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**Book Part**

## Rural development policies and the second pillar of the common agricultural policy

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# Rural Development Policies and the Second Pillar of the Common Agricultural Policy

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## **1 Introduction**

The debate about rural development and rural policies is relatively recent in the EU (late Eighties) in relation to agricultural policies, which date back to the origins of the European Community. This fact complicates the discussion because it is never clear whether rural policies are being developed because of the specific problems of rural areas (as territorial policies) or because of the specific problems arising from the need to reform the CAP (as sectorial policies). At present these two “visions” of rural development exist side by side in the “second pillar”<sup>2</sup> of the CAP.

This paper tries to bring together the various arguments that make a reform of rural development policies desirable and useful for the stakeholders involved. The policy implications of a desirable reform are also considered. CAP, in its long story has established powerful interest groups in the administrations, in the sector and even in expert's circles. Past shortcomings of reform attempts suggest that a consensus on reform is difficult to achieve and requires a clear and shared outline of what will agricultural and rural policy look like after the reform process. A transition period, the inclusion of wider interest groups than those directly concerned by the policy, the possibility of regionally adapted versions rural policy appear to be important components for insuring a strengthened support and a more effective policy.

In current documents and literature, a shift from the “first” to the “second” pillar, implying a reduction of the funds allocated for market support and an increase of the funds available for the second pillar, is often presented as a strengthening of rural

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<sup>1</sup> ELENA SARACENO is presently working in the Group of Policy Advisers, in the European Commission. This contribution reflects her personal views on rural development, in her expert capacity in this field. The contents of this paper do not reflect the opinion of the Commission services and in no way prejudice the Commission's official position on this matter. She is extremely grateful to the working group for the very useful discussions and comments made to previous drafts of this paper.

<sup>2</sup> The “second pillar” in EU terminology and within the framework of the Common Agricultural Policy includes different forms of direct support for farmers (less favoured areas compensation allowances, environmental payments, investment grants) and rural areas (local development, services, crafts, patrimonial heritage). While the “first pillar” has provided support to the agricultural sector through price support (common market organisation), the second pillar provides payments or grants to farmers for specific investments, situations, services or activities.

policy. However, as will be shown below, such a shift maintains unchanged the sectorial objective of the policy, would have the same beneficiaries (farmers), while changing “only” the rationale and instruments used for the transfer of resources. As farmers are imagined having similar needs across Europe, measures are the same for all areas. This approach is a good example of rural policies developed in response to the need to reform the CAP.

There is also a different understanding of rural areas, present in the Structural Funds programmes, in EU initiatives such as LEADER, and in the definition of objective 5b areas during the Nineties. These rural areas have been considered in a spatial dimension (regional or local) as an integrated whole, covering all sectors of the economy and benefiting all actors living and operating in rural areas, including, of course, farmers. There might be complementarities between the territorial and the sectorial rural policies, but the aim is usually not the same. Instead of farm structures and incomes, or agro-environmental concerns, the aim is the development of the rural-local economy with its peculiar mix of resources, on the basis of perceived strengths and opportunities. The instruments of such a policy have a development rationale, proactive rather than compensatory. The programmes have common guidelines but the actions undertaken vary from one rural area to another and are adapted to meet local/regional needs. This approach is a good example of policies developed to meet the specific problems of rural areas.

Both approaches to rural policy are currently found in EU policies. A second pillar that responds predominantly to one or the other function would mean quite different things and aim at different results. There are also important implications of policy management and implementation since the sectorial function has been traditionally a horizontal one (common for all farms) while the territorial function has been defined in its contents at regional or national level, and is different from area to area.

This paper will argue that both rural visions respond to existing policy needs and are therefore legitimate and relevant. The issue should not be to choose one or the other but rather to address each of these needs explicitly and distinctly. From this perspective, the “second pillar” should become the container of two different policy objectives: the first addressing the structural needs of the agricultural sector in a reformed CAP (the sectorial function); the second addressing the development of rural areas with a multi-sectorial, integrated approach (the territorial function). Environmental concerns need to be included both within the sectorial function for matters related to agriculture (water, soil, production practices) as well as in the territorial function for matters related to the sustainability of the rural area as a whole (impact of tourism, industries, energy production and consumption, infrastructures, services, etc.).

Distinguishing between these two functions of rural policy does not imply that there are no linkages between them. Quite the opposite: in the past it was thought that there was no need for such a distinction because farming was the main activity of rural areas and the two coincided. Empirical evidence has proven that this assumption was not accurate to start with, and is increasingly not so. Rural areas have modernised not only in its farm structures but also by becoming mixed economies, often competitive and dynamic, thus reducing the imagined overlap between agricultural activity and rural space. It is this growing differentiation, as will be shown, that largely explains the “take off” of some rural areas, rather than the specialisation in farming activities.

In the future these two functions should be expected to diverge rather than to converge. The relationship between the territorial and the sectorial also needs to be reformulated conceptually: diversified modern rural areas become attractive and viable

areas providing advantages both for professional farmers and their families, as well as for other activities. This reduces the need for an indefinite support of the agricultural sector<sup>3</sup> or at least makes it more limited and circumscribed. The sustainability of rural areas does not depend on the farming sector alone but on the diversity and attractiveness of the rural resource base in relation to other types of areas, both rural and urban.

A brief summary and assessment of current EU rural policy is our starting point, providing a framework of reference, a sort of baseline of the policy supply today. To understand it, however, some explanation and critical assessment about its evolution is necessary. This will show the strengths and weaknesses of the current policy set up and give a preliminary indication of a desirable evolution (section 2). A review of recent trends in rural areas indicates a process of growing diversification of activities and of differentiated responses to spatial restructuring challenges. The result is an increased attractiveness in some cases and a continued decline in others. Acknowledging the different dynamics of rural areas implies a change in the original CAP assumptions and should influence the strategy of desirable policy adjustments (section 3). Some of the policy reform options that have been considered recently are reviewed in order to assess whether they meet the weaknesses of present policies and recent trends in rural areas (section 4). The arguments of each section are then drawn together to indicate the broad components of a desirable rural policy for the future, both in its sectorial as well as in its territorial functions, making explicit the inter-relationship between the two and the political-institutional options they imply (section 5).

## **2 An assessment of current EU rural development policy**

This section reviews current EU rural policy from the perspective of the sectorial and territorial functions identified above and its evolution over time.

### **2.1 Today's components of EU rural policy**

The present framework of rural policy within the European Union was defined in Agenda 2000 in 1997<sup>4</sup> and in 1999 in Berlin, with the final decisions on the financial allocations for the period 2000-2006. A set of regulations<sup>5</sup> establishes the norms and procedures for the utilisation of those allocations by Member States. The first and most important one is the Regulation for Rural Development (Reg. 1257/99). A second form of intervention in rural areas is also possible with the Structural Funds either in objective 1 (lagging behind) and objective 2 (conversion of areas facing structural difficulties) areas. A third instrument is the LEADER + Community Initiative.

The Rural Development regulation has reassembled under one single heading already existing measures, established at different times. The “menu” of measures available has been classified according to broad categories of factors addressed and their sectorial or territorial function, based on the economic sector or actor benefiting from the support.

The table shows the heterogeneity and variety of rural development measures available for the current programming period. A number of observations can be made:

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<sup>3</sup> The US farm bill, recently approved by Congress, increases the support for large farms and is a good example of the failure of agricultural policies alone to produce competitive farm structures of any size (not depending on support), as well as their inability to generate viable rural areas based exclusively on agricultural activities.

<sup>4</sup> EUROPEAN COMMISSION: Agenda 2000, for a stronger and wider Union, Com (97) 2000.

<sup>5</sup> Reg. n. 1260/99; Reg. 1261/99 on the European Regional Development Fund; Reg. 1262/99 on the European Social Fund; Reg. 1263/99 on SFOP; Reg. 1257/99 on the support for rural development with the Guarantee section of the European Fund for Agricultural Orientation and Guarantee; Reg. 1750/99 and Reg. 2603/99.

- They cover both the sectorial and territorial functions mentioned. Very few of these measures are really new. In fact they represent the historical accumulation of direct interventions since the CAP was launched and reflect different rationales of policy intervention in successive programming periods rather than a coherent overall design.

<b>Rural Development Measures (Title II of Regulation n. 1257/99)</b>		
<b>Function (aim of measure)</b>	<b>Category</b>	<b>Measure</b>
<b>Sectorial function</b> (for the agricultural sector only)	Investments in farms	Investment in agricultural holdings
		Processing and Marketing of agricultural products
		Marketing of quality agricultural products
		Land improvement
		Re-parcelling
	Services and infrastructures for farmers	Setting up farm relief and farm management services
		Agricultural water resources management
		Development and improvement of infrastructure connected with the development of agriculture
		Financial engineering
	Human resources in farming	Setting up of young farmers
		Early retirement
		Training
	Income support for less favoured areas and areas with environmental restrictions	Compensation to farmers (by hectare)
		Compensation to farmers in environmentally sensitive or protected areas
	Environment and Forestry	Agro-environmental schemes
Afforestation of agricultural surface		
Other forest measures		
<b>Mixed sectorial and territorial function</b>	Environment and Forestry	Protection of the environment in connection with agriculture, forestry and landscape conservation as well as with the improvement of animal welfare
<b>Territorial function</b> (for the population at large and/or the rural population and non-farm activities)	Promoting the adaptation and development of rural areas	Basic services for the rural economy and population
		Renovation and development of villages and protection and conservation of the rural heritage
		Diversification of agricultural activities and activities close to agriculture to provide multiple activities or alternative incomes
		Promotion of tourist and craft activities

- The measures responding to the sectorial function are well articulated and cover a wide range of farming needs. They have different intervention rationales: to accelerate and facilitate the modernisation of farms through investment aid and infrastructure provision, to compensate perceived handicaps in particular areas through income support, to make available services through subsidies, to facilitate the turnover of farmers and capacity building through capital and training, to pay for environmental practices. There is both a structural adjustment objective as well

as assistance for what is perceived as less competitive farming conditions. The actions contemplated by these measures are the same for all rural areas; they are horizontal measures (formerly included in the 5a objective).

- The measures with a territorial approach appear less articulated in relation to the sectorial ones and, since they are quite recent, have a more coherent rationale that supports the diversification of activities in rural areas. This is justified in terms of the need to create services and sources of alternative employment and income for farmers who will have “to adapt to market evolution, market policy and trade rules, consumer demand preferences and enlargement” (rather than the development of rural areas per se). The territorial function is perceived as responding to the constraints influencing farming. The actions covered by these measures may be different in each area and are therefore adapted to specific rural conditions (former 5b objective).

Members States and Regions may draw up rural development programmes. Their implementation procedure varies according to the type of area. In objective 1 areas rural development measures should be integrated with other measures promoting their development and structural adjustment. In objective 2 areas, they should accompany the other measures supporting the social and economic re-conversion of areas defined as rural.<sup>6</sup> Rural areas not included in either objective 1 and 2 areas may also submit programmes. In this way *all rural areas of the EU are eligible for the measures indicated above*. These measures are financed by the EAGGF through its guarantee or guidance section, including the diversification measures in rural areas outside objectives 1 and 2.

These type of rural development programmes are not the sole instruments available: the European Regional Development Fund (ERDF) and the European Social Fund (ESF) may finance interventions in objective 1 and 2 areas in other sectors of activity such as infrastructure, tourism, small and medium enterprises, the environment, human capital through specific programmes. Therefore a large part of what we have called the territorial function (integrated, multi-sectorial development in sectors different from agriculture) is included in the intervention of the other Structural Funds instead of in the rural development programmes. Where this is not possible however, is in rural areas outside the objective 1 and 2, where the only measures for diversification available are limited to those indicated in the Regulation and may be financed with the EAGGF, Guarantee Section.

The programming documents of the Structural Funds in objective areas, respectful of the subsidiarity principle that must characterise their intervention, are defined at sub-national level. This decentralised procedure implies that the strategy and actions chosen in each programme are adapted to regional contexts, involve consultation and partnership arrangements that should insure broad participation of different interest groups and concerted practices for decision making. They are expected to be multi-sectorial, integrated and to have development (territorial cohesion) objectives that will reduce disparities between regions. This is not true of rural development programmes that contain a “menu” of standard measures. National authorities may choose between

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<sup>6</sup> Rural areas are defined as NUTS level III territorial units which have either: a) a population density of 100 people per km<sup>2</sup>, or a percentage share of agricultural employment which is equal to, or higher than, twice the Community average for any reference year from 1985; b) an average unemployment rate over the last three years above the Community average, or a decline in population since 1985.

them, but are not required to integrate them and or show that the structural difficulty addressed will be overcome as a result of the support received.

A third form of EU intervention in rural areas is the LEADER + initiative. This is the continuation of an innovative approach to rural development, already experimented with LEADER I (1991-1993) and LEADER II (1994-1999). It is a Community Initiative, financed through the Structural Funds, which started as a pilot, experimental approach. It is based on a method for establishing a strategy and actions adapted to the area rather than a particular list of standard measures offered for implementation. This innovative approach has the following features:

- The area based approach. The geographical area for the intervention is small and homogeneous. In this way social, economic and institutional actors know each other well and also know what are the strengths and opportunities, the weaknesses and constraints of the area.
- The bottom up approach. In order to arrive at the actions that will be realised the local actors need to be mobilised through participation and involvement in the formulation of a strategy and the contents and priorities of the business plan.
- The local action group. This is a partnership between private and public actors, relevant at local level, which becomes the agent for stimulating a participatory approach, defining the strategy and the actions, the costs, the financing and manages the implementation of the plan.
- Innovative, multi-sectorial, integrated actions. All sectors of activity are eligible, actions must be coherent and integrated, and new for the area (not already financed by other programmes). They may choose to specialise on a particular theme or type of measure, or to diversify the interventions. Emphasis is put on resources that are unique and specific to the area and may increase its competitive advantage (rather than imitating what other rural areas do). Complementarities and synergies between sectors should be sought.
- Networking and transnational co-operation. Local action groups do not operate in isolation but are interacting with each other either directly or through regional, national or European networks, funded by the initiative, and provide technical assistance, training, circulation of information, study visits, agreements, facilitate exchanges of experience and transfer of innovative actions.
- The financing. Local Action Groups receive a global budget for the realisation of their business plan, decide the allocation of funds to actions and have a certain degree of flexibility in shifting funds from one action to another. They are subject to financial controls by the relevant authorities.

This approach to rural development is a good example of a policy responding exclusively to the territorial function. Even if its cost has been extremely modest in relation to other Structural Fund expenditure (see below) and it has maintained its pilot and experimental character, it has proven an extremely popular and adapted approach. In terms of outcome, it has provided modest but tangible alternatives (employment, entrepreneurship, attraction of resources, empowerment of local actors). All rural areas, even those not included in objective 1 and 2 areas, may be eligible for LEADER +. The initiative is financed entirely by the EAGGF, Guidance Section.

The three forms of intervention analysed in this section represent quite differentiated approaches to rural development. Together they represent the policy “supply” at EU level, certainly complex in its design and not necessarily coherent as a package. The

rural development programmes have substantially a sectorial function and appear weak as instruments for diversification, still perceived and legitimated as a sort of undesirable but necessary alternative for “inefficient” farmers who might be pushed out of their activity. The Structural Fund Programmes in objective areas and the LEADER + initiative address the territorial function with a multi-sectorial and integrated approach, perceive the diversification of activities as a positive strategy for economic development. Since interventions are fragmented in different types of programmes, the co-ordination among them is weak and mostly left to Member States’ preferences. Although apparently Member States can pick and choose among the “menu” of measures available within Rural Development Programmes, these measures are rigid and standardised and do not allow for any adaptation to local conditions. This is only possible with the LEADER initiative and the Structural Funds’ Programmes.

One way of assessing the relative importance attributed to the different functions is to consider the financial allocations for the various forms of intervention. For the period 2000-2006 the agricultural sector receives appropriations of between 41.7 and 45.6 billion Euros per year (at 2001 prices). This represents around 45% of total EU expenditure: 40% for market support (the common organisation of markets, the first pillar) and a little less than the remaining 5% is for the Rural Development Programmes and the LEADER + initiative (the second pillar). Another 32% goes for Structural Funds expenditure. It is no news that both in absolute and relative terms the agricultural sector is the largest beneficiary of EU spending with almost half of the total resources available. Rural development receives a very modest share of agricultural expenditure and diversification measures (the territorial function) have an even more modest share (about 10% of rural development funds, 1% of agriculture expenditure and 0.5 of the total). However, because the total expenditure is significant, in absolute terms the funds for rural development objectives (around 4.7 billion Euros per year) is substantive, especially when matched by national co-financing and other additional resources available at national and regional level. When Structural Funds Programmes are included in the picture, although it is not known what portion goes to rural areas, the big disproportion between allocations to the sectorial and the territorial function of rural development is certainly reduced but remains significant.

The policy supply here described is managed and implemented at national or regional administrations on the basis of the subsidiarity principle and it is subject to co-financing by the EU, Member States and regions. The programming instruments are quite different in each case and may involve different administrations, according to the Member State allocation of competencies. For example, Regulation 1257/99 is usually managed by Agricultural and/or Rural or Regional Ministries at State or regional level. Regional policies with the Structural Funds are usually implemented by industrial, infrastructure or treasury ministries at the level of competence established for the specific intervention within the Member State. LEADER + is managed by very different administrations in the different member states, not coinciding necessarily with the first two forms of intervention. The result is that rural development policies are not managed or implemented as a package of integrated measures and there is little co-ordination between the different administrations involved.

## **2.2 How did we get to the present situation?**

The situation just described is the result of an historical addition of successive rationales and measures that were introduced without undoing or revising substantially previous approaches. Until the late Eighties there was not even the claim that the EU had or needed a rural development policy. However, since Agenda 2000 and the inclusion of

farm structures' support within the framework of rural development programmes, it has become current practice to consider traditional forms of support for the farming sector as part of rural policies, thus blurring a clear distinction between the territorial and the sectorial functions, although in fact expanding the latter.

The European policy for rural development was conceived since its origins as an accompanying policy to the CAP rather than as a policy with its own autonomy and objectives. Three periods or "waves" of policymaking may be distinguished, each with its own peculiar philosophy and instruments.

- The first generation of measures was intended as an accompanying policy for market support, addressed the modernisation of farm structures (from the mid Sixties) and had a clearly defined sectorial function. Its most original aspect was the transformation of a structure of peasant farms into one of professional family farms, of medium size, well equipped and connected to markets. It was meant to facilitate the exit of small subsistence farms and compensate farms operating in marginal ("disadvantaged" areas). This policy, coherent in its design, played only a marginal role in the modernisation of farm structures, especially in the less developed Member States. It was based on a compensatory approach. Its original design did not contain any limitations on the duration of the policy, did not contemplate a system of substantial checks and balances, the possibility of changes and adaptations over time, was never systematically evaluated in its efficiency or effectiveness.
- The second set of measures, in the second half of the Eighties, introduced the territorial function in agricultural policy. The integrated Mediterranean projects tried firstly to link different forms of agricultural interventions between themselves, adapting measures to particular contexts; then the specific needs of rural areas were more openly addressed (with "The future of rural society",<sup>7</sup> the LEADER Community initiative). These changes coincided with the reform of the Structural Funds that allowed more flexibility to Regional authorities in their programming and in the implementation of multi-sectorial approaches. It became clear then that the modernisation of farm structures and a sectorial approach were not sufficient to promote viable rural areas. On the other hand the limits and excesses of market policy were becoming visible. A new set of accompanying policies was conceived together with the MACSHARRY reform (agro-environmental measures, extensification and afforestation). The territorial function and the sectorial function both expanded significantly but were kept distinct as policy instruments: the new accompanying measures were not considered part of the rural development policy and were explicitly intended to address the problems of CAP reform. The overall expenditure for both functions increased.
- The third period, initiated with the preparation of Agenda 2000 in the second half of the Nineties, consolidated the sectorial and territorial interventions under what has been called the 2<sup>nd</sup> pillar of the CAP, introducing Rural Development Programmes at national and regional level. This implied re-labelling previous sectorial interventions as rural development policies, and the creation of a new "container" (the 2<sup>nd</sup> pillar) for all measures not included in market support (the 1<sup>st</sup> pillar). This new package was extended to all rural areas, with the above-mentioned differences for objective and non-objective areas. No new measures were introduced, and all the old ones were included with modest changes. The effect of putting them all

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<sup>7</sup> CEC, 1988

under the same rural development label made more visible the predominance of the sectorial function.

Furthermore Agenda 2000 introduced a clear separation between the expenditure for market and first pillar support on the one hand and the rural development measures of the second pillar on the other, as separate components of the Guarantee section of the EAGGF, to be indicated in separate sub-headings and not allowing any internal shifts between the two. This was meant to keep distinct the two types of expenditure for accounting reasons, because of the different co-financing arrangements that they implied and also to block any flexibility between the two pillars.

Agenda 2000 also established a budget ceiling for agricultural expenditure. This meant that any change in priority between functions or measures could only be achieved by shifts in the allocations (and no longer by an increase in the overall expenditure). The agricultural interests were stronger and better organised in defending their share of the budget and, as a result, the territorial function lost visibility and relevance (or did not grow as expected) in relation to the “success” that it had achieved in the previous period. Agenda 2000 did also address the problem of enlargement by creating a separate pre-accession appropriation for candidate countries, without however making clear the future of CAP after accession.

The integration achieved between the three Structural Funds since the end of the Eighties was partially set back by the possibility of preparing national or rural development plans with EAGGF funding separately from the other programming documents with the other funds. The degree of integration that is now possible depends on the type of area: it is potentially higher for objective 1 and 2 areas, but no longer required by the Commission and left to the decision of national policymakers and interest groups; it is not possible for interventions in non-objective areas since rural development plans should be the only instrument operating in these areas. The possibility of making national plans run counter to the area based approach that prevailed in the second period.

This short reconstruction of how the EU arrived at the present rural development policy supply makes possible some general observations, useful to keep in mind for future policy reforms.

The rural policy of today is the result of successive additions of measures with different rationales. It is no longer clear what kind of structural farm adjustment is desirable or what kind of farming practices are recommended in terms of the common policy. The income problem is not perceived in relation to the actual needs of particular categories of farmers but rather on the basis of historically acquired benefits. Compensation allowances to farmers in less favoured or environmentally sensitive areas still ignores the existence of other sources of income opportunities. The presence of farm pluriactivity, agro-tourism, quality products, commuting, small and medium enterprises, environmental amenities and services have been acknowledged, but have not succeeded in modifying the abstract assumption that rural areas are undifferentiated, rely only on agricultural production, therefore needing to be compensated if they show any handicap in farming. Agro-environmental measures have been added to unchanged traditional modernisation measures and market support, ignoring the conflicting rationales that they promote. The learning of the Eighties (the viability of rural areas cannot be obtained by farm modernisation and compensations alone, the diversification of activities is beneficial for both farmers and non-farmers) appear to have gone out of

focus as policy objectives. Defensive policies based on generically defined disadvantages are by far predominant over pro-active ones for specific and well-delimited situations.

Within this policy context, the key issue should not be the choice between the two alternative functions, pitched against each other. This is not desirable and – as the Agenda 2000 experience showed - counterproductive. Considering the sectorial and the territorial functions either as unrelated or in competition with each other has had the result of blocking each function in a defensive, entrenched position, thus obscuring the positive complementarities between them. It has also reduced the capacity to deal adequately with the reform process (for example by addressing quality and environmental issues within agricultural policy) as well as with a more consistent rural development policy (for example by repeating a pilot experience like LEADER for the third time).

It would seem reasonable to acknowledge that both functions are necessary, that each of them has to be reassessed in order to meet new consumer needs, that their specific objectives and interrelationships have to be redefined, adopting a more comprehensive and pluralistic vision of rural development, within which agricultural activities may represent a variable component. Each function has different beneficiaries, contents and instruments; they both need a conceptual brush-up to adjust to ongoing processes. Diversification of activities has already occurred in many areas spontaneously and far from becoming a threat to farming activities, it has provided an opportunity for increasing farm size, for providing contract services, for alternative jobs for farm families; it has opened new markets and technological opportunities, facilitating farm turnover, demographic balance and improving the attractiveness of rural areas as places to live in.

None of the two functions will be able to work on its own, because one cannot respond to the needs of the other. Farmers benefit from diversified rural areas not only when they need a job because they are unable (or no longer want) to go on farming, but also to maintain their competitiveness as farmers because they facilitate knowledge of consumers and technological innovation. The sectorial and territorial functions should be conceived as complementary dimensions of a rural policy that acknowledges that sector and space no longer coincide. Rural areas, where farmers live and work, are not and will not be – independently of policies or unlimited support - areas where farming is the predominant activity or the motor of the rural economy. This was a wrong conceptual assumption, which needs to be corrected, and appears to be valid for any modern rural area, even outside the EU. Current experience suggests that insisting on farming as the sole and main activity to be supported in modern rural areas is likely to lead to ever increasing demands for support, a narrower number of progressively larger farms, desertified rural areas and a strengthening of big farmers as a pressure group.

The need to differentiate the two functions should not be taken as mechanically implying that funds should be equally distributed between them or maintained in the proportions they have today. It would be better to start by defining what kind of measures are most effective to obtain the objectives of each function and only then identify expenditure needs, rather than starting by the budget claims on the basis of past receipts and only afterwards filling in the content of actions.

The sectorial function within the second pillar should include on the one hand transition measures for adjusting to reductions in price support (such as funds resulting

from modulation<sup>8</sup> or payments in exchange for services) with or without degressivity, and on the other more pro-active measures to reorient farm investments towards higher quality products, organic crops, new safety requirements, food chain co-ordination, the provision of environmental amenities and the conservation of landscapes by farmers.

The territorial function should include a diversification of activities strategy, adapted to the specific resources available in the rural area, have an integrated and multi-sectorial approach, address social problems of employment and human capital, the provision of services for the population (health, education, transport) as well as infrastructures linking the area to the external context. The local (LEADER) and the regional (Structural Programmes) programmes, since they deal with different aspects of the territorial function, need to be better co-ordinated while maintaining a decentralised decision-making and a bottom up approach. The environmental concerns should also be present in the territorial function (and not just in the sectorial one), for all aspects dealing with off-farm activities.

It is important to make explicit how sectorial and territorial policies intersect in a specific rural area. The weight of each function within the second pillar and its financial resources, may have to be defined at the regional level, varying from one area to the other. Factors such as the level of diversification already achieved, the relevance of the farming sector, the restructuring needs, should be considered in the elaboration of the programming documents. It is also important to allow flexibility between the two functions. A carefully tailored mix of both functions would provide an excellent field for developing the multiple functions of rural areas (equivalent to a territorial diversification strategy) as well as the multiple functions of farmers (equivalent to a sectorial diversification of farm income sources).

### **3 Recent trends in rural areas**

The elaboration of policies is often realised on the basis of political need, principles and theories that simplify and idealise real processes. In fact, the original assumptions of the CAP are still informing policy decision making today. There has been plenty of research and evidence that new and unexpected trends have been operating but this knowledge has not been used to modify those assumptions, since this would have implied a more radical revision of market support, for which very few are politically ready. This is also the reason for adding new policy rationales such as the territorial function or environmental concerns to the old ones, without revising previous policy.

Current policies have been challenged politically for the distortions they have generated, their mounting cost, their international trade effects and also praised for the food sufficiency achieved. However the general assumptions that had informed the original policy design, such as the expected evolution of farm structures, the levels of income used as reference, the attention paid to economies of scale while ignoring economies of scope (or diversification),<sup>9</sup> the irrelevance of quality and environmental

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<sup>8</sup> This term was introduced with Agenda 2000 and has been understood as a shift of funds from direct coupled payments in the first pillar to rural development support in the second pillar as defined by Reg. 1257/99. The funds to be shifted may be obtained by establishing thresholds in direct payments or degressivity. In the logic of the arguments discussed in this paper, modulation maintains a sectorial function for the shifted funds. The overall level of agricultural expenditure does not change as a result.

<sup>9</sup> The relevance of economies of scope has been shown for industrial development by CHANDLER (CHANDLER 1990).

constraints, the expected division of labour between rural and the urban economies, have all proved at best to be only partial truths. This is not the place for a detailed analysis of why these proved to be incorrect assumptions. However, any serious discussion about CAP reform that ignores these conceptual mistakes is bound to reproduce them. What modernisation may mean for agriculture and for rural areas needs to be reformulated on the basis of experience so far and inform policy reform more substantially. Correct assumptions about the real dynamics of past processes and the impact of policies should constitute the basis for a more adequate agricultural and rural policy.

The fact that no agricultural policy has been successful in making the sector “sustainable” in any developed country – as the recent US farm bill has eloquently shown - should be a sufficient reason for some conceptual rethinking. But also the presence of other actors and sectors in rural areas who could realise the same “multiple” functions that farmers have traditionally performed, the existence of economies of diversification side by side to the economies of scale, the impact of pluriactivity on farm structures’ evolution and incomes, the existence of segmented and quality markets for food products, are realities that need to be incorporated in the conceptual framework of experts and then inform policymaking.<sup>10</sup>

Some of the most widely shared assumptions that should require policy adjustments are indicated and discussed below. The “disobedience” of expected events has been quite evident in the evolution of land use, rural population, farm structures, employment and value added of agriculture.

### **“The agricultural sector and rural areas are substantially the same thing”**

One current assumption is that the agricultural sector is the characterising activity of rural areas. It follows that space (rural) and sector (agriculture) coincide and mean the same thing. A policy for one is not differentiated from the policy for the other. The problems of rural areas are perceived as those of farm structures, efficient production, and marketing. Services and other activities are there to satisfy farmers’ needs. Agricultural activities, with some policy support due to their “special” nature, will continue to provide the economic backbone of rural economies (more so than before modernisation) even after economic development has taken place. If agriculture as the main remaining activity in rural areas is not supported, these will be abandoned and desertified. This will make more serious the environmental problem.

If we take a look at Agenda 2000 and the logic behind rural development programmes (Reg. 1257/99) we can see that this logic still informs the perception of rural policy needs at EU level. Some early and preparatory documents for Agenda 2000 questioned this “traditional” vision but somehow this did not feed into the final documents.

Agricultural land in Europe represents a constantly declining share of the total land in the post-war period (44% of the EU-15 in 1997). This varies significantly according to the period considered and State concerned. Those with the highest share are the UK (70%) and Ireland (63%). On the average and in most of the other countries agriculture is no longer the main land user and it appears unlikely that this trend will change. On the other hand, forest areas occupy 36% of the total area and have been increasing over time, with great variations in relation to the period and State.

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<sup>10</sup> The need for a conceptual revision became more urgent and evident in the discussion of the “acquis communautaire” to be adopted by candidate countries in their negotiation for accession.

Rural areas are in general defined in residual terms as non-urban areas. The extent of rural areas may vary because of competing definitions of rurality. If we use the OECD definition<sup>11</sup> (OECD 1996) the 'most rural regions' cover 60% of the total land area and intermediate rural regions cover another 28%. Taken together they account for 88% of the total land area. The EU has used a lower threshold of density (100 inhabitants per km<sup>2</sup>) than the OECD and the same method, with the result of having 17.5% of the EU-15 population in rural areas and over 80% of the total land. Other methods of calculation vary in the share of population included but give similar shares of land.

Having a rural development policy implies a problem of land management, not limited to agricultural areas: forests, mountains and land used for other purposes (villages, roads, industrial or craft sites, tourists resorts, parks, abandoned areas) different from agriculture are included. Since agricultural use has been declining and other uses have been increasing, we could say with some approximation that rural areas are half used by farmers and half by other users. This would seem to justify the existence of a rural policy that does not coincide with an agricultural policy but is able to identify alternative land uses, without assuming that the agricultural land matches the rural area.

In terms of population trends, predominantly rural regions hold at present almost 10% of the total population: almost half of the regions characterised in this way had an increase in population between 1981 and 1991; another 41.6 of them showed a decrease, and the remaining areas remained static. If we turn to significantly rural regions - which hold a larger share (about 30%) of the total EU population - the regions increasing in population are well over half (57.4%), those declining are only a third (33.9%) and those static are 8.7% (EC 1997 b). This is telling us two important things: one that about half of rural Europe is attracting population from the outside (instead of losing it); the second is that in the intermediate situations, which hold by far the largest proportion (three quarters) of rural dwellers, the attraction is stronger. Of course there are significant variations by country, but both phenomena are present in all of them, with varying degrees. In every case the number of rural areas attracting population exceeds that of rural areas expelling population. Therefore all rural areas do not have a unique evolution and the rural exodus is no longer the rule.

What explains these changes in rural areas? Looking at the agricultural sector and in particular to farm structures and agricultural employment trends we find that the number of farms has continued to decline (-15% since 89/90) with different rates of intensity but in all countries. The average size of farms has increased on the whole but reproducing a small-holding structure in the Mediterranean countries (with some regional exceptions) and a medium-large farm structure in the northern countries. Although the EU farm structure is largely based on family farms, indicating the success of the Mansholt strategy in favour of peasant modernisation, this did not imply a convergence in terms of farm-size across countries, on the contrary. The diffusion of contract farming, by providing machinery and equipment to small farms at a reasonable cost has provided an important additional revenue for well equipped farms and the means for a rational persistence of small farms.

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<sup>11</sup> The OECD classifies rural areas according to a double criterion, population density at community level (NUTS V) and the share of the population in rural communities within a region. The threshold of population density that distinguishes rural from non-rural communities is of 150 inhabitants per km<sup>2</sup>. If communities classified as rural account for 50% or more of the regional population, the region is classified as predominantly rural; if they account for between 15 and 50%, the region is classified as significantly rural or intermediate; if their share is less than 15% they are classified as predominantly urban.

**Share of population and variation between 1981-1991 by type of regions (OECD methodology using 100 inhabitants/km<sup>2</sup> as threshold)**

Type of Regions	Share (%) of total European Union		Type of population change between 1981 and 1991 (% of communes weighted by their population)		
	Population*	area	Positive (over 1% increase)	Negative (over 0.5% decrease)	Stable (between -0.5 and +1 % variation)
Predominantly rural regions	9.7	47.0	46.2	41.6	12.2
Significantly rural (or intermediate) regions	29.8	37.4	57.4	33.9	8.7
Predominantly urban regions	60.5	15.6	56.0	30.8	12.6

(Source: EUROPEAN COMMISSION, DIRECTORATE GENERAL FOR AGRICULTURE (1997): Rural Developments. CAP 2000 Working Document VI/1117/97)

There is evidence from research that opportunities for farm pluriactivity play an important role in the evolution of farm structures and the diversification of activities in rural areas. Small holdings with access to off-farm job opportunities in the same area are not likely to disappear as “inefficient” farm structures (or at least not as fast) as was assumed at the outset of CAP. Agricultural employment has declined in all types of rural areas: between 1965 and 1985 it declined by one half, and between 1985 and 1996 by one third, today accounting for 5.3% of total employment (12 % in predominantly rural regions and 6% in significantly rural ones). Three points are important for their policy implications: farm modernisation support and income support measures have slowed but have not stopped the decline of farm structures and the exit from farms as a source of employment. In the evolution of farm structures, economies of scale are not the only ones operating, because multiple job holding influences such evolution. The population growth observed in some rural areas is therefore not the result of pull factors from the agricultural sector but from non-farm sectors.

**“Rural areas are less competitive than urban areas in attracting resources”**

A second assumption of the original philosophy that inspired the CAP is that urban areas and industrial/service activities are more competitive in attracting resources than rural ones and agricultural activities. To compensate for the drainage of resources and the disparity of incomes that this generates, an income support (in the form of price support) or some other form of compensation was needed. The idea of comparable incomes (between farmers and industrial workers) which was used to justify payments to farmers on a regular basis, was based on the low price of agricultural products and the need to remunerate farmers who would otherwise leave for better jobs and income in cities and industry.

Recent employment trends in rural Europe indicate a divergent scenario from this one. OECD has shown that new employment opportunities in general have not been correlated with the degree of rurality or urbanisation in most industrialised countries since the Eighties (OECD 1996). Intermediate rural regions and a part of the most rural ones showed an increase in industrial employment at a time when it was declining for the whole of the EU (+ 0.4% annual rate between 1980 and 1993) as well as a more marked increase in services (+0.8% annual rate) for both types of rural areas. The most striking element is that such rates of increase were higher in rural than urban areas (TERLUIN 2001).

The population growth observed in rural areas is therefore explained by an increase in employment opportunities in the industrial and service sector that outbalanced the negative trend in agricultural employment. This indicates that instead of specialising in agriculture rural areas have diversified their activities becoming increasingly mixed economies. In fact community services are the leading employer both in most rural and intermediate areas (with over a quarter of the rural labour force), followed by manufacturing (with a little less than a quarter) trade, hotels, restaurants and other personal services (another 20%), construction and business (almost 9% for each). This of course ignores the important differences between different rural areas but makes well the point that these no longer rely on agriculture for employment opportunities, and people may leave the farming activity but not necessarily the rural area because they are able to find off-farm jobs nearby and because the attractiveness of urban centres has relatively diminished. If we consider the dynamics of added value in rural economies by sector we find the same picture as for employment, with agriculture accounting for a minor share.

Concluding, recent trends show that the original assumptions about rural areas, on which the original CAP was designed, have proved to be inaccurate over time. Therefore they need to be reformulated taking into consideration real ongoing trends. Rural areas have evolved in a different way than expected: the modernisation of farm structures and the income support for farmers have certainly slowed down the exodus from farming and from rural areas. But the attractiveness of some rural areas in terms of population and employment cannot be attributed to agricultural activities or sectorial policy measures because these have occurred in off farm sectors, and farmers have not been the main agents of such diversification, although it turned out to be also in their benefit. Therefore considering rural areas as agricultural areas does not reflect the present situation or the expected evolution. Ignoring these facts distorts the diagnosis of the problems of rural areas and the policies for them. It also contributes to make “invisible” the existence of a variety of income opportunities both for farmers and non-farmers which are already providing viable solutions for these areas.

The diversified rural area that has been able to attract resources and reverse or stop depopulation should be used as the ideal model of reference for development policies and the creation of modern rural areas. The traditional view that urban areas always drain resources from the countryside should also be revised. The new push and pull factors operating in rural urban dynamics should be used as opportunities: the contraction of manufacturing activities in urban areas, the high cost and low quality of life in some urban centres have contributed to the attractiveness of rural areas and the development of new functions. Endogenous entrepreneurship, a qualified labour force and quality, niche products and services have provided goods that consumers are willing to pay for.

These corrected assumptions of course influence the strategic role imagined for agriculture in rural areas, reducing the need to rely on agricultural policy support to insure the viability of rural areas. Agricultural policies should acknowledge the existence of alternative sources of income and off farm activity, that reduce the need for leaving rural areas when farm activities are no longer remunerative. This fact also influences traditional assumptions about income support for farmers. Rethinking income needs may be politically difficult to accept, as was already clear in previous reform attempts. But there is a high cost in not acknowledging the new situation: expenditure becomes inefficient, innovation is blocked, more effective policies are not followed.

The analysis of recent trends has been described as a generalised phenomenon for purposes of clarity, simplicity and brevity. The diversification processes that have taken place are of course quite varied across Europe, even within the same country, in terms of mix of sectors and resources intervening, intensity, policy support and “self-sustainability”. Old industrial areas show differences with more recent ones. Mountain areas include cases of successful diversification and complete abandonment. Recognising a general trend towards diversification does not imply that this occurs in the same way everywhere. On the contrary, and this stresses the need for decentralised and adapted programmes to the specific conditions (strengths and opportunities) of each rural area.

The phasing out of market support and direct payments for farmers should be justified not so much as a response to the external constraints imposed by the WTO, or the budget needs for enlargement, but more realistically because the recent trends briefly described are indicating a viable solution for rural areas, not relying only on agriculture and thus changing the assumptions on which agricultural policy was originally designed. In the medium term, non-farming activities are likely to allow a stable population and a less assisted economy. Agriculture will not “save” rural areas, but may offer a significant contribution to its development by responding more imaginatively to quality food production and other functions – leisure, lifestyle, environment, industrial and service activities- that society at large is increasingly demanding from rural areas. The EU rural development experience could also be an extremely interesting learning for rural areas outside the EU.

#### **4 The policy options**

This chapter compares the current policy options “on the table” in relation to the present policy supply (section 2) and the need for a change in the assumptions legitimating policy action (section 3).

An agricultural policy alone, even with corrected assumptions and addressing new needs, will not be able to solve on its own the problems of rural areas. The sectorial and territorial functions have become and should remain well differentiated from each other in terms of assumptions, objectives, instruments, beneficiaries, financial resources and expected results. Neither of the two should try to eliminate the other, however powerful the interests at stake, because this would backfire and damage also the “winning” function. The key political issues are:

- how to address the relationship between the territorial and the sectorial function with the above mentioned reformulated assumptions (the overall strategy),
- how can the reform process best express the support for the new policy needs and dismantle obsolete approaches both for agriculture and for rural development (the end result and the transition needed to get there),
- draw the institutional implications of this transition in terms of what should be done at EU, national and regional level (who should do what).

From this perspective the policy “menu” available at EU level appears out of focus and addressing issues that are no longer the real problem. The present situation is the result of several policy reform attempts. However, if we are still talking about reform today it is because those attempts stopped short of posing the right questions and remained within a framework of correcting the damages and inefficiencies of the CAP without addressing the implications of real processes and new needs.

What is then left to be done, since the two functions are already present in current rural policy? A variety of reform alternatives have been generated and discussed in the second half of the Nineties within the framework of the elaboration of Agenda 2000 and the decisions taken during the GATT (then WTO) negotiations. The Cork declaration, the report on a “Common Agricultural and Rural Policy for Europe” (CARPE), the current debate on a desirable reform in view of the enlargement negotiations and the food safety crisis that have affected the sector.

In preparation for Agenda 2000 the Commission organised a rural development conference in Cork, Ireland, where a “Declaration” identified desirable rural development policies for the future (EC 1996). In that occasion rural policies were imagined as having only a territorial function and the LEADER approach was used as a successful model that could be extended to all rural areas. The main statements made by the Declaration were: the relevance of rural areas in the framework of cohesion policies; the need for an integrated, multi-sectorial, bottom up approach; the diversification of activities; the environmental sustainability; the extension of the partnership approach, programming and subsidiarity. The linkage of rural policy with agricultural policy was perceived as complementary but in fact the two were kept independent of each other as separate tools.

The shortcomings of the Cork Declaration were: to have dealt with only one of the functions of rural development (the territorial one) ignoring the sectorial one; to have avoided clarifying the relationship between the existing agricultural policy and the new rural policy; to have failed to link the future rural development policy with regional policy and Structural Funds’ expenditure (therefore leaving the LEADER initiative as the main bearer of the new policy, which became a weakness). Cork was a partial failure also for other and more political reasons: some Member States’ and farmers’ organisations perceived the new policy as a threat to what was considered as “their” budget. Since it had been made clear that the overall budget for the CAP would not increase after 2000, any expansion of the territorial functions was perceived as an implicit reduction of agricultural expenditure. In fact the rural budget was and remains very modest in relation to the agricultural expenditure as already mentioned: an increase would not have changed dramatically the disproportion between the two.

A second rural development initiative undertaken by the Commission in preparation for Agenda 2000 was the setting up of a group of experts, which produced the CARPE report (EC 1997 a) and worked on different hypothesis than the Cork Declaration. Here the problems considered were two: the need for further reform of the CAP, mainly in its price support mechanisms (first pillar), and the reformulation of the CAP legitimacy in view of enlargement and future WTO constraints. The main recommendation of this study is the establishment of a common agricultural and rural policy involving four main elements: market stabilisation, environmental and cultural landscape payments, rural development incentives and transitional adjustment assistance. The environmental payments, a horizontal measure for all rural areas, should be given only in exchange for the provision of some “public good” service that could be added to the provision of private goods for the market. This was the most innovative proposal. Rural development incentives should emphasise opportunities for non-agricultural uses of farm resources and for resources released from agriculture. Regional rural development plans should integrate the three Structural Funds, LEADER and the environmental measures.

From the perspective of this paper the shortcomings of the CARPE approach are two: rural development is perceived predominantly in its sectorial function and rural space is conceptualised as substantially dominated by farm activities. It ignores the diversification of activities that had occurred spontaneously in the majority of rural

areas. The proposed environmental payments, given in exchange for services and legitimated on the basis of a perceived market failure to remunerate them, are certainly a way for addressing real environmental concerns. However, because these payments are intended only for farmers and not for other rural dwellers who might be interested in providing them, and because such payments could be permanent and acceptable within the WTO negotiations, it also provided a framework for legitimising an alternative form of farm support. On these aspects it has a different approach from the Cork declaration, responding to the need for CAP reform rather than emphasising the territorial function.

The proposals contained in the report were not incorporated in Agenda 2000 and remained as suggestions for the future. The same political constraints that influenced the results of Cork were influential in delaying the application of the suggestions contained in the report. The eco-conditionality of payments was considered too restrictive and having coupled direct payments was considered easier to manage and politically preferable. In this way the substantial problems posed by enlargement and the new round of WTO negotiations were left unsolved by Agenda 2000, to be addressed with the new programming period afterwards.

An interesting question that could be raised is why was it necessary for Agenda 2000 to put the label of rural development on a package of second pillar measures that included traditional forms of support if at the same time the territorial component previously associated with rural development was reduced in visibility and relevance? Why not leave the old names for these policies after all? The probable answer to this question is again of a political nature: the reason for this is that a “rural development box” as second pillar of the CAP was thought to be necessary as a container for future “shifts” from market support. The lack of focus of present rural development measures and their unchanged assumptions are not the real point: what was important was the creation of a container and the label, the contents would come later with shifts between the two “pillars” and “modulation”. The second pillar in this context is conceived almost exclusively as an instrument for addressing CAP reform in the future. Its present contents and financial relevance are of secondary relevance and destined to change while the reform makes progress.

Discussion about further reform started almost immediately after Agenda 2000 was approved. Enlargement negotiations, budget constraints, the new WTO round and the food safety crisis explain the urgency. This new set of issues modified the terms in which the reform had been debated only a few years before.

The current debate addresses almost exclusively the specific problems arising from the need for further CAP reform (what we have called the sectorial function) and considers of secondary relevance the territorial function of rural areas. There is a suggestion to shift a certain percentage of support from the first pillar (common organisation of markets) to the second pillar (rural development) through modulation. The proposal for a Mid-term Review made by the Commission proposes a 20% gradual shift, of 3% per year (EC 2002). There is a preference for shifting within the framework of Agenda 2000 as little as possible (due to compatibility with previous engagements), as late as possible, with the least possible conditions (weak eco-conditionality), while at the same time delaying any phasing out.

This is a defensive approach, based on the acknowledgement that however legitimated the post-reform situation will provide less financial resources for the agricultural sector and therefore it is convenient to maximise short-term gains. This fact influences very heavily any attempt to design a more innovative policy approach, based on quality, organic production, environmental payments or diversification of activities.

Reform proposals tend to be judged not so much for how effectively they respond to new needs or recent problems but mainly in relation to past support, relative “winners” and “losers” in budgetary terms.

Another element of the reform is the multi-functional role of agriculture. This concept is usually taken to mean that agriculture, beyond its primary function of producing food, feed and fibre, has other functions, appreciated and necessary to society but not remunerated by the market. These ‘other’ functions are considered ‘positive externalities’, like for the case of the preservation of the rural environment and landscape, or the contribution to the viability of rural areas. These other functions are considered as ‘non-trade concerns’ and any payments to farmers in exchange of public goods will be eligible for the “green box” and could therefore be of a permanent nature.

Strengthening the multi-functionality of agriculture is one way of justifying the shift from the first to the second pillar and remains within a sectorial view of rural development: it is agriculture who is multifunctional rather than rural areas, and it is only farmers who may receive such payments. Multi-functionality is considered the peculiarity of the “European model of agriculture” and addresses in a new way the need for supporting farmers’ income. The main problem in the use of this concept is the same indicated at the beginning of this paper regarding rural development policies: it is never clear whether multi-functionality has become a key concept because of the need to reform the CAP (sectorial function) or because the other functions need to be addressed (the territorial and the environmental function). In principle, if we were truly worried about the “other functions” in remote areas we should allow anyone, not just farmers, provide environmental or rural development services in exchange for compensation.

These approaches to reform address almost exclusively the sectorial function within a reform rationale, while the territorial one plays a very marginal role. Rural areas are still perceived as coinciding with agriculture. A reform along these lines would be another step in the direction of reducing agricultural market support and replacing it with a direct payment. This is mainly legitimated by the assumption that without (or with a lower) income support farmers would be pushed out of farming, the land abandoned with negative environmental and rural consequences. This vision does not take into consideration recent trends in rural development or the demand for a more competitive and quality oriented agriculture. The diversification of activities in rural areas does not exclude the multi-functional role for agriculture. But to stress only multi-functionality as the solution for rural areas conduces to a distorted view of them and ignores the real processes that explain their development in the recent past.

## **5 Key components of a rural development policy**

### **The sectorial and the territorial function: distinct and complementary**

The analysis so far has argued in favour of considering – given the present situation - two main components in the second pillar: a sectorial function, specific to agricultural policy reform, and a territorial function specific for the rural economy and population. These two functions of rural development policies have already been developed in the historical evolution of the CAP and the Structural Funds; they respond to different and legitimate needs. The relevance of each function has been quite different over time: the early “structures” policy accompanied the market policy and privileged the sectorial function; the need for market reform and integrated rural policies introduced the territorial function in the Eighties; with Agenda 2000 the need for further market reform came mainly from an external and liberalising pressure, and reinforced the sectorial

function within the second pillar. Today the pressures for reform have widened (consumers, environmentalists, financial ministers...) and deepened, suggesting a reconsideration of the territorial function alongside a re-orientation of the sectorial one. Both functions are already there and need some fresh thinking and orientation. The first conclusion that we can draw from this is that *the two functions should be stable components of any rural development policy of the future*, given the existence of the CAP as it has developed until today.

How the two functions should be differentiated (within or outside the second pillar) and what should be their expected impact in the long run are the key issues of the reform process, that have important conceptual, practical and political implications.

In the past both functions have had different names, objectives, financial weight, political relevance, instruments, beneficiaries and impact. The reasons for putting them all under one rural development pillar in Agenda 2000 responds – as mentioned – to the need for creating a generic container that allows transfers from the first pillar to the second (through modulation), while maintaining broadly the same sectorial function (farmers are the main beneficiaries, forestry as an “assimilated” sector) and – in the wishes of many – the same level of expenditure. The sectorial function includes already and may expand environmental support, diversification of farmers’ activities (multi-functionality), investments for the reorientation of structures towards quality or organic production.

In the future, the two functions could be defined more explicitly as having different objectives, beneficiaries, instruments and expected impact on the viability of rural areas. *The distinct nature of the two functions is strategic for introducing the new assumptions about agriculture in relation to rural development.* The sector and the area cannot be confused because agriculture is not - and only exceptionally is likely to become - the “motor” of the rural economy. There is agreement on the fact that the attractiveness of rural areas in terms of population and employment opportunities is not driven by agriculture but by other sectors. A sectorial rural development policy alone, however generous and indefinite for farm structures, will never be able to create the opportunities for reversing the depopulation and resources drain.

The reverse is also true: a diversification policy alone, which ignores the needs of farm structures in response to reduced price support, environmental concerns and increased demand for quality food production would create problems of land management, rural heritage, social cohesion and tourist attraction. The territorial function needs to be a policy in its own right, distinct in its scope and ambition from the sectorial one but coherent and linked with each other. Whether this takes place within a single programming document or not, at the same institutional level (European, national or regional) and within the same administration (agriculture or other ministries) is a political and management issue with advantages and disadvantages (see below) which should not change the requirement of complementarity between the two functions.

Keeping the two functions distinct should not be understood as establishing a divide or a competition between them: to address openly their interrelationship and complementarity should be considered an asset and a key strategic factor for rural development, strengthening and multiplying its impact. The multi-functionality of agriculture in this perspective is one way – but not the only way – in which the complementarity between the two functions is pursued and valorised. An increased flexibility (possibility of modulation between the sectorial and territorial function) would be a great asset. This should facilitate adapted and integrated strategies for the farmers as well as for the population, avoiding confusions.

Both the sectorial and the territorial function need to be regulated at European level, establishing the general principles, eligibility of areas and rules of the game, quite independently of any future “re-nationalisation” of implementation and spending procedures. This is coherent with the single market and European integration. However, both functions are likely to be more efficient and effective if they are conceived and implemented at a decentralised level (the region) and adapted to specific contexts. The present sectorial measures have inherited a standardised horizontal approach, the same for each area. This is too rigid and should be reconsidered because past experience has shown that farm structures do not converge with modernisation but remain different in many aspects. This implies that structures’ policy should be adapted to regional differences and individual entrepreneurship. Typical products, quality and organic products often have a territorial relevance which is linked to a specific know-how and technology that can only be codified at regional level. The diversification of farming activities may be quite different in terms of opportunities according to the specific mix of resources available in a particular rural area. For the territorial function there is a wide consensus on a decentralised design and implementation, well established with the Community initiatives such as LEADER as well as in the operation of the Structural Funds.

**The contents of each function: aims, instruments, beneficiaries, cost.**

Having stated that the sectorial and territorial functions should both be *stable and complementary* components of rural policies, be kept *distinct* from each other and be *decentralised and adapted* to specific rural conditions, the next step is to imagine for each function their main contents in terms of aims, instruments, beneficiaries, expectations and cost.

**The main tasks of a sectorial function**

The aim of a sectorial rural development policy should be to accompany ongoing agricultural policy. The beneficiaries in this case are farm-holders. It should address at least two main tasks: a) to provide any multi-functional payments to farmers in exchange for public good services; b) to provide structural aid for investments promoting quality food production, organic farming, diversification of on-farm activities or more traditional modernisation investments. Tasks should not simply be added up to old ones: a more coherent overall framework pursuing a food policy (for example) should give a positive sense of orientation about the needs and expectations of consumers, about what is expected from farmers and production, about how to reorganise technical assistance and training, marketing arrangements, labelling and traceability, etc. A thorough revision of the present accumulation of measures should find the courage to eliminate those who no longer fit with the chosen orientation. The task of the sectorial function cannot only be understood on the basis of a defence of historical benefits but should also promote a positive alternative for the future of the sector. It is this positive vision that should be the core of the European agricultural model rather than its more defensive aspects.

Direct payments for farmers are usually included in the first pillar since they are coupled with production. However, if such payments are decoupled and/or made conditional on the production of some service or public good, then, since they become forms of income support rather than market support they will be included in the second pillar under the heading of rural development in its sectorial function. This is a highly sensitive passage both conceptually and politically: if support is no longer linked to production but to income needs then the establishment of income parameters will

eventually have to be introduced.<sup>12</sup> The reference is certainly no longer a comparable income in manufacturing, as was considered in the Sixties, but some kind of an upper threshold of support will be necessary (this was not considered so with coupled payments). If the rationale is income support, pluri-active arrangements, since they affect substantially total income will have to be included in the picture. Income support should not discriminate between ‘professional’ and ‘pluri-active’ farms as in the past: the presence of small farms has proved to be an extraordinary resource for the diversification of activities in rural areas, has stimulated entrepreneurship and innovation, has created a demand for contract services from professional farmers and should not be considered “inefficient” from a rural development perspective. Besides upper limits, the duration of income support should also be defined. Here the arguments are quite different: if farmers are receiving payments in exchange for services to society then there is no question either of thresholds or duration. As long as they provide the service they will receive the payment, regardless of their income. However, if the level of income is the criteria for support then the question of the duration of this form of support becomes central and its phasing out appears necessary in the medium term.

Aid for investments and the provision of services for farmers should assist the restructuring and reorientation of farm activities towards food production in general, which remains the core business of agricultural production, and for quality products which have a growing demand in advanced economies and represent the most competitive segment of the European production on world markets. The concept of farm modernisation should include both economies of scale and of diversification as possible rationales. Innovative farmers may also come from the non-farm sector of the rural population and not exclusively from the farming ranks. A rationale of competitiveness and market orientation, not necessarily relying on support, should be a desirable and attractive long-term policy goal. Farmers in marginal areas should participate in the elaboration of common local strategies that integrate farming with other local activities and services. Compensation allowances should be applied only where there are no alternatives either through farming or non-farming activities.

The financial allocation for the sectorial function is likely to remain the largest one in the medium term. This is due to the chosen criterion of “shifting” existing support from the first to the second pillar rather than redefining (and reducing) resources directly in the first pillar. Ideally, at the end of a transition period only payments in exchange for environmental services, minimal compensations for well delimited situations and structural aid should remain as permanent components of the sectorial rural development policy. Financial packages for rural development could be based on a global allowance for both the sectorial and the territorial functions, allowing for some flexibility in the allocations between the two functions according to the rural area. Funding may be quite unbalanced between the two functions (as it is today) and this is not in principle good or bad: it is a matter to be established case-by-case, according to the priorities of a chosen strategy.

If the two functions are not under the same administrative competence (at European, national or regional level), then the financial aspects and the flexibility between the two functions are likely to become more difficult to manage.

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<sup>12</sup> The Mid-Term Review (EC, 2002) proposes a threshold of 300.000 Euros.

## **The main tasks of a territorial rural development policy**

The territorial function should be expected to be a permanent component of any rural development policy, playing a low cost and strategic role both for agriculture and rural areas. The beneficiaries of this policy should be all the residents and economic actors in these areas, including, of course, farmers. In the medium term the objective is to provide a viable, diversified, sustainable economy and society to rural areas. It is not just agriculture that is and may remain multi-functional: it is the territory that has to become multi-functional, in the sense of a mixed economy responding to internal needs and the new functions that the wider society demands in terms of products, environmental goods, leisure, activities, life-styles, accessibility. Rural areas should 'invent' a modernity of their own, different from the one that was imagined and constructed around urban industrialisation. A success in this task would give a positive image to the European rural model, one to be proud of also internationally. Mobility in and out of rural areas is not necessarily an exodus or a brain drain: it can be the result of a wider horizon in the search for opportunities that as long as it is an exchange of mobility should not be perceived like a threat.

The rural territorial approach needs to have close linkages with regional development, promoted through the Structural Funds. The instruments (LEADER and regional programmes) operating with a territorial approach need to be co-ordinated in their conception and management. Reform of the rural development policies should be coherent and linked with reformed regional and cohesion policies after enlargement.

Programmes such as LEADER have shown that the territorial function can be very effective with modest amounts of money. It can provide solutions in terms of income and employment where other and more costly initiatives had failed. It introduces in the rural debate concepts such as transfer of know how, human capital, intangible factors, participatory approaches, innovation, integration between actions, networks, that were previously absent in the sectorial function and could stimulate a less assisted and defensive mentality, reducing the isolation of single rural areas.

The instruments of the territorial function must rely on an area-based approach. This should be pro-active and development oriented, avoiding the rhetoric of compensation for local handicaps. Local development as was experimented in LEADER is a very efficient way of organising the participation of all rural actors and institutions, get them around a table to exchange alternative strategies for the area. The contextual knowledge that local actors can bring to the planning process cannot be matched by any codified knowledge about rural development in general. However, LEADER cannot be the only instrument available for the territorial function. Employment, gender issues, adapted services (public and private), transportation, tourism, business, a sustainable use of resources, land use and housing are contents that need to be brought into the rural planning framework for a specific area in a more systematic and integrated way, so that problems and priorities can be established with a complete and realistic picture of the context. The territorial function cannot be only a question of mobilisation and animation.

New employment opportunities and diversification of activities should be seen here as tools for increasing the competitiveness and the attractive character of the rural area, regardless of whether the farmers are pushed out of farming or not. A well-articulated and varied labour market provides opportunities also for the farming population, offering a choice between alternative careers for the farmer and his family.

A particular attention should be given to the innovative functions that have been developed by rural areas. Other actors different than farmers can also provide

environmental concerns and services. Leisure homes and commuting practices should be seen as opportunities that require some regulation, service infrastructure and efforts towards social cohesion. Endogenous or relocating enterprises have similar needs. Forestry is presently included in the second pillar and could be kept as a distinct strand of rural development policies, as a different type of sectorial function.

The financial allocation for the territorial function should have its own logic independent of the sectorial one. Like other territorial expenditure it is based on aid for investments (tangible and intangible) and collective infrastructure. It should not include compensatory payments or income support.

### *The relationship between the two functions: learning to live together*

The territorial and sectorial functions are complementary and not competing with each other. The idea that rural policies are only accompanying policies for agriculture should be replaced by the need to have two distinct and complementary policies that could develop significant synergies by co-operating. Changing the initial assumptions of the CAP should make clear that rural areas are not the same thing as agriculture. It is the territorial function who should provide the development and modernisation of the rural area and agriculture may be a large or small part in this strategy. The exchanges between the farming community and other sectors of activity as well as with the external world will increase the competitiveness of the area as a whole. There are plenty of examples of innovative business ideas and practices taken from the manufacturing and service sectors and transferred to the agricultural sector. The same for exchanges between the local population and newcomers or tourists. There is evidence that the turnover of land increases with diversification of activities and rising incomes, thus creating new opportunities for adjusting farm size to the farm family. Farm pluriactivity is an advantage for farm families. There is a broader and more real range of opportunities offered by a diversified rural economy than the current abstract descriptions of multi-functionality imagine as a possible solution.

The environmental dimension should be considered both in the sectorial as well as in the territorial functions. Forestry, natural parks, conservation, tourism have also a non farm dimension which should be addressed. All the rural population should be in principle eligible to realise environmental services and public goods.

### **The political-institutional question: who should do what, when, how, with what resources and interest groups**

The political-institutional question is extremely relevant in any reform initiative because it affects the organisation of interests, the role of the institutions, the method of delivery, financial flows. It is relatively simple to think of a new policy and adding it to the existing ones, but it is extremely difficult – and there is little know-how about how to go about it - to change, reorient or even worse downsize a policy, especially when it is the most important and original policy associated with the construction of the European Union. A reform is not just a conceptual or technical affair, but it should not be either just a political one or a question of “tuyauterie financière”.

The relevant actors are likely to be the administrations responsible for designing and implementing rural policies and the interest groups involved in the political debate. Financial, environmental and foreign ministers may hold different views about the reform. Member States have expressed quite different preferences for alternative reform packages. Stakeholders have enlarged: consumers, health officers, food chain operators, trade entrepreneurs are now more vocal in expressing their interests.

In principle, it would seem reasonable to say that the sectorial function of rural policies should be integrated with agricultural policies, while the territorial function should be integrated with other territorial policies, regional and cohesion policies. However, there are also advantages in keeping them under the same institutional umbrella: the two functions are complementary to each other, synergies and co-operation between farmers and the rest of the rural actors would be improved with greater efficiency and innovation for both. The problem in the past has been that when a territorial function is placed under the competence of a sectorial administration it gets distorted or pushed to a marginal role (and the reverse is also true). Therefore if the two functions operate within the same institutional administration, checks and balances are needed to avoid that one function takes it all; if the two functions operate under different institutional administrations, checks and balances are needed to avoid competition between the two functions and a loss of synergies. As mentioned above, modulation between the two functions would be extremely positive and to the benefit of all. National governments' organisation and regions very often reproduce at different level and scale this dilemma of the sectorial versus territorial competencies.

Another issue related to institutional arrangements is the governance of the reformed CAP. The growth of the second pillar implies a growth of co-financing, of programming, of more complex administrative procedures for spending funds, of more levels of government being involved and different sectors/ministries/agencies having to cooperate. Market support procedures were and will remain simple, attractive, automatic. The bureaucratic burden attached to the shift from the first to the second pillar will be a very significant constraint that influences the magnitude of the shift. There is of course room for a lot more "simplification" than the one that has been realised until now but there is no doubt that spending the funds made available will become much more complex.

It should also be considered that the sectorial agricultural interests have a well-established, organised power base, both in terms of economic actors and political representation at all institutional levels. The same is not true for the territorial rural interests, which are more recently established. They are by definition heterogeneous, have no clear political identity and are better represented at local and regional level than at national or European level. Such a wide gap in the "rapports de force" at the relevant institutional levels is a political weakness of the territorial function. Making much more clear than has been done so far what are the advantages for the farming population (in terms of land availability, income and job opportunities, valorisation of agricultural products, new market outlets and commercialisation circles, better services, ...) of developing the territorial function would certainly help. The positive side of this development needs to be more convincing; otherwise it will be just seen as a competition for having a part of the financial resources "belonging" to farmers. This is true also for other potential supporters of the territorial function: environmental groups interested in sustainable development would be particularly sensitive to agro-environmental measures, payments for public good services, reorientation from a productivist to a more qualitative and organic approach to food production from the sectorial function side, but also to parks, rural amenities, integrated development and cultural heritage from the territorial function. Consumers of products and space could also be supportive of both functions.

The question of timing is also likely to be a complex and tricky issue, particularly in the perspective of enlargement. On paper the CAP reform should be ready for the next programming period starting after 2006. Logically, it seems irrational to transfer questioned policies that are about to change. Since rural development policies will have

a larger role to play in the reformed CAP than in the present situation, the current approach of “anticipating” such emphasis in the policies available to candidate countries that join before 2006 is appropriate. Precisely for this reason, however, the sectorial function of rural development in candidate countries risks to be oriented towards the wrong targets if the present “menu” of rural measures, conceived for a traditional productivist modernisation and as accompanying measures for the agricultural sector is maintained. The territorial function, which has played such an important role in the recent competitiveness of some rural areas of the present Member States, risks to play a marginal role in the CEEC countries, engaged in repeating the experience that proved to be based on inaccurate assumptions about rural development. In order to avoid this, the general philosophy of the reform should be made known before 2006, not only for justifying the different starting point of the CEECs but also to make sure that the EU-15 are committed to substantial change. An idea of what is likely to be ‘phased out’ helps to accept different rules for the phasing in.

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