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Research Report

Policy vision for sustainable rural economies in an enlarged Europe

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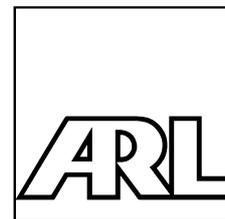


STUDIES IN
SPATIAL DEVELOPMENT

Policy Vision for Sustainable Rural Economies in an Enlarged Europe

DATAR

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



Akademie für Raumforschung
und Landesplanung, ARL

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Preface

By a joint initiative of the Akademie für Raumforschung und Landesplanung (Academy for Spatial Research and Planning, ARL) and the Délégation à l'Aménagement du Territoire et à l'Action Régionale (DATAR) a West-European Working Group was established in parallel with an East European Working Group and a Baltic Sea Working Group with the objective to have a closer look at territorial development in Europe. Within the framework of the West European Working Group a special group on the future of the CAP and its implications for rural Europe was established based on the particular interest of both ARL and DATAR in the development of rural areas. This interest had previously led to the establishment of an international working group, which dealt with the potential impact of the CAP reform of 1992 and the structural funds interventions envisaged for the financial period 1994-1999 on rural areas, and submitted its report on 1996.¹

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)".² Some of the experts who had been involved in the CARPE proposal also participated in the Working Group.

Members of the Working Group were:

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Préface

Dans le cadre d'une initiative conjointe de l'Akademie für Raumforschung und Landesplanung (Académie pour la Recherche Territoriale, ARL) et de la Délégation à l'Aménagement du Territoire et à l'Action Régionale (DATAR), un groupe de travail Europe de l'Ouest a été mis en place, parallèlement à un groupe de travail Europe de l'Est et un groupe de travail Mer Baltique dont la mission est d'observer l'évolution territoriale en Europe. Dans le cadre du groupe de travail Europe de l'Ouest, un groupe spécial né de l'intérêt spécifique de la DATAR et de l'ARL pour le développement des zones rurales a été créé pour se charger de l'avenir de la PAC et de ses implications pour l'Europe rurale. Cet intérêt avait précédemment conduit à l'établissement d'un groupe de travail international qui s'était consacré à l'impact potentiel de la réforme de la PAC de 1992 et aux interventions du fonds structurel envisagées pour la période financière comprise entre 1994 et 1999 sur les zones rurales. Le groupe avait soumis un rapport en 1996.³

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

Les membres du groupe de travail étaient :

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Executive Summary

Background Assumptions and Challenges

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

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

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

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

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

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

Policy Vision for Sustainable Rural Development

The changing role of agriculture and agricultural policies

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

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

The traditional objectives

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

have to be reconsidered.

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

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

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

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

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

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

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

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

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

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

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

Policy for ensuring the viability of rural areas

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Getting to the New Policy Vision

The inadequacy of reform efforts to date

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

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

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

From a sectoral to a territorial approach

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

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

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

Steps required to change Pillar 1 and Pillar 2 measures

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

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

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

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

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

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

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

Récapitulatif

Hypothèses générales et défis

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

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

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

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

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

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

Vision d'une politique pour le développement rural durable

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

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

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

Les objectifs traditionnels comme

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

doivent être revus.

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

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

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

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

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

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

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

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

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

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

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

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

Politique de garantie de la viabilité des zones rurales

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

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

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

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

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

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

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

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

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

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

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

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

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

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

En marche vers une nouvelle vision politique

L'inadéquation des efforts de réforme jusqu'à présent

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

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

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

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

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

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

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

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

Étapes requises pour modifier le pilier 1 et le pilier 2

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

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

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

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

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

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

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

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

Part I

Policy Vision

for Sustainable Rural Economies

in an Enlarged Europe

1. Background Assumptions and Challenges

1.1 Rural areas and agriculture - a changing paradigm

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

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

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

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

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

1.2 Assumptions about future trends

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

1.3 Challenges for a reformed agricultural and rural policy

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

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

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

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

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

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

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

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

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

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

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

2. Policy Vision for Sustainable Rural Economies

2.1 Why is a European Agricultural and Rural Policy required?

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

The second reason for EU intervention is that the transfer of resources between 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 (see the contribution of RABINOWICZ in this volume).

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

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

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

With respect to the role 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 (see the contribution of RABINOWICZ in this volume).

Food safety and quality and animal welfare

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

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

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

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

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

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

These desirable actions are goals of agricultural development which may require training and skills acquisition, information, institutional development and some investments. However these are generally the instruments of the sectoral aspect of rural development programmes and therefore would not normally be found in the first pillar.¹ 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

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

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

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

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

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

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

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

Rural Environment

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

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

Supporting farm incomes

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

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

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

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

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

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

Maintaining farming activity

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

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

Food security

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

2.3 A policy for ensuring the viability of rural areas

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

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

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

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

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

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

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

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

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

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

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

Why are rural policies required?

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

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

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

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

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

- not all rural areas have experienced such spontaneous diversification,

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

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

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

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

The assumptions and tasks of the new rural policy

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

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

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

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

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

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

The first policy task: Diversification of the rural economy

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

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

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

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

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

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

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

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

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

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

The second policy task: Integrating agricultural policy and rural policy

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

The methodology of the new rural policy

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

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

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

Institutional approaches to rural development

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

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

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

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

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

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

2.4 Summarising the Vision

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

The future role of agricultural and food policy

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

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

The future role of rural policies

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

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

3 Getting to the New Policy Vision

3.1 The incompleteness of reform efforts to date

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

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

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

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

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

From the outset of the RDR, there were no real additional resources made available for its measures. This in turn meant that Member States exercised little imagination in using what scope it gave for a wider and more innovative approach to rural development. As there were no extra funds available most Member States had little choice but to continue with their existing 'accompanying measures'. The mechanism offered to switch funds between Pillars (Article 4 of the Horizontal Regulation 1259/99)³ 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

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

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

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

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

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

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

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

3.3 Putting the Vision in place

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

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

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

From a sectoral to a territorial approach: institutional implications

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

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

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

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

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

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

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

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

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

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

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

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

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

The transition to new rural development plans

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

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

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

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

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

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

The transition between the old and the new vision may be facilitated by allowing stakeholders to negotiate the speed of the reform with relevant actors at regional level according to their “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.⁴ It is necessary to give *time* for the industry to adjust, and *to assist* with the adjustment process. The former suggests a transitional period for reducing the payments and supports – one criterion for the length of such a period is the time horizon for large capital investments undertaken before the policy change, say 15 years. The latter suggests that producers should have maximum flexibility to use supports, as they are phased-out, to rearrange their businesses. This is an argument in favour of decoupling payments. There should also be significant assistance made available – through Rural Development measures and Structural Policy – to strengthen their agricultural and food activities, by raising quality, value-added, improving marketing and productivity, and to enable farmers and their families to diversify the range of income sources available to them.

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

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

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

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

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

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

With the assurances of provision for payment for environmental services, and of help for stabilisation, the target must be to agree a schedule of payment cuts which leaves only the residual payment for compensation for the higher animal welfare standards and certain plant and animal health precautions in place. To the extent that this residual will be accepted at all in international trade rules, the magnitude of such payments and their distribution⁵ will require some objective basis in the incremental costs imposed by stated regulations.

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

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

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

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

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

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

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

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

Steps to adapt Pillar 2

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

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

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

Exploiting economies of diversification without giving up economies of scale

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

Using the experience of the Community Initiatives and the Structural Funds

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

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

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

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

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

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

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

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

Extending the scope of payments for environmental land management services

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

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

3.5 Closing remarks

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

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

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

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

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

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

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

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

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

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

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

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Part II

Background Papers

Expectations and Challenges - Reasons for Re-initiating the Discussion on a CAP Reform³

Contents

- 1 Introduction
- 2 Domestic dissatisfaction with the CAP
 - 2.1 New needs for a change
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1 Introduction

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

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

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

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

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

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

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

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

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

2 Domestic dissatisfaction with the CAP

2.1 New needs for change

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

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

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

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

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

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

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

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

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

2.2 Traditional criticism of the CAP

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

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

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

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

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

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

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

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

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

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

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

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

2.3 Where to go?

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

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

⁸ See the contribution of ELENA SARACENO in this volume.

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

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

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

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

3 The issue of re-nationalisation of agricultural policy

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

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

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

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

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

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

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

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

4 The framework set by the Agenda 2000

4.1 Market and price policy

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

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

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

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

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

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

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

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

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

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

4.2 Structural policy

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

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

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

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

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

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

4.3 Shortcomings of the Agenda 2000

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

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

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

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

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

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

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

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

5 Mid-Term Review and Reform Proposals of 2003

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

7 The eastward enlargement of the EU

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

From the point of view of the CEEC the importance placed on agricultural policy is comprehensible because the role of agriculture in their national economies is much more important than in the EU-15.¹⁸ Taking the 10 CEECs together, about 23% of the economically active population works in the agricultural sector, in the EU-15 the corresponding figure is only 5%. In the mid-1990s, 10.3 million persons were employed in agriculture in the CEEC-10 compared to 7.6 million in the EU-15, which roughly corresponds to the combined agricultural workforce of Poland and Romania. There is still a high degree of disguised unemployment in the agricultural sector of the CEECs. They expected large financial transfers via the CAP and hoped that acute economic and political problems would be eased.

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

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

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

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

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

¹⁹ POULIQUEN, A.: Competitiveness and Farm Income in the CEEC Agri-food Sectors – Implications before and after Accession for EU Markets and Policies.
www.europa.eu.int/comm/agriculture/publi/reports/ceeccomp/index_en.htm

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

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

Several model calculations have been used to find an answer to the first question. A recent one, done by the IAMO in Halle/Germany,²¹ in which the situation in the CEEC-10 in 2007 with and without accession was calculated, came to the conclusion that the implementation of the Common Market Organisations in their present form in the CEECs would lead to considerable additional export surpluses in the case of milk²² and beef and to a smaller extent in the case of sugar. Export surpluses in wheat, coarse grains and pork would be reduced. With regard to eggs and poultry, additional import demand would absorb part of the surpluses of the present EU-15. To some extent the results reflect the inefficiency in the conversion of feed grain into pork, poultry and eggs. Vegetables would lose part of their competitiveness and be replaced by imports.

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

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

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

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

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

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

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

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

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

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

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

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

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

²⁵ POULIQUEN, A.: Competitiveness and Farm Income in the CEEC Agri-food Sectors – Implications before and after Accession for EU Markets and Policies.
www.europa.eu.int/comm/agriculture/publi/reports/ceeccomp/index_en.htm

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

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

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The Future of the CAP - A Discussion about the Needs of a Shift in Instruments²

Contents

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1 Introduction

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

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

2 Agenda 2000

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

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

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

³ Cf. J.A. Schumpeter, chapter VII on the process of creative destruction.

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

Commodities

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

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

Rural development

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

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

3 Dominant forces during this decade

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

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

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

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

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

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

¹ There is little external trade

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

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

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

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

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

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

4 Consequences for agriculture and the rural areas in Europe

The role of farming in Europe has so far been seen as a supplier of food and fibres. It is only recently that the public function of farming has been acknowledged by a wider public. Not withstanding the fact that in countries like Austria and Switzerland the

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

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

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

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

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

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

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

5 Necessary changes in instruments and institutions

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

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

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

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

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

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

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

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

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

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

Tab. 2: Policies and instruments: an overview

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

6 Discussion and conclusions

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

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

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

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

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

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

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

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

Annex I

Structural funds versus rural development under the CAP - A comparison

| Structural funds | Rural development under CAP Regulation 1257/1999 |
|--|--|
| <p>Objectives</p> <p>Objective 1: promoting the development and structural adjustment of regions whose development is lagging behind</p> <p>Objective 2: supporting the economic and social conversion of areas facing structural difficulties</p> <p>Objective 3: supporting the adaptation and modernisation of education, training and employment policies and systems</p> | <p>Objectives</p> <p>Rural development measures shall accompany and complement other instruments of the CAP and thus contribute to the achievement of the objectives laid down in Article 33 of the Treaty. Rural development measures shall be integrated with measures promoting Objective 1 and accompany the measures supporting Objective 2.</p> |
| <p>Financial provisions</p> <p>European Regional Development Fund (ERDF)</p> <p>European Social Fund (ESF)</p> <p>European Agricultural Guidance and Guarantee Fund (EAGGF-Guidance section)</p> <p>Financial Instrument for Fishery Guidance (FIFG)</p> | <p>Financial provisions</p> <p>European Agricultural Guidance and Guarantee Fund (EAGGF) Guarantee and Guidance section.</p> |
| <p>Budget period 2000-2006</p> <p>135,9 billion Euro for Objective 1</p> <p>22,5 billion Euro for Objective 2</p> <p>24,0 billion Euro for Objective 3</p> <p>195,0 billion Euro in Total</p> | <p>Budget period 2000-2006</p> <p>30,4 billion Euro</p> |
| <p>Implementation</p> <p>Finances from the Guidance Section shall form part of the programming for Objective 1 regions.</p> <p>Rural development measures other than those referred to in Article 35 (1) may form part of the Objective 2 regions (see Joint Measures)</p> | <p>Implementation</p> <p>Rural development plans. Rural development support measures to be applied in one area shall be integrated, whenever possible, into a single plan.</p> |
| <p>Joint Measures</p> <p>The EAGGF is the financial instrument supporting the rural development policy, which is considered as the second pillar of the CAP. It finances rural development measures throughout the European Union. Measures will be financed by the Guidance section of the EAGGF in Objective 1 regions (with the exception of compensatory allowances for disadvantaged areas and the three accompanying measures of the CAP¹ [Article 35 (1)]), and elsewhere by the EAGGF-Guarantee section.</p> <p>The EAGGF-Guarantee section is not a Structural Fund, but contributes to the implementation of the new Objective 2. In the areas, Member States can choose whether to integrate rural development measures into the regional development programmes funded jointly with the other Structural Funds, or to incorporate them into a horizontal programme for rural development measures outside Objective 1 areas.</p> | |

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

Annex II

Functions and policy aims in the rural area

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

XXX means an important function for this policy aim

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

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

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How could the CAP pillars be balanced for the promotion of a multifunctional European model?³

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- 2 The levels at which the environment is integrated into agriculture
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- 4 Prospective scenario for the articulation of the two pillars
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1 Introduction

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

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

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

This second pillar is based around three new instruments:

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

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

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

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

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

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

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

2 The levels at which the environment is integrated into agriculture

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

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

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

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

3 Ways of integrating the environment into agriculture

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

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

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

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

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

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

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

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

4 Prospective scenario for the articulation of the two pillars

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

4.1 The articulation of the two pillars would benefit from clarification

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

4.2 A rebalancing of budget allocations between the two pillars

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

5 Tools for the future...

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

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

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

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

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

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

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

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

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

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

6 Conclusions

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

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

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

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

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

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

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

Obstacles and Constraints for a New CAP³

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

1 Introduction

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

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

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

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

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

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

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

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

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

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

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

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

3 Obstacles and constraints coming from lobby pressures

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

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

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

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

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

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

- Farmers should be competitive in a more open economy.

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

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

4 Obstacles coming from distributional effects of a new CAP

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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