

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

by

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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 Sumpsi,	Madrid
François Colson,	Nantes/Paris	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.

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

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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.

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 "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 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 Joel Mathurin.* Obstacles to reforms were discussed by *Tomas Garcia Azcarate and José Sumpsi.*

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 Sumpsi.*

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 and the Harbinson paper 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.

## Executive Summary

### 3.3 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.

### 4.3 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 measures 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.

### 5.3 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, transnational 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.

# Chapter 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 (von Urff, ARL 2003).

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 (Colson; Mathurin, ARL 2003).

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 (Blom, ARL 2003).

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 (Saraceno, ARL 2003).

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.

## **Chapter 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 Member 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 (Rabinowicz, ARL 2003).

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 or 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 markets 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 (Rabinowicz, ARL 2003).

### **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 (Buckwell, ARL 2003).

**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 (Buckwell, ARL 2003).

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>3</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 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 (Buckwell, ARL 2003).

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<sup>3</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.

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 (Buckwell, ARL 2003).

## **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 (Buckwell, Sumpsi, ARL 2003)

### **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>4</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.

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<sup>4</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.

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 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 (Saraceno, ARL 2003).

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 (Saraceno, ARL 2003).

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 (Saraceno, ARL 2003)

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 (Saraceno, ARL 2003)

### **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 (Wilkin, ARL 2003).

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 (Saraceno, ARL 2003).

### **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.

## Chapter 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>5</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 the

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<sup>5</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.

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. (Saraceno, ARL 2003).

### **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 “rappports 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>6</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

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<sup>6</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.

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 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 or collapse in prices. It is expected that in the horizon under consideration the use of export subsidies will have ceased (Anania, ARL 2003).

The third adjustment to current Pillar I 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>7</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 (Sumpshi; Garcia-Azcarate, ARL 2003). 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 for Member State match funding for the co-financed Pillar 2

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<sup>7</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.

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 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 (Saraceno, ARL 2003).

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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