmers but rather on the basis of historically acquired benefits. Compensation allowances to farmers in less favoured or environmentally sensitive areas still ignores the existence of other sources of income opportunities. The presence of farm pluriactivity, agro-tourism, quality products, commuting, small and medium enterprises, environmental amenities and services have been acknowledged, but have not succeeded in modifying the abstract assumption that rural areas are undifferentiated, rely only on agricultural production, therefore needing to be compensated if they show any handicap in farming. Agro-environmental measures have been added to unchanged traditional modernisation measures and market support, ignoring the conflicting rationales that they promote. The learning of the Eighties (the viability of rural areas cannot be obtained by farm modernisation and compensations alone, the diversification of activities is beneficial for both farmers and non-farmers) appear to have gone out of

focus as policy objectives. Defensive policies based on generically defined disadvantages are by far predominant over pro-active ones for specific and well-delimited situations.

Within this policy context, the key issue should not be the choice between the two alternative functions, pitched against each other. This is not desirable and – as the Agenda 2000 experience showed - counterproductive. Considering the sectorial and the territorial functions either as unrelated or in competition with each other has had the result of blocking each function in a defensive, entrenched position, thus obscuring the positive complementarities between them. It has also reduced the capacity to deal adequately with the reform process (for example by addressing quality and environmental issues within agricultural policy) as well as with a more consistent rural development policy (for example by repeating a pilot experience like LEADER for the third time).

It would seem reasonable to acknowledge that both functions are necessary, that each of them has to be reassessed in order to meet new consumer needs, that their specific objectives and interrelationships have to be redefined, adopting a more comprehensive and pluralistic vision of rural development, within which agricultural activities may represent a variable component. Each function has different beneficiaries, contents and instruments; they both need a conceptual brush-up to adjust to ongoing processes. Diversification of activities has already occurred in many areas spontaneously and far from becoming a threat to farming activities, it has provided an opportunity for increasing farm size, for providing contract services, for alternative jobs for farm families; it has opened new markets and technological opportunities, facilitating farm turnover, demographic balance and improving the attractiveness of rural areas as places to live in.

None of the two functions will be able to work on its own, because one cannot respond to the needs of the other. Farmers benefit from diversified rural areas not only when they need a job because they are unable (or no longer want) to go on farming, but also to maintain their competitiveness as farmers because they facilitate knowledge of consumers and technological innovation. The sectorial and territorial functions should be conceived as complementary dimensions of a rural policy that acknowledges that sector and space no longer coincide. Rural areas, where farmers live and work, are not and will not be – independently of policies or unlimited support - areas where farming is the predominant activity or the motor of the rural economy. This was a wrong conceptual assumption, which needs to be corrected, and appears to be valid for any modern rural area, even outside the EU. Current experience suggests that insisting on farming as the sole and main activity to be supported in modern rural areas is likely to lead to ever increasing demands for support, a narrower number of progressively larger farms, desertified rural areas and a strengthening of big farmers as a pressure group.

The need to differentiate the two functions should not be taken as mechanically implying that funds should be equally distributed between them or maintained in the proportions they have today. It would be better to start by defining what kind of measures are most effective to obtain the objectives of each function and only then identify expenditure needs, rather than starting by the budget claims on the basis of past receipts and only afterwards filling in the content of actions.

The sectorial function within the second pillar should include on the one hand transition measures for adjusting to reductions in price support (such as funds resulting

from modulation<sup>8</sup> or payments in exchange for services) with or without degressivity, and on the other more pro-active measures to reorient farm investments towards higher quality products, organic crops, new safety requirements, food chain co-ordination, the provision of environmental amenities and the conservation of landscapes by farmers.

The territorial function should include a diversification of activities strategy, adapted to the specific resources available in the rural area, have an integrated and multi-sectorial approach, address social problems of employment and human capital, the provision of services for the population (health, education, transport) as well as infrastructures linking the area to the external context. The local (LEADER) and the regional (Structural Programmes) programmes, since they deal with different aspects of the territorial function, need to be better co-ordinated while maintaining a decentralised decision-making and a bottom up approach. The environmental concerns should also be present in the territorial function (and not just in the sectorial one), for all aspects dealing with off-farm activities.

It is important to make explicit how sectorial and territorial policies intersect in a specific rural area. The weight of each function within the second pillar and its financial resources, may have to be defined at the regional level, varying from one area to the other. Factors such as the level of diversification already achieved, the relevance of the farming sector, the restructuring needs, should be considered in the elaboration of the programming documents. It is also important to allow flexibility between the two functions. A carefully tailored mix of both functions would provide an excellent field for developing the multiple functions of rural areas (equivalent to a territorial diversification strategy) as well as the multiple functions of farmers (equivalent to a sectorial diversification of farm income sources).

### **3 Recent trends in rural areas**

The elaboration of policies is often realised on the basis of political need, principles and theories that simplify and idealise real processes. In fact, the original assumptions of the CAP are still informing policy decision making today. There has been plenty of research and evidence that new and unexpected trends have been operating but this knowledge has not been used to modify those assumptions, since this would have implied a more radical revision of market support, for which very few are politically ready. This is also the reason for adding new policy rationales such as the territorial function or environmental concerns to the old ones, without revising previous policy.

Current policies have been challenged politically for the distortions they have generated, their mounting cost, their international trade effects and also praised for the food sufficiency achieved. However the general assumptions that had informed the original policy design, such as the expected evolution of farm structures, the levels of income used as reference, the attention paid to economies of scale while ignoring economies of scope (or diversification),<sup>9</sup> the irrelevance of quality and environmental

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<sup>8</sup> This term was introduced with Agenda 2000 and has been understood as a shift of funds from direct coupled payments in the first pillar to rural development support in the second pillar as defined by Reg. 1257/99. The funds to be shifted may be obtained by establishing thresholds in direct payments or degressivity. In the logic of the arguments discussed in this paper, modulation maintains a sectorial function for the shifted funds. The overall level of agricultural expenditure does not change as a result.

<sup>9</sup> The relevance of economies of scope has been shown for industrial development by CHANDLER (CHANDLER 1990).

constraints, the expected division of labour between rural and the urban economies, have all proved at best to be only partial truths. This is not the place for a detailed analysis of why these proved to be incorrect assumptions. However, any serious discussion about CAP reform that ignores these conceptual mistakes is bound to reproduce them. What modernisation may mean for agriculture and for rural areas needs to be reformulated on the basis of experience so far and inform policy reform more substantially. Correct assumptions about the real dynamics of past processes and the impact of policies should constitute the basis for a more adequate agricultural and rural policy.

The fact that no agricultural policy has been successful in making the sector “sustainable” in any developed country – as the recent US farm bill has eloquently shown – should be a sufficient reason for some conceptual rethinking. But also the presence of other actors and sectors in rural areas who could realise the same “multiple” functions that farmers have traditionally performed, the existence of economies of diversification side by side to the economies of scale, the impact of pluriactivity on farm structures’ evolution and incomes, the existence of segmented and quality markets for food products, are realities that need to be incorporated in the conceptual framework of experts and then inform policymaking.<sup>10</sup>

Some of the most widely shared assumptions that should require policy adjustments are indicated and discussed below. The “disobedience” of expected events has been quite evident in the evolution of land use, rural population, farm structures, employment and value added of agriculture.

### **“The agricultural sector and rural areas are substantially the same thing”**

One current assumption is that the agricultural sector is the characterising activity of rural areas. It follows that space (rural) and sector (agriculture) coincide and mean the same thing. A policy for one is not differentiated from the policy for the other. The problems of rural areas are perceived as those of farm structures, efficient production, and marketing. Services and other activities are there to satisfy farmers’ needs. Agricultural activities, with some policy support due to their “special” nature, will continue to provide the economic backbone of rural economies (more so than before modernisation) even after economic development has taken place. If agriculture as the main remaining activity in rural areas is not supported, these will be abandoned and desertified. This will make more serious the environmental problem.

If we take a look at Agenda 2000 and the logic behind rural development programmes (Reg. 1257/99) we can see that this logic still informs the perception of rural policy needs at EU level. Some early and preparatory documents for Agenda 2000 questioned this “traditional” vision but somehow this did not feed into the final documents.

Agricultural land in Europe represents a constantly declining share of the total land in the post-war period (44% of the EU-15 in 1997). This varies significantly according to the period considered and State concerned. Those with the highest share are the UK (70%) and Ireland (63%). On the average and in most of the other countries agriculture is no longer the main land user and it appears unlikely that this trend will change. On the other hand, forest areas occupy 36% of the total area and have been increasing over time, with great variations in relation to the period and State.

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<sup>10</sup> The need for a conceptual revision became more urgent and evident in the discussion of the “acquis communautaire” to be adopted by candidate countries in their negotiation for accession.

Rural areas are in general defined in residual terms as non-urban areas. The extent of rural areas may vary because of competing definitions of rurality. If we use the OECD definition<sup>11</sup> (OECD 1996) the 'most rural regions' cover 60% of the total land area and intermediate rural regions cover another 28%. Taken together they account for 88% of the total land area. The EU has used a lower threshold of density (100 inhabitants per km<sup>2</sup>) than the OECD and the same method, with the result of having 17.5% of the EU-15 population in rural areas and over 80% of the total land. Other methods of calculation vary in the share of population included but give similar shares of land.

Having a rural development policy implies a problem of land management, not limited to agricultural areas: forests, mountains and land used for other purposes (villages, roads, industrial or craft sites, tourists resorts, parks, abandoned areas) different from agriculture are included. Since agricultural use has been declining and other uses have been increasing, we could say with some approximation that rural areas are half used by farmers and half by other users. This would seem to justify the existence of a rural policy that does not coincide with an agricultural policy but is able to identify alternative land uses, without assuming that the agricultural land matches the rural area.

In terms of population trends, predominantly rural regions hold at present almost 10% of the total population: almost half of the regions characterised in this way had an increase in population between 1981 and 1991; another 41.6 of them showed a decrease, and the remaining areas remained static. If we turn to significantly rural regions - which hold a larger share (about 30%) of the total EU population - the regions increasing in population are well over half (57.4%), those declining are only a third (33.9%) and those static are 8.7% (EC 1997 b). This is telling us two important things: one that about half of rural Europe is attracting population from the outside (instead of losing it); the second is that in the intermediate situations, which hold by far the largest proportion (three quarters) of rural dwellers, the attraction is stronger. Of course there are significant variations by country, but both phenomena are present in all of them, with varying degrees. In every case the number of rural areas attracting population exceeds that of rural areas expelling population. Therefore all rural areas do not have a unique evolution and the rural exodus is no longer the rule.

What explains these changes in rural areas? Looking at the agricultural sector and in particular to farm structures and agricultural employment trends we find that the number of farms has continued to decline (-15% since 89/90) with different rates of intensity but in all countries. The average size of farms has increased on the whole but reproducing a small-holding structure in the Mediterranean countries (with some regional exceptions) and a medium-large farm structure in the northern countries. Although the EU farm structure is largely based on family farms, indicating the success of the Mansholt strategy in favour of peasant modernisation, this did not imply a convergence in terms of farm-size across countries, on the contrary. The diffusion of contract farming, by providing machinery and equipment to small farms at a reasonable cost has provided an important additional revenue for well equipped farms and the means for a rational persistence of small farms.

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<sup>11</sup> The OECD classifies rural areas according to a double criterion, population density at community level (NUTS V) and the share of the population in rural communities within a region. The threshold of population density that distinguishes rural from non-rural communities is of 150 inhabitants per km<sup>2</sup>. If communities classified as rural account for 50% or more of the regional population, the region is classified as predominantly rural; if they account for between 15 and 50%, the region is classified as significantly rural or intermediate; if their share is less than 15% they are classified as predominantly urban.



**Share of population and variation between 1981-1991 by type of regions (OECD methodology using 100 inhabitants/km<sup>2</sup> as threshold)**

Type of Regions	Share (%) of total European Union		Type of population change between 1981 and 1991 (% of communes weighted by their population)		
	Population*	area	Positive (over 1% increase)	Negative (over 0.5% decrease)	Stable (between -0.5 and +1 % variation)
Predominantly rural regions	9.7	47.0	46.2	41.6	12.2
Significantly rural (or intermediate) regions	29.8	37.4	57.4	33.9	8.7
Predominantly urban regions	60.5	15.6	56.0	30.8	12.6

(Source: EUROPEAN COMMISSION, DIRECTORATE GENERAL FOR AGRICULTURE (1997): Rural Developments. CAP 2000 Working Document VI/1117/97)

There is evidence from research that opportunities for farm pluriactivity play an important role in the evolution of farm structures and the diversification of activities in rural areas. Small holdings with access to off-farm job opportunities in the same area are not likely to disappear as “inefficient” farm structures (or at least not as fast) as was assumed at the outset of CAP. Agricultural employment has declined in all types of rural areas: between 1965 and 1985 it declined by one half, and between 1985 and 1996 by one third, today accounting for 5.3% of total employment (12 % in predominantly rural regions and 6% in significantly rural ones). Three points are important for their policy implications: farm modernisation support and income support measures have slowed but have not stopped the decline of farm structures and the exit from farms as a source of employment. In the evolution of farm structures, economies of scale are not the only ones operating, because multiple job holding influences such evolution. The population growth observed in some rural areas is therefore not the result of pull factors from the agricultural sector but from non-farm sectors.

**“Rural areas are less competitive than urban areas in attracting resources”**

A second assumption of the original philosophy that inspired the CAP is that urban areas and industrial/service activities are more competitive in attracting resources than rural ones and agricultural activities. To compensate for the drainage of resources and the disparity of incomes that this generates, an income support (in the form of price support) or some other form of compensation was needed. The idea of comparable incomes (between farmers and industrial workers) which was used to justify payments to farmers on a regular basis, was based on the low price of agricultural products and the need to remunerate farmers who would otherwise leave for better jobs and income in cities and industry.

Recent employment trends in rural Europe indicate a divergent scenario from this one. OECD has shown that new employment opportunities in general have not been correlated with the degree of rurality or urbanisation in most industrialised countries since the Eighties (OECD 1996). Intermediate rural regions and a part of the most rural ones showed an increase in industrial employment at a time when it was declining for the whole of the EU (+ 0.4% annual rate between 1980 and 1993) as well as a more marked increase in services (+0.8% annual rate) for both types of rural areas. The most striking element is that such rates of increase were higher in rural than urban areas (TERLUIN 2001).

The population growth observed in rural areas is therefore explained by an increase in employment opportunities in the industrial and service sector that outbalanced the negative trend in agricultural employment. This indicates that instead of specialising in agriculture rural areas have diversified their activities becoming increasingly mixed economies. In fact community services are the leading employer both in most rural and intermediate areas (with over a quarter of the rural labour force), followed by manufacturing (with a little less than a quarter) trade, hotels, restaurants and other personal services (another 20%), construction and business (almost 9% for each). This of course ignores the important differences between different rural areas but makes well the point that these no longer rely on agriculture for employment opportunities, and people may leave the farming activity but not necessarily the rural area because they are able to find off-farm jobs nearby and because the attractiveness of urban centres has relatively diminished. If we consider the dynamics of added value in rural economies by sector we find the same picture as for employment, with agriculture accounting for a minor share.

Concluding, recent trends show that the original assumptions about rural areas, on which the original CAP was designed, have proved to be inaccurate over time. Therefore they need to be reformulated taking into consideration real ongoing trends. Rural areas have evolved in a different way than expected: the modernisation of farm structures and the income support for farmers have certainly slowed down the exodus from farming and from rural areas. But the attractiveness of some rural areas in terms of population and employment cannot be attributed to agricultural activities or sectorial policy measures because these have occurred in off farm sectors, and farmers have not been the main agents of such diversification, although it turned out to be also in their benefit. Therefore considering rural areas as agricultural areas does not reflect the present situation or the expected evolution. Ignoring these facts distorts the diagnosis of the problems of rural areas and the policies for them. It also contributes to make “invisible” the existence of a variety of income opportunities both for farmers and non-farmers which are already providing viable solutions for these areas.

The diversified rural area that has been able to attract resources and reverse or stop depopulation should be used as the ideal model of reference for development policies and the creation of modern rural areas. The traditional view that urban areas always drain resources from the countryside should also be revised. The new push and pull factors operating in rural urban dynamics should be used as opportunities: the contraction of manufacturing activities in urban areas, the high cost and low quality of life in some urban centres have contributed to the attractiveness of rural areas and the development of new functions. Endogenous entrepreneurship, a qualified labour force and quality, niche products and services have provided goods that consumers are willing to pay for.

These corrected assumptions of course influence the strategic role imagined for agriculture in rural areas, reducing the need to rely on agricultural policy support to insure the viability of rural areas. Agricultural policies should acknowledge the existence of alternative sources of income and off farm activity, that reduce the need for leaving rural areas when farm activities are no longer remunerative. This fact also influences traditional assumptions about income support for farmers. Rethinking income needs may be politically difficult to accept, as was already clear in previous reform attempts. But there is a high cost in not acknowledging the new situation: expenditure becomes inefficient, innovation is blocked, more effective policies are not followed.

The analysis of recent trends has been described as a generalised phenomenon for purposes of clarity, simplicity and brevity. The diversification processes that have taken place are of course quite varied across Europe, even within the same country, in terms of mix of sectors and resources intervening, intensity, policy support and “self-sustainability”. Old industrial areas show differences with more recent ones. Mountain areas include cases of successful diversification and complete abandonment. Recognising a general trend towards diversification does not imply that this occurs in the same way everywhere. On the contrary, and this stresses the need for decentralised and adapted programmes to the specific conditions (strengths and opportunities) of each rural area.

The phasing out of market support and direct payments for farmers should be justified not so much as a response to the external constraints imposed by the WTO, or the budget needs for enlargement, but more realistically because the recent trends briefly described are indicating a viable solution for rural areas, not relying only on agriculture and thus changing the assumptions on which agricultural policy was originally designed. In the medium term, non-farming activities are likely to allow a stable population and a less assisted economy. Agriculture will not “save” rural areas, but may offer a significant contribution to its development by responding more imaginatively to quality food production and other functions – leisure, lifestyle, environment, industrial and service activities- that society at large is increasingly demanding from rural areas. The EU rural development experience could also be an extremely interesting learning for rural areas outside the EU.

## **4 The policy options**

This chapter compares the current policy options “on the table” in relation to the present policy supply (section 2) and the need for a change in the assumptions legitimating policy action (section 3).

An agricultural policy alone, even with corrected assumptions and addressing new needs, will not be able to solve on its own the problems of rural areas. The sectorial and territorial functions have become and should remain well differentiated from each other in terms of assumptions, objectives, instruments, beneficiaries, financial resources and expected results. Neither of the two should try to eliminate the other, however powerful the interests at stake, because this would backfire and damage also the “winning” function. The key political issues are:

- how to address the relationship between the territorial and the sectorial function with the above mentioned reformulated assumptions (the overall strategy),
- how can the reform process best express the support for the new policy needs and dismantle obsolete approaches both for agriculture and for rural development (the end result and the transition needed to get there),
- draw the institutional implications of this transition in terms of what should be done at EU, national and regional level (who should do what).

From this perspective the policy “menu” available at EU level appears out of focus and addressing issues that are no longer the real problem. The present situation is the result of several policy reform attempts. However, if we are still talking about reform today it is because those attempts stopped short of posing the right questions and remained within a framework of correcting the damages and inefficiencies of the CAP without addressing the implications of real processes and new needs.

What is then left to be done, since the two functions are already present in current rural policy? A variety of reform alternatives have been generated and discussed in the second half of the Nineties within the framework of the elaboration of Agenda 2000 and the decisions taken during the GATT (then WTO) negotiations. The Cork declaration, the report on a “Common Agricultural and Rural Policy for Europe” (CARPE), the current debate on a desirable reform in view of the enlargement negotiations and the food safety crisis that have affected the sector.

In preparation for Agenda 2000 the Commission organised a rural development conference in Cork, Ireland, where a “Declaration” identified desirable rural development policies for the future (EC 1996). In that occasion rural policies were imagined as having only a territorial function and the LEADER approach was used as a successful model that could be extended to all rural areas. The main statements made by the Declaration were: the relevance of rural areas in the framework of cohesion policies; the need for an integrated, multi-sectorial, bottom up approach; the diversification of activities; the environmental sustainability; the extension of the partnership approach, programming and subsidiarity. The linkage of rural policy with agricultural policy was perceived as complementary but in fact the two were kept independent of each other as separate tools.

The shortcomings of the Cork Declaration were: to have dealt with only one of the functions of rural development (the territorial one) ignoring the sectorial one; to have avoided clarifying the relationship between the existing agricultural policy and the new rural policy; to have failed to link the future rural development policy with regional policy and Structural Funds’ expenditure (therefore leaving the LEADER initiative as the main bearer of the new policy, which became a weakness). Cork was a partial failure also for other and more political reasons: some Member States’ and farmers’ organisations perceived the new policy as a threat to what was considered as “their” budget. Since it had been made clear that the overall budget for the CAP would not increase after 2000, any expansion of the territorial functions was perceived as an implicit reduction of agricultural expenditure. In fact the rural budget was and remains very modest in relation to the agricultural expenditure as already mentioned: an increase would not have changed dramatically the disproportion between the two.

A second rural development initiative undertaken by the Commission in preparation for Agenda 2000 was the setting up of a group of experts, which produced the CARPE report (EC 1997 a) and worked on different hypothesis than the Cork Declaration. Here the problems considered were two: the need for further reform of the CAP, mainly in its price support mechanisms (first pillar), and the reformulation of the CAP legitimacy in view of enlargement and future WTO constraints. The main recommendation of this study is the establishment of a common agricultural and rural policy involving four main elements: market stabilisation, environmental and cultural landscape payments, rural development incentives and transitional adjustment assistance. The environmental payments, a horizontal measure for all rural areas, should be given only in exchange for the provision of some “public good” service that could be added to the provision of private goods for the market. This was the most innovative proposal. Rural development incentives should emphasise opportunities for non-agricultural uses of farm resources and for resources released from agriculture. Regional rural development plans should integrate the three Structural Funds, LEADER and the environmental measures.

From the perspective of this paper the shortcomings of the CARPE approach are two: rural development is perceived predominantly in its sectorial function and rural space is conceptualised as substantially dominated by farm activities. It ignores the diversification of activities that had occurred spontaneously in the majority of rural

areas. The proposed environmental payments, given in exchange for services and legitimated on the basis of a perceived market failure to remunerate them, are certainly a way for addressing real environmental concerns. However, because these payments are intended only for farmers and not for other rural dwellers who might be interested in providing them, and because such payments could be permanent and acceptable within the WTO negotiations, it also provided a framework for legitimising an alternative form of farm support. On these aspects it has a different approach from the Cork declaration, responding to the need for CAP reform rather than emphasising the territorial function.

The proposals contained in the report were not incorporated in Agenda 2000 and remained as suggestions for the future. The same political constraints that influenced the results of Cork were influential in delaying the application of the suggestions contained in the report. The eco-conditionality of payments was considered too restrictive and having coupled direct payments was considered easier to manage and politically preferable. In this way the substantial problems posed by enlargement and the new round of WTO negotiations were left unsolved by Agenda 2000, to be addressed with the new programming period afterwards.

An interesting question that could be raised is why was it necessary for Agenda 2000 to put the label of rural development on a package of second pillar measures that included traditional forms of support if at the same time the territorial component previously associated with rural development was reduced in visibility and relevance? Why not leave the old names for these policies after all? The probable answer to this question is again of a political nature: the reason for this is that a “rural development box” as second pillar of the CAP was thought to be necessary as a container for future “shifts” from market support. The lack of focus of present rural development measures and their unchanged assumptions are not the real point: what was important was the creation of a container and the label, the contents would come later with shifts between the two “pillars” and “modulation”. The second pillar in this context is conceived almost exclusively as an instrument for addressing CAP reform in the future. Its present contents and financial relevance are of secondary relevance and destined to change while the reform makes progress.

Discussion about further reform started almost immediately after Agenda 2000 was approved. Enlargement negotiations, budget constraints, the new WTO round and the food safety crisis explain the urgency. This new set of issues modified the terms in which the reform had been debated only a few years before.

The current debate addresses almost exclusively the specific problems arising from the need for further CAP reform (what we have called the sectorial function) and considers of secondary relevance the territorial function of rural areas. There is a suggestion to shift a certain percentage of support from the first pillar (common organisation of markets) to the second pillar (rural development) through modulation. The proposal for a Mid-term Review made by the Commission proposes a 20% gradual shift, of 3% per year (EC 2002). There is a preference for shifting within the framework of Agenda 2000 as little as possible (due to compatibility with previous engagements), as late as possible, with the least possible conditions (weak eco-conditionality), while at the same time delaying any phasing out.

This is a defensive approach, based on the acknowledgement that however legitimated the post-reform situation will provide less financial resources for the agricultural sector and therefore it is convenient to maximise short-term gains. This fact influences very heavily any attempt to design a more innovative policy approach, based on quality, organic production, environmental payments or diversification of activities.

Reform proposals tend to be judged not so much for how effectively they respond to new needs or recent problems but mainly in relation to past support, relative “winners” and “losers” in budgetary terms.

Another element of the reform is the multi-functional role of agriculture. This concept is usually taken to mean that agriculture, beyond its primary function of producing food, feed and fibre, has other functions, appreciated and necessary to society but not remunerated by the market. These ‘other’ functions are considered ‘positive externalities’, like for the case of the preservation of the rural environment and landscape, or the contribution to the viability of rural areas. These other functions are considered as ‘non-trade concerns’ and any payments to farmers in exchange of public goods will be eligible for the “green box” and could therefore be of a permanent nature.

Strengthening the multi-functionality of agriculture is one way of justifying the shift from the first to the second pillar and remains within a sectorial view of rural development: it is agriculture who is multifunctional rather than rural areas, and it is only farmers who may receive such payments. Multi-functionality is considered the peculiarity of the “European model of agriculture” and addresses in a new way the need for supporting farmers’ income. The main problem in the use of this concept is the same indicated at the beginning of this paper regarding rural development policies: it is never clear whether multi-functionality has become a key concept because of the need to reform the CAP (sectorial function) or because the other functions need to be addressed (the territorial and the environmental function). In principle, if we were truly worried about the “other functions” in remote areas we should allow anyone, not just farmers, provide environmental or rural development services in exchange for compensation.

These approaches to reform address almost exclusively the sectorial function within a reform rationale, while the territorial one plays a very marginal role. Rural areas are still perceived as coinciding with agriculture. A reform along these lines would be another step in the direction of reducing agricultural market support and replacing it with a direct payment. This is mainly legitimated by the assumption that without (or with a lower) income support farmers would be pushed out of farming, the land abandoned with negative environmental and rural consequences. This vision does not take into consideration recent trends in rural development or the demand for a more competitive and quality oriented agriculture. The diversification of activities in rural areas does not exclude the multi-functional role for agriculture. But to stress only multi-functionality as the solution for rural areas conduces to a distorted view of them and ignores the real processes that explain their development in the recent past.

## **5 Key components of a rural development policy**

### **The sectorial and the territorial function: distinct and complementary**

The analysis so far has argued in favour of considering – given the present situation - two main components in the second pillar: a sectorial function, specific to agricultural policy reform, and a territorial function specific for the rural economy and population. These two functions of rural development policies have already been developed in the historical evolution of the CAP and the Structural Funds; they respond to different and legitimate needs. The relevance of each function has been quite different over time: the early “structures” policy accompanied the market policy and privileged the sectorial function; the need for market reform and integrated rural policies introduced the territorial function in the Eighties; with Agenda 2000 the need for further market reform came mainly from an external and liberalising pressure, and reinforced the sectorial

function within the second pillar. Today the pressures for reform have widened (consumers, environmentalists, financial ministers...) and deepened, suggesting a reconsideration of the territorial function alongside a re-orientation of the sectorial one. Both functions are already there and need some fresh thinking and orientation. The first conclusion that we can draw from this is that *the two functions should be stable components of any rural development policy of the future*, given the existence of the CAP as it has developed until today.

How the two functions should be differentiated (within or outside the second pillar) and what should be their expected impact in the long run are the key issues of the reform process, that have important conceptual, practical and political implications.

In the past both functions have had different names, objectives, financial weight, political relevance, instruments, beneficiaries and impact. The reasons for putting them all under one rural development pillar in Agenda 2000 responds – as mentioned – to the need for creating a generic container that allows transfers from the first pillar to the second (through modulation), while maintaining broadly the same sectorial function (farmers are the main beneficiaries, forestry as an “assimilated” sector) and – in the wishes of many – the same level of expenditure. The sectorial function includes already and may expand environmental support, diversification of farmers’ activities (multi-functionality), investments for the reorientation of structures towards quality or organic production.

In the future, the two functions could be defined more explicitly as having different objectives, beneficiaries, instruments and expected impact on the viability of rural areas. *The distinct nature of the two functions is strategic for introducing the new assumptions about agriculture in relation to rural development.* The sector and the area cannot be confused because agriculture is not - and only exceptionally is likely to become - the “motor” of the rural economy. There is agreement on the fact that the attractiveness of rural areas in terms of population and employment opportunities is not driven by agriculture but by other sectors. A sectorial rural development policy alone, however generous and indefinite for farm structures, will never be able to create the opportunities for reversing the depopulation and resources drain.

The reverse is also true: a diversification policy alone, which ignores the needs of farm structures in response to reduced price support, environmental concerns and increased demand for quality food production would create problems of land management, rural heritage, social cohesion and tourist attraction. The territorial function needs to be a policy in its own right, distinct in its scope and ambition from the sectorial one but coherent and linked with each other. Whether this takes place within a single programming document or not, at the same institutional level (European, national or regional) and within the same administration (agriculture or other ministries) is a political and management issue with advantages and disadvantages (see below) which should not change the requirement of complementarity between the two functions.

Keeping the two functions distinct should not be understood as establishing a divide or a competition between them: to address openly their interrelationship and complementarity should be considered an asset and a key strategic factor for rural development, strengthening and multiplying its impact. The multi-functionality of agriculture in this perspective is one way – but not the only way – in which the complementarity between the two functions is pursued and valorised. An increased flexibility (possibility of modulation between the sectorial and territorial function) would be a great asset. This should facilitate adapted and integrated strategies for the farmers as well as for the population, avoiding confusions.

Both the sectorial and the territorial function need to be regulated at European level, establishing the general principles, eligibility of areas and rules of the game, quite independently of any future “re-nationalisation” of implementation and spending procedures. This is coherent with the single market and European integration. However, both functions are likely to be more efficient and effective if they are conceived and implemented at a decentralised level (the region) and adapted to specific contexts. The present sectorial measures have inherited a standardised horizontal approach, the same for each area. This is too rigid and should be reconsidered because past experience has shown that farm structures do not converge with modernisation but remain different in many aspects. This implies that structures’ policy should be adapted to regional differences and individual entrepreneurship. Typical products, quality and organic products often have a territorial relevance which is linked to a specific know-how and technology that can only be codified at regional level. The diversification of farming activities may be quite different in terms of opportunities according to the specific mix of resources available in a particular rural area. For the territorial function there is a wide consensus on a decentralised design and implementation, well established with the Community initiatives such as LEADER as well as in the operation of the Structural Funds.

#### **The contents of each function: aims, instruments, beneficiaries, cost.**

Having stated that the sectorial and territorial functions should both be *stable and complementary* components of rural policies, be kept *distinct* from each other and be *decentralised and adapted* to specific rural conditions, the next step is to imagine for each function their main contents in terms of aims, instruments, beneficiaries, expectations and cost.

#### **The main tasks of a sectorial function**

The aim of a sectorial rural development policy should be to accompany ongoing agricultural policy. The beneficiaries in this case are farm-holders. It should address at least two main tasks: a) to provide any multi-functional payments to farmers in exchange for public good services; b) to provide structural aid for investments promoting quality food production, organic farming, diversification of on-farm activities or more traditional modernisation investments. Tasks should not simply be added up to old ones: a more coherent overall framework pursuing a food policy (for example) should give a positive sense of orientation about the needs and expectations of consumers, about what is expected from farmers and production, about how to reorganise technical assistance and training, marketing arrangements, labelling and traceability, etc. A thorough revision of the present accumulation of measures should find the courage to eliminate those who no longer fit with the chosen orientation. The task of the sectorial function cannot only be understood on the basis of a defence of historical benefits but should also promote a positive alternative for the future of the sector. It is this positive vision that should be the core of the European agricultural model rather than its more defensive aspects.

Direct payments for farmers are usually included in the first pillar since they are coupled with production. However, if such payments are decoupled and/or made conditional on the production of some service or public good, then, since they become forms of income support rather than market support they will be included in the second pillar under the heading of rural development in its sectorial function. This is a highly sensitive passage both conceptually and politically: if support is no longer linked to production but to income needs then the establishment of income parameters will



eventually have to be introduced.<sup>12</sup> The reference is certainly no longer a comparable income in manufacturing, as was considered in the Sixties, but some kind of an upper threshold of support will be necessary (this was not considered so with coupled payments). If the rationale is income support, pluri-active arrangements, since they affect substantially total income will have to be included in the picture. Income support should not discriminate between ‘professional’ and ‘pluri-active’ farms as in the past: the presence of small farms has proved to be an extraordinary resource for the diversification of activities in rural areas, has stimulated entrepreneurship and innovation, has created a demand for contract services from professional farmers and should not be considered “inefficient” from a rural development perspective. Besides upper limits, the duration of income support should also be defined. Here the arguments are quite different: if farmers are receiving payments in exchange for services to society then there is no question either of thresholds or duration. As long as they provide the service they will receive the payment, regardless of their income. However, if the level of income is the criteria for support then the question of the duration of this form of support becomes central and its phasing out appears necessary in the medium term.

Aid for investments and the provision of services for farmers should assist the restructuring and reorientation of farm activities towards food production in general, which remains the core business of agricultural production, and for quality products which have a growing demand in advanced economies and represent the most competitive segment of the European production on world markets. The concept of farm modernisation should include both economies of scale and of diversification as possible rationales. Innovative farmers may also come from the non-farm sector of the rural population and not exclusively from the farming ranks. A rationale of competitiveness and market orientation, not necessarily relying on support, should be a desirable and attractive long-term policy goal. Farmers in marginal areas should participate in the elaboration of common local strategies that integrate farming with other local activities and services. Compensation allowances should be applied only where there are no alternatives either through farming or non-farming activities.

The financial allocation for the sectorial function is likely to remain the largest one in the medium term. This is due to the chosen criterion of “shifting” existing support from the first to the second pillar rather than redefining (and reducing) resources directly in the first pillar. Ideally, at the end of a transition period only payments in exchange for environmental services, minimal compensations for well delimited situations and structural aid should remain as permanent components of the sectorial rural development policy. Financial packages for rural development could be based on a global allowance for both the sectorial and the territorial functions, allowing for some flexibility in the allocations between the two functions according to the rural area. Funding may be quite unbalanced between the two functions (as it is today) and this is not in principle good or bad: it is a matter to be established case-by-case, according to the priorities of a chosen strategy.

If the two functions are not under the same administrative competence (at European, national or regional level), then the financial aspects and the flexibility between the two functions are likely to become more difficult to manage.

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<sup>12</sup> The Mid-Term Review (EC, 2002) proposes a threshold of 300.000 Euros.

## **The main tasks of a territorial rural development policy**

The territorial function should be expected to be a permanent component of any rural development policy, playing a low cost and strategic role both for agriculture and rural areas. The beneficiaries of this policy should be all the residents and economic actors in these areas, including, of course, farmers. In the medium term the objective is to provide a viable, diversified, sustainable economy and society to rural areas. It is not just agriculture that is and may remain multi-functional: it is the territory that has to become multi-functional, in the sense of a mixed economy responding to internal needs and the new functions that the wider society demands in terms of products, environmental goods, leisure, activities, life-styles, accessibility. Rural areas should 'invent' a modernity of their own, different from the one that was imagined and constructed around urban industrialisation. A success in this task would give a positive image to the European rural model, one to be proud of also internationally. Mobility in and out of rural areas is not necessarily an exodus or a brain drain: it can be the result of a wider horizon in the search for opportunities that as long as it is an exchange of mobility should not be perceived like a threat.

The rural territorial approach needs to have close linkages with regional development, promoted through the Structural Funds. The instruments (LEADER and regional programmes) operating with a territorial approach need to be co-ordinated in their conception and management. Reform of the rural development policies should be coherent and linked with reformed regional and cohesion policies after enlargement.

Programmes such as LEADER have shown that the territorial function can be very effective with modest amounts of money. It can provide solutions in terms of income and employment where other and more costly initiatives had failed. It introduces in the rural debate concepts such as transfer of know how, human capital, intangible factors, participatory approaches, innovation, integration between actions, networks, that were previously absent in the sectorial function and could stimulate a less assisted and defensive mentality, reducing the isolation of single rural areas.

The instruments of the territorial function must rely on an area-based approach. This should be pro-active and development oriented, avoiding the rhetoric of compensation for local handicaps. Local development as was experimented in LEADER is a very efficient way of organising the participation of all rural actors and institutions, get them around a table to exchange alternative strategies for the area. The contextual knowledge that local actors can bring to the planning process cannot be matched by any codified knowledge about rural development in general. However, LEADER cannot be the only instrument available for the territorial function. Employment, gender issues, adapted services (public and private), transportation, tourism, business, a sustainable use of resources, land use and housing are contents that need to be brought into the rural planning framework for a specific area in a more systematic and integrated way, so that problems and priorities can be established with a complete and realistic picture of the context. The territorial function cannot be only a question of mobilisation and animation.

New employment opportunities and diversification of activities should be seen here as tools for increasing the competitiveness and the attractive character of the rural area, regardless of whether the farmers are pushed out of farming or not. A well-articulated and varied labour market provides opportunities also for the farming population, offering a choice between alternative careers for the farmer and his family.

A particular attention should be given to the innovative functions that have been developed by rural areas. Other actors different than farmers can also provide

environmental concerns and services. Leisure homes and commuting practices should be seen as opportunities that require some regulation, service infrastructure and efforts towards social cohesion. Endogenous or relocating enterprises have similar needs. Forestry is presently included in the second pillar and could be kept as a distinct strand of rural development policies, as a different type of sectorial function.

The financial allocation for the territorial function should have its own logic independent of the sectorial one. Like other territorial expenditure it is based on aid for investments (tangible and intangible) and collective infrastructure. It should not include compensatory payments or income support.

### ***The relationship between the two functions: learning to live together***

The territorial and sectorial functions are complementary and not competing with each other. The idea that rural policies are only accompanying policies for agriculture should be replaced by the need to have two distinct and complementary policies that could develop significant synergies by co-operating. Changing the initial assumptions of the CAP should make clear that rural areas are not the same thing as agriculture. It is the territorial function who should provide the development and modernisation of the rural area and agriculture may be a large or small part in this strategy. The exchanges between the farming community and other sectors of activity as well as with the external world will increase the competitiveness of the area as a whole. There are plenty of examples of innovative business ideas and practices taken from the manufacturing and service sectors and transferred to the agricultural sector. The same for exchanges between the local population and newcomers or tourists. There is evidence that the turnover of land increases with diversification of activities and rising incomes, thus creating new opportunities for adjusting farm size to the farm family. Farm pluriactivity is an advantage for farm families. There is a broader and more real range of opportunities offered by a diversified rural economy than the current abstract descriptions of multi-functionality imagine as a possible solution.

The environmental dimension should be considered both in the sectorial as well as in the territorial functions. Forestry, natural parks, conservation, tourism have also a non farm dimension which should be addressed. All the rural population should be in principle eligible to realise environmental services and public goods.

### **The political-institutional question: who should do what, when, how, with what resources and interest groups**

The political-institutional question is extremely relevant in any reform initiative because it affects the organisation of interests, the role of the institutions, the method of delivery, financial flows. It is relatively simple to think of a new policy and adding it to the existing ones, but it is extremely difficult – and there is little know-how about how to go about it - to change, reorient or even worse downsize a policy, especially when it is the most important and original policy associated with the construction of the European Union. A reform is not just a conceptual or technical affair, but it should not be either just a political one or a question of “tuyauterie financière”.

The relevant actors are likely to be the administrations responsible for designing and implementing rural policies and the interest groups involved in the political debate. Financial, environmental and foreign ministers may hold different views about the reform. Member States have expressed quite different preferences for alternative reform packages. Stakeholders have enlarged: consumers, health officers, food chain operators, trade entrepreneurs are now more vocal in expressing their interests.

In principle, it would seem reasonable to say that the sectorial function of rural policies should be integrated with agricultural policies, while the territorial function should be integrated with other territorial policies, regional and cohesion policies. However, there are also advantages in keeping them under the same institutional umbrella: the two functions are complementary to each other, synergies and co-operation between farmers and the rest of the rural actors would be improved with greater efficiency and innovation for both. The problem in the past has been that when a territorial function is placed under the competence of a sectorial administration it gets distorted or pushed to a marginal role (and the reverse is also true). Therefore if the two functions operate within the same institutional administration, checks and balances are needed to avoid that one function takes it all; if the two functions operate under different institutional administrations, checks and balances are needed to avoid competition between the two functions and a loss of synergies. As mentioned above, modulation between the two functions would be extremely positive and to the benefit of all. National governments' organisation and regions very often reproduce at different level and scale this dilemma of the sectorial versus territorial competencies.

Another issue related to institutional arrangements is the governance of the reformed CAP. The growth of the second pillar implies a growth of co-financing, of programming, of more complex administrative procedures for spending funds, of more levels of government being involved and different sectors/ministries/agencies having to cooperate. Market support procedures were and will remain simple, attractive, automatic. The bureaucratic burden attached to the shift from the first to the second pillar will be a very significant constraint that influences the magnitude of the shift. There is of course room for a lot more "simplification" than the one that has been realised until now but there is no doubt that spending the funds made available will become much more complex.

It should also be considered that the sectorial agricultural interests have a well-established, organised power base, both in terms of economic actors and political representation at all institutional levels. The same is not true for the territorial rural interests, which are more recently established. They are by definition heterogeneous, have no clear political identity and are better represented at local and regional level than at national or European level. Such a wide gap in the "rapports de force" at the relevant institutional levels is a political weakness of the territorial function. Making much more clear than has been done so far what are the advantages for the farming population (in terms of land availability, income and job opportunities, valorisation of agricultural products, new market outlets and commercialisation circles, better services, ...) of developing the territorial function would certainly help. The positive side of this development needs to be more convincing; otherwise it will be just seen as a competition for having a part of the financial resources "belonging" to farmers. This is true also for other potential supporters of the territorial function: environmental groups interested in sustainable development would be particularly sensitive to agro-environmental measures, payments for public good services, reorientation from a productivist to a more qualitative and organic approach to food production from the sectorial function side, but also to parks, rural amenities, integrated development and cultural heritage from the territorial function. Consumers of products and space could also be supportive of both functions.

The question of timing is also likely to be a complex and tricky issue, particularly in the perspective of enlargement. On paper the CAP reform should be ready for the next programming period starting after 2006. Logically, it seems irrational to transfer questioned policies that are about to change. Since rural development policies will have

a larger role to play in the reformed CAP than in the present situation, the current approach of “anticipating” such emphasis in the policies available to candidate countries that join before 2006 is appropriate. Precisely for this reason, however, the sectorial function of rural development in candidate countries risks to be oriented towards the wrong targets if the present “menu” of rural measures, conceived for a traditional productivist modernisation and as accompanying measures for the agricultural sector is maintained. The territorial function, which has played such an important role in the recent competitiveness of some rural areas of the present Member States, risks to play a marginal role in the CEEC countries, engaged in repeating the experience that proved to be based on inaccurate assumptions about rural development. In order to avoid this, the general philosophy of the reform should be made known before 2006, not only for justifying the different starting point of the CEECs but also to make sure that the EU-15 are committed to substantial change. An idea of what is likely to be ‘phased out’ helps to accept different rules for the phasing in.

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## **Abstracts**

*Winfried von Urff*

### **Expectations and Challenges - Reasons for Re-initiating the Discussion on a CAP Reform**

This paper tries to highlight the most important issues of domestic dissatisfaction with the present CAP and the expectations deriving there from for a reform. It also deals with the challenges resulting from existing WTO commitments and ongoing negotiations as well as with those resulting from the eastward enlargement of the EU. This is done in the sense that these challenges set some limits to the room for manoeuvre of the CAP or make some options more appropriate than others. It is not the purpose of this paper to offer solutions. What can be done to make the CAP more responsive to expectations and challenges is dealt with in other papers prepared by the working group, in which the authors present their opinions and the results of the discussions within the group on some of the main issues.

*Jan C. Blom*

### **The Future of the CAP - A Discussion about the Needs of a Shift in Instruments**

This paper is about the future dynamics of the agricultural sector and the consequences for rural areas in Europe. The following questions will be discussed: 1) what forces will dominate changes in the agricultural sector during the next decades? 2) What consequences are expected for the agricultural sector and the rural areas in Europe? 3) What changes in CAP instruments are preferable and possible, given institutional and financial constraints? The paper starts with an overview of the current CAP under Agenda 2000.

Agenda 2000 was a small step in the direction of a necessary change of the CAP. The challenge is to develop a policy to stimulate market participants to take their roles and to organise society in making the right choices with respect to food production and the vitality of the countryside. Ignoring the needs will lead to irreparable damage.

*François Colson, Joël Mathurin*

### **How could the CAP pillars be balanced for the promotion of a multifunctional European model?**

This paper is about the CAP and got some tools which can promote the European model for a multifunctional agriculture. The recent implementation of these tools in Europe does not, however, not yet allow any evaluation of their effectiveness or their impact on the condition of the environment, or, at the very least, a modification of farming practices. It does open the way to promising prospects for the development of a more sustainable agriculture. Beyond two balanced CAP pillars, it is argued that we can promote transparency, quality and food security through a third pillar of the CAP strategy.

*José M. Sumpsi Viñas, Tomás García Azcarate*

### **Obstacles and Constraints for a New CAP**

The discussion on agricultural policy is polluted by other agendas, private or public, such as the net-contribution of each Member State to the EU budget or the balance of competencies between different European institutions. These concerns are relevant. But they should be addressed through specific and explicit measures, and not through the

use or abuse of sectoral policies. A reform has to be seen as a winning process by ALL contributors. This has been relatively easy to achieve in a context of possible increased expenditure. The transfer of support from consumers to taxpayers, more efficient from an economic point of view, has implied an increase in overall agricultural expenditure. If we take into account a drastic budget restriction (to the current level or even below), an agreement will be more difficult. Reform proposals have to be balanced. The impact should not be concentrated on some regions. This is, for instance, the major political difficulty with European-level modulation.

*Giovanni Anania*

### **The WTO Negotiation on Agriculture and the Common Agricultural Policy**

The contribution briefly discusses the linkages between current WTO negotiations on agriculture and the on-going CAP reform process. Before discussing the implications for the CAP of the possible outcome of current negotiations, an assessment of the impact of the implementation of the 1994 GATT "Agreement on Agriculture" (AoA) for the agriculture and food sector in the EU and for the CAP is offered. Then, the linkages between the CAP reform process and the current negotiations are discussed. Finally, the issues currently on the agenda of the WTO negotiations are identified and the main elements of a possible final agreement are briefly discussed.

Although recent policy developments in the United States have seriously reduced the already relatively slim chances of a far reaching WTO agreement on agriculture, the outcome of the on-going negotiations is still likely to induce the need for significant adjustments in the CAP.

*Jerzy Wilkin*

### **The future of EU agricultural and rural policy from the perspective of CEE candidate countries**

This paper argues that the Eastward enlargement of the EU is the biggest challenge to the Community since its creation. This challenge requires profound reforms of major policies, especially agricultural and regional policy. The reaction of the EU to this challenge has so far been insufficient. Enlargement of the EU by 10 new members is treated more as accession than integration. Without sufficient support, most of the agricultural producers from CEECs will be marginalized in the enlarged EU. Direct aid to the farms in new member states is necessary and justified. Implementation of *degressivity* and *modulation* of direct payments in the EU should be connected with the extension of this form of support to new members.

*Allan Buckwell*

### **Food Safety, Food Quality and the CAP**

Governmental institutions have an essential role to play in food safety, they have a less central, but nonetheless important, role in assisting the development of food quality. This vital work is a matter for public policy, but is not directly a matter for the CAP. The issues of standards of food quality and the method chosen by society to support it can often lead to problems of international trade. This is the subject of the so-called non-trade concerns in the WTO, but is a subject in its own right and is not opened here.

*Ewa Rabinowicz*

### **Should risk management tools play a Role in the CAP?**

This paper raises some questions concerning income/price stabilisation instruments in relation to the CAP. Should some risk management tools be added to the existing CAP measures? Or should they rather replace some of the currently applied policies facilitating the process of the CAP reform? Which options would be preferable in such a case? What is a proper division of responsibilities between the Member States and the European Union with respect to make use risk management tools? Will the enlargement affect pros and cons of using stabilisation instruments and a choice of a preferred method to do so? This paper only addresses the first of the above-mentioned issues, namely market failures. The issue is raised in relation to the CAP. The main focus of the paper is the question whether markets for risk reduction are missing or whether they are incomplete and risk is not sufficiently reduced by existing stabilisation policies. The paper examines two cases: The first one relates to the existing CAP because it contributes substantially to stability of prices and incomes, the second one relates to a future, more liberalised CAP.

*José M. Sumpsi Viñas, Allan Buckwell*

### **GREENING THE CAP: THE FUTURE OF THE FIRST PILLAR**

The principal debate about the future structure of the CAP concerns the switch in the balance of objectives and instruments away from commodity-linked production supports and payments towards payments for provision of non-market environmental and cultural landscape services and the stimulation of wider rural development. The Agenda 2000 reform created the so-called Second Pillar, Rural Development Regulation, to receive more resources to deliver these new functions and the vehicle of Modulation to move the resources from first to second Pillar. However the experience of its first three years showed a reluctance of Member States to use this mechanism. The first half of the paper explores another way of achieving the same goal, by Greening Pillar 1. The second half of the paper compares this approach with other ways of bringing about reform through payment decoupling, compulsory modulation, degressivity and bonds. No attempt is made to conclude that one of these approaches is superior. The purpose is rather to examine some characteristics and effects of each in the hope of assisting rational decision making.

*Elena Saraceno*

### **Rural Development Policies and the Second Pillar of the Common Agricultural Policy**

This paper tries to bring together the various arguments that make a reform of rural development policies desirable and useful for the stakeholders involved. The policy implications of a desirable reform are also considered. CAP, in its long story has established powerful interest groups in the administrations, in the sector and even in expert's circles. Past shortcomings of reform attempts suggest that a consensus on reform is difficult to achieve and requires a clear and shared outline of what agricultural and rural policy will look like after the reform process. A transition period, the inclusion of wider interest groups than those directly concerned by the policy, the possibility of regionally adapted versions rural policy appear to be important components for insuring a strengthened support and a more effective policy.





## **Extraits**

*Winfried von Urff*

### **Attentes et défis : raisons d'une réouverture de la discussion sur la réforme de la PAC**

Ce document tente de mettre en évidence les principaux aspects à l'origine du mécontentement des différents pays vis-à-vis de la PAC actuelle et les attentes à l'égard d'une réforme. Il traite également des défis que posent les engagements pris dans le cadre de l'OMC et des pourparlers en cours et de ceux découlant de l'élargissement à l'est de l'UE. La réflexion va dans le sens où ces défis restreignent la marge de manœuvre de la PAC ou rendent certaines options plus appropriées que d'autres. Ce document n'a pas l'ambition de proposer des solutions. Les mesures pouvant être prises pour rendre la PAC plus réceptive aux attentes et aux défis ont fait l'objet d'autres documents préparés par le groupe de travail dans lesquels les auteurs présentent leurs opinions et les résultats de la discussion ayant eu lieu au sein du groupe sur certains sujets essentiels.

*Jan C. Blom*

### **L'avenir de la PAC : discussion sur les besoins d'un changement d'instrument**

Ce papier concerne la dynamique future du secteur agricole et les conséquences qu'elle implique pour les zones rurales en Europe. Il porte sur les questions suivantes : 1) Quelles sont les forces qui domineront les changements dans le secteur agricole au cours des prochaines décennies ? 2) Quelles conséquences sont attendues pour le secteur agricole et pour les zones rurales en Europe ? 3) Quels changements sont préférables et possibles au niveau des instruments de la PAC en tenant compte des contraintes institutionnelles et financières ? Le papier commence par un panorama de la PAC actuelle dans le cadre de l'Agenda 2000.

L'Agenda 2000 fut un petit pas dans la direction des changements nécessaires de la PAC. Le défi consiste à développer une politique visant à stimuler les parties prenantes du marché à remplir leur fonction et à organiser la société en faisant les bons choix en tenant compte de la production alimentaire et de la vitalité de la campagne. Ignorer les besoins causerait d'irréparables dommages.

*François Colson, Joël Mathurin*

### **Comment les piliers de la PAC pourraient-ils être équilibrés pour la promotion d'un modèle européen multifonctionnel ?**

Ce document concerne la PAC et présente certains outils qui peuvent promouvoir le modèle européen d'une agriculture multifonctionnelle. La mise en œuvre récente de ces outils en Europe ne permet cependant pas encore une évaluation de leur efficacité ou de leur impact sur les conditions de l'environnement, ni la modification des pratiques agricoles. Il ouvre la voie vers une perspective prometteuse pour le développement d'une agriculture plus durable. Au delà, la possibilité de la promotion de la transparence, de la qualité et de la sécurité alimentaire par le biais d'un troisième pilier stratégique de la PAC est envisagée.

*José M. Sumpsi Viñas, Tomás García Azcarate*

### **Les obstacles et les contraintes posés à une nouvelle PAC**

La discussion sur la politique agricole est polluée par d'autres sujets à l'ordre du jour, publiques ou privés, comme la contribution nette de chaque État membre au budget de l'UE ou l'équilibre des compétences entre les différentes institutions européennes. Ces inquiétudes sont d'importance. Toutefois, il conviendrait de les traiter dans le cadre de mesures spécifiques et explicites et non pas en se servant ou en exploitant la politique des secteurs. La réforme doit être perçue comme un gain pour TOUTES les parties prenantes. Ceci était relativement simple dans un contexte où l'accroissement des dépenses était possible. Le transfert du soutien par les consommateurs vers un soutien par les contribuables, plus efficace d'un point de vue économique, a entraîné une augmentation des dépenses agricoles globales. Dans l'hypothèse d'une restriction budgétaire drastique (au niveau actuel ou même inférieur), un accord sera plus difficile à trouver. Les propositions de réformes doivent être équilibrées. L'impact ne doit pas se concentrer sur certaines régions seulement. C'est par exemple la difficulté politique majeure que pose la modulation au niveau européen.

*Giovanni Anania*

### **Les pourparlers dans le cadre de l'OMC sur l'agriculture et la Politique agricole commune**

Ce document traite dans les grandes lignes de la relation entre les négociations actuelles dans le cadre de l'OMC sur l'agriculture et le processus de réforme en cours de la PAC. Avant de discuter des implications pour la PAC du résultat possible des négociations actuelles, l'auteur propose de réaliser une évaluation de l'impact de la mise en œuvre des "accords sur l'agriculture" conclu dans le cadre des accords du GATT en 1994 pour l'agriculture et le secteur agroalimentaire au sein de l'UE et pour la PAC. Il traite ensuite, les relations entre le processus de réforme de la PAC et les négociations actuelles. Finalement, les points actuellement à l'ordre du jour des négociations de l'OMC sont identifiés et les principaux éléments d'un possible accord final sont abordés brièvement.

Bien que les récentes évolutions politiques aux États-Unis aient sérieusement compromis les chances déjà minimes d'aboutir à un accord de grande envergure sur l'agriculture au sein de l'OMC, il est probable que le résultat des négociations en cours puisse de nouveau entraîner la nécessité de procéder à des ajustements de taille de la PAC.

*Jerzy Wilkin*

### **L'avenir de la politique agricole et rurale de l'UE selon le point de vue des pays candidats à l'adhésion**

Ce document décrit que l'élargissement de l'UE à l'Est est le plus grand défi posé à l'UE depuis sa création. Ce défi entraîne de profondes réformes des politiques majeures, en particulier la politique agricole et la politique régionale. La réaction de l'UE à ce défi a été insuffisante jusqu'à ce jour. L'élargissement de l'UE à 10 nouveaux membres est davantage considéré comme une accession que comme une intégration. Sans un soutien suffisant, la majorité des producteurs agricoles en provenance des PECO seront marginalisés dans l'UE élargie. L'aide directe aux exploitations agricoles dans les nouveaux pays membres est nécessaire et justifiée. La mise en œuvre de la *dégressivité*

et de la *modulation* des paiements directs au sein de l'UE devrait être liée à l'extension de cette forme de soutien aux nouveaux membres.

*Allan Buckwell*

### **La sécurité et la qualité alimentaire et la PAC**

Les institutions gouvernementales ont un rôle primordial à jouer en matière de sécurité alimentaire. Elles ont un rôle moins central, mais néanmoins important relatif à l'aide au développement de la qualité alimentaire. Ce travail vital relève de la politique publique, mais n'est pas une question concernant directement la PAC. Les thèmes concernant les normes de la qualité alimentaire et la méthode choisie par la société pour l'encourager peuvent souvent conduire à des difficultés sur le plan du commerce international. Ils font l'objet des inquiétudes dites non commerciales au sein de l'OMC, mais ceci constitue un sujet en soi qui n'est pas traité dans ce document.

*Ewa Rabinowicz*

### **Les outils de gestion du risque devraient-ils jouer un rôle dans la PAC ?**

Ce document concis soulève certaines questions relatives aux instruments de stabilisation des prix et des revenus en rapport avec la PAC. Certains outils de gestion du risque devraient-ils être ajoutés aux mesures existantes de la PAC? Ou doivent-ils plutôt remplacer certaines des politiques appliquées actuellement afin de faciliter le processus de réforme de la PAC? Quelles options seraient-elles préférables dans un tel cas? Quelle est la division appropriée des responsabilités entre les États membres et l'Union européenne en ce qui concerne l'utilisation des outils de gestion du risque? L'élargissement affectera-t-il les raisons pour ou contre l'utilisation d'instruments de stabilisation et le choix d'une méthode préférable pour le faire? Ce papier ne traite que du premier des points mentionnés ci-dessus, à savoir les dysfonctionnements du marché. La question est soulevée en rapport à la PAC. Le papier se concentre principalement sur la question de savoir si les marchés de réduction du risque manquent ou s'ils sont incomplets et si le risque n'est pas suffisamment réduit par les politiques de stabilisation existantes.

Le document examine deux cas : le premier se référant à la PAC existante car il contribue substantiellement à la stabilité des prix et des revenus, le second se référant à une PAC future plus libéralisée.

*José M. Sumpsi Viñas, Allan Buckwell*

### **Rendre la PAC plus verte : l'avenir du premier pilier**

Le débat principal concernant la future structure de la PAC a trait au passage, en équilibrant les objectifs et les instruments, des soutiens et des paiements liés à la production de biens vers des paiements en faveur de mesures pour favoriser les services non-marchands rendus au profit des paysages culturels et environnementaux et la stimulation d'un développement rural plus vaste. La réforme de l'Agenda 2000 a créé le dit second pilier, la régulation du développement rural pour recevoir davantage de ressources afin de fournir ces nouvelles fonctions et le véhicule de la modulation dans le but de déplacer les ressources du premier vers le second pilier. Cependant l'expérience de ces trois premières années a montré la répugnance des États membres à utiliser ce mécanisme. La première moitié du document explore une autre manière d'atteindre le même objectif en verdissant le pilier n°1. La seconde partie du document compare cette approche à d'autres manières de réaliser la réforme par le biais du découplage des

paiements, la modulation obligatoire, la dégressivité. Il ne cherche pas à conclure sur la supériorité d'une méthode par rapport aux autres. L'objectif est plutôt d'examiner certaines caractéristiques et les effets de chacune, dans l'espoir de contribuer à la prise d'une décision rationnelle.

*Elena Saraceno*

### **Les politiques de développement rural et le second pilier de la politique agricole commune**

Ce document tente de rassembler les différents arguments plaidant en faveur d'une réforme des politiques de développement rural, désirable et utile pour les parties prenantes impliquées. Les conséquences politiques d'une réforme désirable y sont également prises en considération. La PAC, au cours de sa longue histoire, a mis en place des groupes d'intérêt puissants au sein des administrations, dans le secteur et également au sein des cercles d'experts. Les échecs passés des tentatives de réforme laissent penser qu'il est difficile d'aboutir à un consensus sur la réforme et qu'une telle réforme nécessite une définition claire et partagée de ce que devra être la politique agricole et rurale suite au processus de réforme. Une période de transition, l'implication de groupes d'intérêts plus larges que ceux directement concernés par cette politique, la possibilité d'avoir des versions adaptées par régions de la politique rurale semblent être autant de composantes importantes pour assurer un soutien renforcé et une politique plus efficace.



Implemented by a joint initiative of ARL and DATAR (Délégation à l'Aménagement du Territoire et à l'Action Régionale) an international group of experts elaborated the *Vision* encompassing the shift from a *sectoral*, i.e. pure agricultural policy of today, to a *territorial* policy for rural regions to be implemented over a 25 year time horizon. This policy constitutes a desired vision for Europe's rural areas which requires: (1) appropriate institutions, (2) diversifying the economic activities in rural areas, and (3) integrating agricultural and rural policy.

To achieve that shift to an integrated policy we need

- new institutional frameworks, both on European and national levels,
- effective instruments to guarantee the sustainable use of natural resources in agriculture,
- the care for the rural population as a whole not only for farmers,
- the improvement of quality products and production processes meeting the required environmental and animal welfare standards guaranteeing international competitiveness,
- compatibility of the single European market for agricultural products with respect to prices and safety standards with commitments under the WTO,
- a policy design and implementation at a decentralised level, and
- a coordination of that policy at European and national levels for the benefit to implement the principles of solidarity and cohesion.

Instauré par une initiative conjointe de l'ARL et de la DATAR (Délégation à l'Aménagement du Territoire et à l'Action Régionale) un groupe international d'experts a élaboré la *Vision* du passage d'une politique agricole purement *sectorale*, telle qu'on la connaît aujourd'hui, vers une politique *territoriale* des régions rurales devant être mise en œuvre au cours des 25 prochaines années. Cette politique constitue une vision désirable pour les zones rurales d'Europe qui requiert: (1) les institutions appropriées, (2) la diversification de l'activité économique dans les zones rurales et (3) l'intégration de la politique agricole et rurale.

Pour accomplir ce passage vers une politique intégrée les éléments suivants sont requis:

- de nouveaux cadres institutionnels, tant au niveau national qu'au niveau européen,
- des instruments efficaces pour garantir l'utilisation durable des ressources naturelles dans l'agriculture,
- la prise en considération des populations rurales dans leur intégralité et non pas seulement des agriculteurs,
- l'amélioration des produits et processus de production de qualité pour respecter les normes de protection de l'environnement et du respect du bien-être des animaux garantissant la compétitivité internationale,
- la compatibilité du marché unique européen pour les produits agricoles dans le respect des prix et des normes de sécurité et des engagements pris dans le cadre de l'OMC,
- l'élaboration et la mise en œuvre d'une politique à un niveau décentralisé ,
- une coordination de cette politique tant au niveau européen qu'au niveau national dans le but de mettre en œuvre les principes de solidarité et de cohésion.