The EU added value of agricultural expenditure – from market to multifunctionality – gathering criticism and success stories of the CAP

Jorge Núñez Ferrer

and

Eleni A. Kaditi

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Centre for European Policy Studies
Place du Congrès 1
B-1000 Brussels
Tel: (32.2) 229.39.11
Fax: (32.2) 219.41.51
www.ceps.eu

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EXECUTIVE SUMMARY

The value added of public interventions has attracted the attention of academics and politicians alike. On the expenditures of the EU budget, value added has become a key element of any discussion. Unfortunately, the term is vaguely understood and its meaning interpreted according to the specific wishes of those who use it.

The result of the debate on value added and its interpretation will have important consequences for the direction of the future CAP and rural development programmes. A serious debate about value added requires an understanding of the fundamental notions of this term. This will ensure that decisions will be taken with a wider understanding of the internal and external implications of policies.

It is a matter of political debate whether protecting agriculture at EU level generates a value added for Europe, as opposed to separate national policies. It is likely that the answer varies according to the individual measures. There are good reasons why food quality, trade rules and some environmental issues should to be governed at EU level. On the other hand, the EU Treaty places the responsibility for running the agricultural policies to the EU level which somehow settles the question institutionally, but the policy still needs to comply with basic rules for public expenditure and basic notions of value added. These can be summarised as efficiency and the minimisation of opportunity costs.

The demonstration of the existence of some benefits of a policy is not sufficient to prove the existence of value added. A policy has a value added if the benefits outweigh the costs, not only of implementing the policy, but also the costs created in other areas. Price support for example not only generates financial costs to consumers, it distorts other markets. The impact of price support on farm incomes was reduced by the indirect leakages of the policy, such as increased input prices. The final real benefit has to exceed the benefits of alternative uses of the funds, i.e. the opportunity costs, before one can speak of a real value added of a public policy. Value added is thus closely linked to efficiency, the lower the waste of resources, the lower the opportunity costs.

This report acknowledges that CAP reforms have ensured a greater market orientation and sustainability of the policy. Major disequilibria have disappeared, while strained relations with EU trading partners have to a large extent been soothed. Support to the farm sector through price intervention has been substituted for direct payments. Direct payments have been a large improvement to price support. While the level of support has not really changed, the modalities have and a shift of direct payments toward the second pillar objectives has been initiated.

Nevertheless, the present situation is far from fully satisfactory. Reforms were primarily aimed at reducing the distortions of the policy on the domestic and international markets, rather than ensuring that the policies achieve efficiently stated objectives and present needs. One can consider the present situation one of transition to a new policy, but without a clear orientation. Presently, the support measures of the Common Agricultural Policy score badly in terms of EU value added due to a lack of efficient

targeting and ensuing excessive opportunity costs. The reason is simple: the direct payment system is based on parameters that have no link to the cost of achieving the objectives. Actual needs are largely dissociated from the financial interventions.

The way direct support is administered needs to be changed, e.g. separating the functions of 'income support', 'cross-compliance' or other objectives and basing payments more rigorously to the real costs of reaching the objectives. Achievements of the existing goals can be managed by reducing the costs substantially, thereby freeing funds for other worthwhile interventions within or beyond agriculture and rural areas. For the same cost a lot more could be attained.

As for Rural Development, it is maturing to become an important tool for environmental and economic development in rural areas, but it is still questionable if it should not expand further to interventions beyond agriculture. Given that it has been repeatedly demonstrated that rural development depends on many factors beyond agriculture, the strong sectoral approach is too restrictive. Promising successes can be found for environmental programmes and in more holistic approaches, such as the LEADER programme. The latest reform improved the policy but failed short to reform some questionable interventions. Deadweight costs caused by the lack of stricter eligibility criteria are also affecting negatively the additionality of the measures, reducing their value added.

There are arguments to maintain support for the agricultural sector and the rural areas. Some are very important, e.g. environment and food safety are a key issues. Many other arguments are based on a political and social valuation of the need to preserve certain features of the sector and the rural areas. Some have also real wider economic importance, e.g. tourism may be affected by regional changes in the rural structures and the environment. However, the present policy does not address these in an efficient manner, failing to maximise the value added of the result and weakening the rationale.

The search for value added starts with the design of policies addressing correctly the objectives they are supposed to achieve.

For the CAP direct payments:

- Direct payments at the moment have a suboptimal distribution given their stated objectives. From a value added point of view it is recommended to align payments further to their objectives and to tighten eligibility criteria to ensure funds are allocated where needed. It is highly questionable if farms with large turnovers should not be excluded from most of those payments.

- Direct payments should be based on a cost-based analysis.

- Improving the targeting of the direct payments should free considerable resources, which could be used for increasing rural development actions, especially for holistic actions.

For rural development:

- A substantial share of support should be aimed at generating economic development on a 'territorial' basis, focusing on strategic actions to generate endogenous growth. The Leader programme has successfully demonstrated the positive implications of such a policy approach.

- Rural development funding ought to be closely linked to the Community goals to be achieved (and not take historic funding or the amount of direct payments in a given country as reference). Support for the agricultural sector should have stricter eligibility criteria to avoid deadweight costs. The economic development of the rural areas, food safety, food quality standard and environmental protection are very serious and important issues. Support for those should be carefully devised and targeted.

- The eligibility rules for the funds should be refined, based on the objectives aimed and the economic circumstances, especially for those funds aimed at the economic development of the rural regions.

1. UNDERSTANDING VALUE ADDED FOR THE CAP IN THE CONTEXT OF EU EXPENDITURE POLICIES

The debate on the future of the EU budget has placed the search for value added from EU expenditures at the heart of the debate on the future of financial interventions. The definition of value added can become very complex. The seriousness of the debate in particular for the market measures of the Common Agricultural Policy (CAP) is clear when, according to the definition by Sapir (2004) of (European) value added, the CAP would have to be abolished and completely renationalised. In fact, the Sapir Report, refers to the EU budget in general as an "historical relic... inconsistent with the present and future state of EU integration" (p. 162), and the CAP features prominently in that document. The UK made no attempt to hide its disapproval of the CAP during the negotiations of the Financial Perspectives and called for a value-added approach to expenditure.

One can point out that if the CAP was a necessary policy to allow the establishment of the European Economic Community, then its European value added *at the time* was very high, regardless of economic returns of the policy in itself. The value of a policy changes in time as circumstances evolve and the present European value added of the CAP is questioned.

An analysis of the value added of agricultural expenditure has thus to be undertaken with particular care. In fact, the CAP's impact in creating value added is not uncontroversial. Like all policies it creates costs as well as benefits: it impacts farmers and thus their incomes; farming practices and thus the environment; the food industry and thus consumers and food safety; the rural population and thus the rural economy; and prices and thus competitiveness and trade. It is in fact extremely difficult to assess fully the net outcome of the policy in terms of value added.

This paper does not address the question of whether or not agricultural policy should be run at EU, on the grounds that the EU has a mandate by the Treaty (Article 33) to manage the policy. Thus it concentrates on the merits of the policy in creating value added in the agricultural sector and the rural areas, as a sectoral policy and as part of the EU budget. This limits the scope of the paper to two kinds of assessment.

The first is endogenous to the policies. Do the CAP and the rural development policies generate the potentially highest value added in the areas in which they intervene?

Further to seeking an answer to this question, an analysis on the value added of interventions cannot avoid taking into account the wider setting of the EU budget, the expenditure items are part of a larger, but limited budget. It is necessary to take into account that interventions should be generating a value added which allows to justify the share of expenditure of the EU budget in the agricultural sector.

As a result, the second question which has to be touched upon is the following: Is the value added generated sufficiently high in comparison to the opportunity costs of the expenditure required? Discussions abound on the merits of financing R&D, education or transport, rather than agriculture, and need to be addressed even if only superficially due to the need to narrow the focus of the study.

Before directly jumping into the analysis of the value added of agricultural and rural development policies, it is important to present the fundamental criteria on which this study on value added of EU public expenditure is based. Different interpretations of value added, particularly in such a politically sensitive area, can have considerable repercussions on policy directions in the budget review process.

1.1. Value added of public expenditure

Public expenditure intervention should be based on certain fundamental criteria. EU expenditures should follow those, as well as additional rules which apply to supranational interventions.

Public intervention is considered necessary when market failures create a suboptimal outcome for society, reducing present or future welfare. Environmental protection interventions are a clear case. At EU level, interventions are important when pollution has a transnational aspect.

Exceptions are possible and interventions may be important even in the absence of a clear-cut market failure. For example, interventions may be considered for social equity reasons, or to preserve or foster desired outcomes. Support for cultural programmes is a case in point: while they may undoubtedly be socially important, their value added in economic terms and the correct level of provision are often very difficult to determine.

In any event, the value added of public policies has to take into consideration the cost to society from the transfer of resources, i.e. the opportunity costs in other areas.

1.2. Value added of public expenditure for the EU

The value added of EU public expenditures also has to include a reasoning on the correct level of governance in line with the subsidiarity principle. Are the interventions at supranational level achieving a better result than actions at the local level? The issue of the division of labour between member states and the EU has been amply discussed by fiscal federalists and the European branch of this discipline (see e.g. Persson et al., 1996; Tabellini, 2003; Nuti & Nava, 2003; Gros & Micossi, 2005), most of whom dismiss the necessity of agriculture as an EU policy. This paper does not discuss this question, but acknowledges it as a thorny one that will resuscitate regularly and needs acknowledging when considering the future role and the optimisation of the value added of agricultural and rural interventions.

In the end, the question is not only what value added has the CAP created for agriculture, but at what cost to society and if there are ways to improve its performance.

The interpretation of value added in EU expenditure has large consequences. If value added is simply calculated on the basis of the value of primary agricultural production minus the costs of production, the final net value added is lower than the OECD estimated TSE (total support estimate) to agriculture (Wichern, 2004). The total support estimate includes the price support (which is falling still accounted for approximately 50% of support to agriculture in 2004), as well as direct payments and other subsidies to the farm sector in the EU. The value added of support was thus negative in purely economic terms, even from a simple sectoral perspective.

2. THE CAP AND RURAL DEVELOPMENT: A SUMMARY OF REFORMS

Despite the numerous objectives of the CAP enshrined in Article 33 of the Treaty, only one dominated the policy until the MacSharry reforms of 1992: farm incomes. Only one tool was introduced to address the income problem: price support. Some farm-oriented rural development policies were also pursued, starting in 1972 and based on a very diluted set of the recommendations in the Mansholt plan of 1968, but within regional policy. The Mansholt plan, called after the then European Commissioner Sicco Mansholt, clearly foresaw the increasing failings of the CAP. The increasing importance of rural development polices today vindicates the Commissioner's stand.

The use of price support as the main policy of the CAP introduced a large number of distortions. Food production intensification was fostered, while land rents and increased input costs captured the policy rents of the induced earnings of farmers, thus reducing the price transmission to farm incomes to a fraction of the total. The CAP was failing to improve farm incomes in a significant way, while inducing overproduction, distorting world prices and damaging the environment.

While some damage limitation reforms started during the 1980s, such as the introduction of milk quotas, it was only the MacSharry reform of 1992 that created the basis for a novel approach to agricultural support. The MacSharry reform introduced two main innovations: direct payments and accompanying measures. The former was a form of compensation to farmers for the reduced income due to lower institutional prices, and the latter was a direct support to a more environmentally sound agriculture, the care of rural landscape, afforestation and assistance to farm restructuring through a young farmers and early retirement scheme.

Price support reductions were still not large enough to eliminate the large imbalance between supply and demand, and a policy of land set-aside was introduced to eliminate part of the pressure.

The subsequent Agenda 2000 reforms adopted in 1999, reinforced those of MacSharry. These further decoupled the direct payments from production by turning the compensation payments into direct aids, aimed at supporting farmers' income. The payments also were linked to modest cross-compliance obligations. The use of good farming practices became linked to the granting of the direct payment support.

The most revolutionary aspect of the Agenda 2000 reform was the reinforcement of rural development policies. Those were declared the 'second pillar' of the CAP to sustain agriculture by complementing the market policies (first pillar). Moreover, Agenda 2000 introduced the so-called 'horizontal regulation', in which two brand new instruments were set out: modulation of direct aids (to reinforce the second pillar) and stronger cross-compliance obligations for direct aids to meet minimum (environmental) standards.

While the Agenda 2000 reforms were globally an improvement to the policies introduced by MacSharry, the latest CAP reform (the misleadingly called 'Mid-Term Review' (MTR), also known as the Fischler reform) was far more radical. It introduced the practically full decoupling of the direct payments through the so-called 'single payment scheme', which features a total de-coupling support for farmers with no obligation of production. Furthermore, direct payments have been made conditional on stronger minimum standards related to environment, animal welfare and food safety. Modulation of direct payments was also made compulsory, so that each member state is obliged to divert a (small) part of its direct payment endowments to the resources available for Rural Development policies.

Decoupling of payments is important, because direct payments linked to certain products distorted the product mix, reducing the potential value of production (see Wichern, 2004; OECD, 2004).

The MTR has attempted to shift the emphasis and funding further to the second pillar of the CAP. The financial allocation in the Financial Framework for the 2007-2013 period, however, still maintains the relative sizes of the direct payments and rural development. Nevertheless, the rural development policy has finally matured to an independent sub-heading of the budget, and no longer divided between the CAP and structural funds.

Modulation was reinforced, but member states have resisted calls to shift funding between the pillars, and the level of 'modulation', which is the only active measure that diverts resources from the first to the second pillar, is limited not only in size, but no more than 20% can be redistributed between countries and sometimes even regions.[1]

CAP reforms have followed a consistent path towards greater market orientation and sustainability. Major disequilibria have disappeared, while strained relations with EU trading partners have to a large extent been soothed. Support to the farm sector through price intervention has been substituted for direct payments. While the level of support has not really changed, the modalities have. A shift of direct payments toward the second pillar objectives has been initiated.

In addition to those reforms, the MTR introduced support in pillar II to improve the quality of agricultural and food products in the EU. The motivation has been largely to assist the farmers and food industries from the new member states to manage to adopt EU standards, but this can be used for increasing quality in general.

In terms of environmental issues, already the 1992 reform of the CAP introduced support for agri-environment measures at European level to encourage more environment-friendly production and farm management methods. In the context of its successive reforms, the MTR is a response to the need to achieve a multifunctional, sustainable, competitive agriculture throughout Europe.

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[1] Modulation requires shifting a share of CAP direct payments to rural development (from 3 to 5% over three years). This will only affect direct payments for farms receiving in excess of €5000.

In particular, the CAP includes cross-compliance linking the payment of production subsidies to the observance of mandatory conditions regarding good husbandry, animal welfare and the environment. Farmers not only have to manage their livestock and crops, but also demonstrate compliance with existing EU legislation (the Statutory Management Requirements, SMR) whilst keeping land in Good Agricultural and Environmental Condition (GAEC).

As a result, new production methods have been growing in importance, farmers changed the way they operate and rational farming increased. Most member states have, for example, implemented measures for the long-term set aside of agricultural land to protect water supplies and create biotope reserves. Other changes of land use employed in programmes include the reversion of arable land to extensive grassland and changes between crops and rotations.

2.1. Reinforced rural development policy

The concept of rural development support is not new. As early as 1964, the fund for supporting agriculture was divided into guarantee and guidance to create the EAGGF.[2] The guidance section was intended for rural development targeting farm restructuring through structural measures and the guarantee section funded the market support mechanisms of the CAP. Rural Development measures to support farm restructuring were introduced in 1972 under the guidance section.

This distinction between guidance and guarantee lost its rationale as other rural development needs and environmental concerns increased in importance and accompanying measures for rural development were also introduced within the guarantee section.[3] It created a confusing mechanism, where depending on the area of intervention, the same rural development measures were funded either by the guarantee or the guidance funds, i.e. the CAP or the structural funds.

The Financial Perspectives for 2007-2013 grouped all rural development measures into one instrument with its own budget line under Heading 2 – Preservation and management of natural resources. This sub-heading combines the rural development measures of the guarantee and guidance sections of the EU budget into one fund.

A rural development policy reform (Council Regulation (EC) No 1698/2005) entered into force on 1 January 2007.[4] The reform expanded the scope of the rural development measures due to the important challenges of the agricultural sector especially in the new member states. It also allows investments in non-agricultural and non-farm related enterprises, but it is limited to micro-enterprises. Modest improvements to the eligibility criteria of funds have been introduced too.

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[2] European Agricultural Guarantee and Guidance Fund**.**

[3] This was necessary to ensure that all agricultural areas are covered. Guidance funds, used through the structural funds, were subject to the regional eligibility criteria of regional policy.

[4] Council regulation (EC) No 1698/2005 on support for rural development by the European Agricultural Fund for Rural Development (EAFRD), OJ L 277/1 – 40, 21/10/2005.

The overall objectives of the rural development policy are set in Art. 4 of the regulation:

- Improving the competitiveness of agriculture and forestry by supporting restructuring, development and innovation;
- Improving the environment and the countryside by supporting management; and
- Improving the quality of life in rural areas and encouraging diversification of economic activities.

3. DIRECT PAYMENTS (PILLAR I) AND VALUE ADDED

The new Financial Perspectives of the European Union neatly separate the financial allocations for direct support and the allocations to rural development. This allows for a separate analysis of the two pillars of support.

To ascertain the value added of direct payments, it is necessary to first clearly determine the objective of such payments. Unfortunately, the direct payments are not objective specific. Their role has shifted in nature, from compensation payments for falling price support, to income support payments and finally to environmental cross-compliance enforcement tools. The payments today are considered to help in achiving multifunctional objectives such as helping farmers to adjust to structural change, providing income support, encouraging environmentally friendly farming practices and preserving the benefits of agricultural production and keeping in business farms which would not be able to subsist under market conditions alone. In other words, the payments are multifunctional.

Evaluating the performance of the direct payments to achieve their objectives is thus difficult. However, direct payments are due to their historical development not designed based on the cost-efficient achievement of preserving the multifunctional benefits of agriculture. The relation of the mechanism and the Treaty Article 33 objectives of the CAP are also weak (Nuñez Ferrer, 2007). Pillar II rural development actions, in particular those for food safety and environment, are more in accordance with those aims, but direct payments are not.

In fact, direct payments attracted the attention of policy-makers as a vehicle to implement desired changes in farming practices. First, the MacSharry reforms linked them with set aside obligations. Subsequently, when the link with production could not be defended at the WTO[5], direct payments were linked to cross-compliance, a set of 'green' farming practices and even animal welfare actions. Without the need to analyse the cost of intended policy changes or creating new implementation tools, the direct payments have become an easy tool for an array of actions. The attractiveness of such a

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[5] Direct payments were conditional on certain land being designated set-aside (and conversely the rest under production).

system is not surprising, but it can cause strains if either the distribution is not considered fair or if the relation between the costs and the value added generated is put into cause in the limited budget.

Serious work has been undertaken on the notion of using cross-compliance to enforce new and changing needs in the sector. The greening of the first pillar through cross compliance can also be considered an attempt to increase the value added of the direct payments. Environmental benefits are often expected from such an approach and it is politically attractive as a tool (see SER, 2006; Sumpsi & Buckwell, 2003).

Regardless of the attractiveness of such an approach, there are serious issues in relation to the lack of a link between the costs of the required farming practices and direct payments. Direct payments are still linked to yields per hectare in the years 1989 to 1991 or the average of three years originating from the last five years with available data before accession for the new member states, as far as national allocation of funds is concerned. As a consequence, regardless of whether they are used as income support, environmental actions, or any action of potentially high EU value, the payments do not relate well with the issues being addressed. This would be a violation of the principles of efficient public intervention and can be considered a violation of interpersonal equity principles of EU support.

Thus even if direct payment interventions were to generate value added, a reform to bring them in line with the costs of cross compliance, other specific farm practices or income support is necessary. The design of direct payments has to be improved if they are to be maintained in the future.

The following subsections analyse if the value added of direct payments can be improved as income support or as an environmental and quality tool through cross-compliance. One section also discusses the new support being given to biofuels through direct support.

3.1. Pillar I as income support and its added value

One recurrent argument offered for granting direct payments to farmers in the EU is the need to provide farmers with income support. Otherwise, so goes the argument, many farmers would abandon agriculture altogether with large negative consequences for the environment, landscape and rural communities.

It is common to have public interventions to support the income of individuals or households in financial difficulty. Income support is granted based on means testing, to ensure that support goes to those who need it. The CAP direct payments are not based on any analysis of the individual needs of farms and as such fail in targeting low-incomes farmers. The CAP is benefiting the owners of primary factors or production rights, and these are not the intended main beneficiaries of the CAP.

Direct payments are in any case a great improvement over price support. It is widely reported that these have stabilised farm incomes and assisted in maintaining agriculture in areas where it would have been abandoned. Undoubtedly, the direct payment transfer efficiency is much higher than for price support; the OECD (2002) has compared the transfer efficiency of price support and direct payments. For price support, it found that the benefits accruing to farmers from the subsidised price was only 23% and to non-farming landowners 13%. Direct payments are capitalised by 47% by farmers and 45% by non-farming landowners. Leakages to input suppliers drop dramatically. Input suppliers managed to appropriate 36% of the value of price support. Excessive resources were also diverted to production (distortion), with a 28% loss in the value of support, compared to 5% with direct payments.

Direct payments and the decoupling process have reduced the level of distortions and waste in the agricultural sector substantially, and have increased the transmission effectiveness of support, but this by itself cannot be considered an increase in the value added, but rather a reduction in the opportunity costs of agricultural subsidies.

Can direct payments create a value added (economic or social) as income support? Payments create a value added if low-income farmers benefit and the policy ensures that farming stays in areas where it is socially desirable. In economic terms the cost of the policy should reflect the desired value added of the impact, the society's willingness to pay to preserve the benefits of agriculture, especially in areas in decline. Direct payments could to be designed by needs in a 'territorial' fashion, focused on rural regions in need, as Gonzalez Regidor (2005) proposes and even specific farm groups.

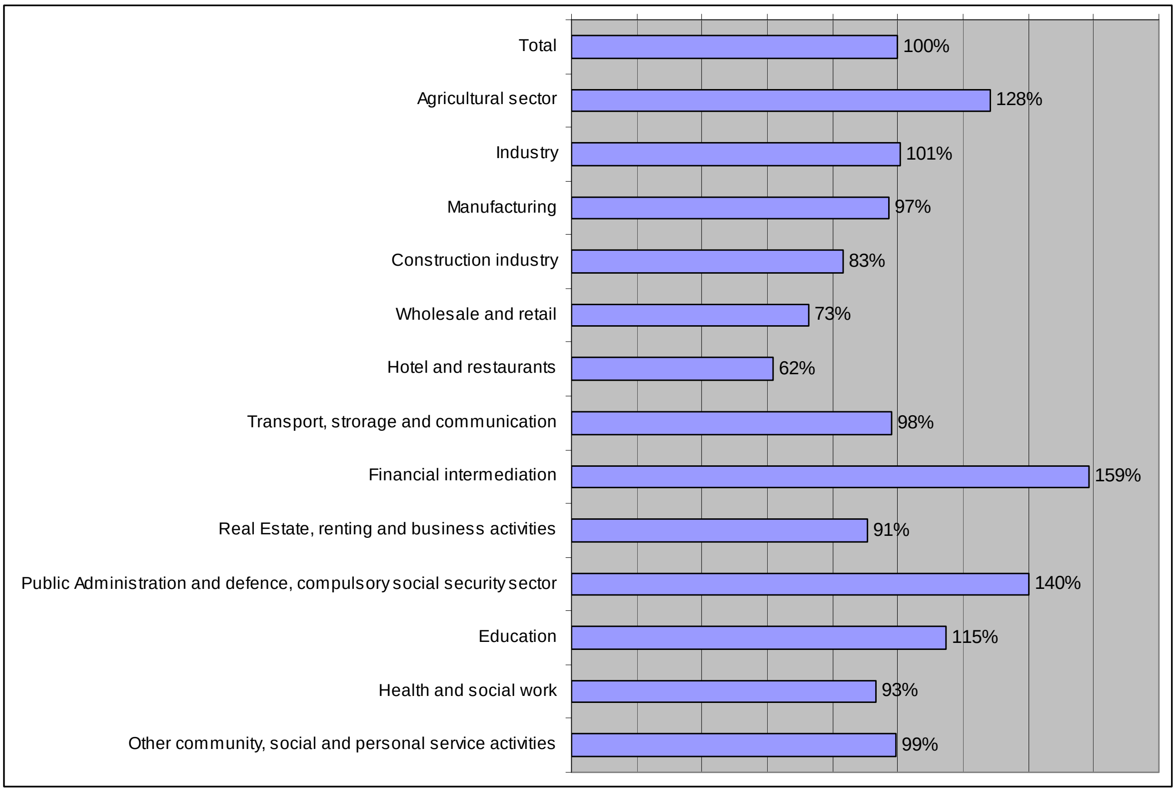
While direct payments may have the effect of maintaining farming in certain areas, these are not well designed as an income support policy. The CAP is regressive, and the intended beneficiaries of an income support are the ones benefiting less from the policy (see Baldwin, 2005). According to ESPON (2004) estimates, 44% of the CAP pillar-one payments fall in highly urbanised regions with high human intervention. This is equivalent to 29% of the Utilised Agricultural Area (UAA). This is not a problem per se, but the fact that those areas are generally those were farm household are wealthier and have more diversified activities put the distribution into question.

It is important to note that the income justification for support rarely takes into account that in a number of EU countries farm activities are not the main or only occupation of the farmers and members of the farm household, thus a low income from agricultural activities is not sufficient to justify income support.

The farm poverty assumption has also been reinforced by the candidate countries. However, the way direct payments are devised, the impacts in does countries are not in line with the need for income equalisation between sectors. With enlargement, the farm incomes in the new member states increased substantially, by 50% in 2004 according to Eurostat data. This happened despite the only partial introduction of direct payments. In fact, even with all the reforms, price support still accounts roughly for half of support (Wichern, 2004).

Statistical data at regional level reveal that poverty amongst non-farmers is as acute if not worse than for farmers. Data from the very rural Polish area of Podkarpazkie for 2005 (source Statistical Office Rzeszow) (Figure 1) show that gross incomes are often lower than in farming, farming households earning over the average. The discrepancies of disposable rather than gross incomes compared may even be larger than the data shown due to the more advantageous tax and social security terms for farmers.

Figure 1. Gross income by economic activity in Rzeszow, Poland, year 2005



Source: Statistical Office Rzeszow (online database).

The data of gross income distribution are surprising, but the worst discrepancies lie within the agricultural sector itself. The higher average incomes are due to the exceptionally high receipts of the larger commercial farm households. There is no doubt that amongst the poorest and most deprived citizens of the region loom many small and semi-subsistence farmers. These, however, are not the target of the bulk of 'income' support.

Given the large inefficiencies of the policy in targeting low-income farmers, direct payments cannot be considered rational as an income support. With the low level of support granted through direct payments to poorer farm households, it is questionable if it is really very influential in reducing the flow of farmers out of agriculture, or rebalancing income differentials between the agricultural and non-agricultural sectors. In fact, the CAP may be exacerbating income disparities in general and especially within the agricultural sector. More support could be directed to low-income farmers while simultaneously reducing the total expenditure for direct payments, encouraging more farmers to stay in farming and reducing income inequalities in society and the sector.

The opportunity costs and the weak targeting of direct support are thus too high to consider direct payments as adding value *as an income support policy*. Any payments granted as income support should be based on an assessment of means by recipients. Such a requirement would exclude a considerable number of farms.

3.2. The value added of decoupling and cross compliance of direct payments

As income support, direct payments are inefficiently distributed and the value added of the payments may well be negative. The impact on farming practices, however, may well generate a value added.

In particular, the CAP includes cross-compliance linking the payment of production subsidies to respect for mandatory conditions regarding good husbandry, animal welfare and the environment. Farmers not only have to manage their livestock and crops, but also demonstrate compliance with existing EU legislation (the Statutory Management Requirements, SMR) whilst keeping land in Good Agricultural and Environmental Condition (GAEC).

As a result, new production methods have been growing in importance, farmers have changed the way they operate and rational farming has increased. Most member states have, for example, implemented measures for the long-term set aside of agricultural land to protect water supplies and to create biotope reserves. Other changes of land use employed in programmes include the reversion of arable land to extensive grassland and changes between crops and rotations.

Through the reinforced cross-compliance obligations of the Mid-Term Review (MTR), the EU intends to ensure that farms implement various environmental directives, such as the directives regulating groundwater standards, nitrate pollution or pesticide use.[6] The Commission Communication of 2003 'Agriculture and the Environment', lists the requirements.

Decoupling and cross-compliance have, according to Bradi et al. (2007) reduced the abandonment of agricultural land. The environmental impact was less clear and the effects varied through the regions. Important benefits were rather found for interventions through agri-environmental payments from Pillar 2.

One cannot deny that there is a value added from coupling support to good farming practices *compared to* no cross-compliance. But this is not sufficient for a continuation of the payments as they are designed today. The size of direct payments is weakly related to the costs of cross-compliance obligations, linked as they are still to past yields at least in the overall amounts. The difference of past yields between countries and regions means that from the point of view of the practices required, farms are paid very different levels of support for similar costs. Some farms may be over-compensated, some under-compensated.

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[6] Council Directive 80/68/EEC on the protection of groundwater against pollution caused by certain dangerous substances (OJ L 20, 26.1.1980).

To achieve a more measurable value added for cross compliance the payments should reflect the cost of implementation. While it is difficult to estimate the costs for each farmer, the costs of cross compliance obligations could have been estimated by region to allocate funds closer to needs. This would of course cause a geographical redistribution of CAP funding, a move that would clearly face strong resistance as it would affect the national redistribution of the funds. However, not improving the financial link between the objectives and their costs weakens the policy rationale.

Summarising, the EU standard of production and quality create costs to farmers, and those may need to be supported if certain farming structures are to subsist. However, the payments need to relate to those costs, as targeting of policies and cost efficiency are integral parts of generating value added. The net value added of the cross compliance obligations may be positive, but could certainly be improved. Opportunity costs could be reduced, and the present distribution based on historical yields abolished and replaced by a better cost base approach.

3.3. Other payment schemes, the biofuel case

The biofuel case is presented here as a special case due to its “modernity”. It addresses a modern concern, but again the mechanism, the stated objectives and actual impacts are not matching. There are opportunities to expand production of biomass and renewable energy sources. This would not only create new economic opportunities in rural regions, but would help Europe respect its greenhouse gas reduction targets under the Kyoto Protocol. Measures to develop renewable energy raw materials and processing capacity already operate under the CAP. One example is the aid of €45 per hectare available to farmers who produce energy crops.

Consequently, support to agro-fuels as an ‘infant industry’ could be justified. However, in the longer run, it is likely that the second generation will lead to the production of ethanol from a variety of crops.

The present support to the first generation of agro-fuels is hard to justify. Promoting agro-fuels as a way to reach energy independence makes little sense. In the most optimistic scenarios, domestic agro-fuels could replace only 1% of imported petroleum products. The environmental balance of agro-fuels is questionable and their positive externality does not seem to justify the current public support. While mandatory incorporation could be a way to have consumers fund the cost of the EU policy in member states that are willing to develop the use of agro-fuels, the support provided by the CAP is not particularly legitimate. It seems to offset some of the agri-environmental measures in some arable areas, by providing extra incentive to grow crops that participate to groundwater pollution. In the same way, energy crops on set-aside land offset some of the ecological benefits of set-aside (Agrienergy, 2007). The CO^2 generation in the production of bio-fuels is also claimed to offset a considerable share of the reductions generated.

Altogether, the agro-fuels policy as a way to transfer income to farmers is particularly ineffective. The cheapest opportunities of producing agro-fuels will soon meet a limit. The present level of bio-diesel already creates serious tensions on the market of rapeseed, and depresses the market of co-products (rapeseed cake), raising the break-even point. Effects on food prices across the world due to the biodiesel expansion are creating concern. Given that any extra production of agro-fuels competes with the utilization of land for food products, and hence increase the cost of producing agro-fuels, support to extra production will be dissipated mainly in production costs.

The second generation of biofuel crops could dramatically change the balance for these products. It has yet to become cost effective, which should take at least 10 to 15 years. However, budgets would perhaps be better used if allocated to research rather than to the promotion of the first generation of agro-fuels.

3.4. Conclusions on the value added of pillar I payments

For Direct support to generate a stronger value added for the EU the payment methods should be considerably revised. The funds aims have to be dissociated and funding directed to criteria based on the specific objectives. There cannot be one payment that covers income support and cross compliance, these are two very different functions.

One cannot just discard the need for support; some farming regions are in fact highly dependent on the direct payments. Figures on individual as well as national accounts show that most of the EU agriculture is not currently viable. Without subsidies, negative farm incomes are the rule in many sectors. The Single Farm Payment represents half of the operating surplus in Ireland, and the direct payments more than 100 percent of the net income of French beef producers. It is not possible however to ascertain is the dependence on direct payments is not caused by fiscal optimisation, i.e. the direct payments avoid necessary restructuring under pure market conditions.

It is also unclear what the future may bring, e.g. costs to climate change adaptation may be high. It is not possible for this paper to declare that abolishing support for the sector will generate value added: the benefits and costs of the process are unclear. However, it is not correct to support all farms in an imbalanced and regressive way weakly realated to the needs targeted. The value added of direct payments in the present form is more likely negative. Lost opportunities elsewhere and within the agricultural sector and rural areas are high.

Direct payments need to be restructured, not necessarily abolished. They may be to some extent WTO compliant, but not adapted to the EU situation of the rural areas and agricultural sector. One could envisage the division of the funds into clearer different functions. One group would be income support, based on a means testing of farm household incomes. The second group could be based on costs incurred due to high EU standards for farming practices. Both should be completely independent of historical yields and of course of production. Care should be taken to avoid overcompensation for implementing standards. Issue specific payments may be introduced or replaced as needs change, but multiple objectives should not be attributed to one payment. The final cost of the direct payments may or may not be lower. No income support should be available to farms with high farm household incomes, while for cross-compliance aid, only farms with a turnover under a certain level should be eligible.

Cross-compliance rules and support can be adapted to regional situations and should be flexible to address rising new challenges of modern agriculture, such as adaptation to climate change.

Along similar lines, Gonzalez Regidor (2005) proposes to change the direct payments following a ‘territorial approach’, i.e. based on the needs on the ground. He considers the need to differentiate direct payments and their allocation based on the typology of farms – ‘commercial’ or ‘territorial’ – and adapted to a typology of rural areas. The differentiation would cater for the multifunctionality of agriculture.

4. RURAL DEVELOPMENT

Rural development grew from an accompanying measure for the Common Agricultural Policy into a major instrument to support the environment, economy and cultural aspects of rural areas.

The rural development policy is becoming a credible tool for economic development in rural areas. Its rationale has been unfortunately affected by its origin of shifting funds from direct payments to rural development linking implicitly its national distribution to the geographical incidence of direct payments. It makes the widening of the scope of rural development beyond agriculture complex. Buckwell and Armstrong-Brown (2004) discuss the gap between rhetoric, needs and the financial distribution.

The rural development policy can be considered in line with the convergence policies and sustainable growth. Its reach and influence have been increased in the latest reform Council Regulation (EC) No 1698/2005, which came into force in January 2007. It is too early to assess the influence of the new regulation, but most measures of the previous policy have been retained. The reform has introduced wider objectives rather than changed existing measures. The rural development policy has a large number of measures that can be subdivided into 4 axes:

1. Improving the competitiveness of the agricultural and forestry sector
2. Improving the environment and the countryside
3. The quality of life and diversification of the rural economy
4. Leader

The first objective absorbs the largest part of the funds; the second and third are targeting mainly farm and farming related environmental and countryside stewardship problems. Leader is an only holistic territorial approach involving all economic sectors of rural areas, but is still at its infancy and attracts still a fraction of the funding.

4.1. The nature of rural areas and territorial targeting of the rural development policy

Rural areas in the EU are very varied and it is difficult to find one specific feature that can characterise them all. There is de facto no clear description of what constitutes a rural area in the EU and neither the old nor the new rural development policy determines it. To describe rural areas, the European Commission generally uses the OECD definition which categorises the rural areas as follows:

• Predominantly rural regions: Over 50 % of the population lives in rural communities;

- Significantly rural regions: between 15 to 50 % of the population lives in rural communities;

- Predominantly urban regions: legs than 15 % of the population living in rural communities.

When presenting rural development problems in the EU, the situation of predominantly rural areas has often been used as an example and rationale for action. However, as there is no definition at the level of the regulation, the measures are available wherever there is farming activity. This can be in areas which are de-facto urban in nature. Good targeting of policies is nevertheless important for value added considerations.

It is generally believed that the rural areas are predominantly agricultural, poor and are losing population, which can give an explanation for the very frequent view that rural development support should be directed to agriculture. The features of rural areas, however, appear to be rather different. While agriculture plays a very important role as predominant land user, it has declined significantly for the economy and employment. In fact, even in the predominantly rural areas employment in agriculture is only 13 % with both industry and services being more important. This is acknowledged by the Extended Impact Assessment of the European Commission (COM(2004) 490 final, p.4) performed as part of the presentation of the new rural development regulation, and a reasoning for the creation and now full integration into the rural development policy of the Leader programmes. The opening of funds for micro enterprises not linked to agriculture is also a reflection of this acknowledgement.

According to the OECD (1996, 2001), the distribution of new employment opportunities in industrialised countries has not been correlated to the degree of urbanisation since the eighties. The rates of increase in services and industry for the 80s have been higher in rural areas than in urban areas.

Rural regions are also often successful economically. Many areas have experienced income and population growth due to increases in employment opportunities in non-agricultural activities. Services and the development of industrial activities have often been a crucial element for these areas, more than the maintenance of agricultural activities. The OECD (2003a) has examples of rural areas which have done very well and even better than urban regions (e.g. Siena region (Italy) or Tirol (Austria)). The OECD attributes the main difference between lagging and leading regions to the level of infrastructures available.

The economy of rural areas is no longer predominantly agricultural and their assumed poverty and population problems cannot be generalised either. However, the Extended Impact Assessment of the Commission does not acknowledge this sufficiently. The impact assessment and the regulations return to the description of rural areas as remote and depopulated. It subtly mixes the undoubtedly very important role of agriculture as land manager with its position as economic engine for rural areas. They also reiterate that rural development cannot be dissociated from its role as 2nd pillar of the CAP.

A Commission's own working document on Rural Development (1997) shows that a higher number of rural regions presented an increase in population rather than a fall between 1981 and 1991 in predominantly and in significantly rural areas. The new rural development regulation pays little attention to this factor. Also Terluin and Post (1999) confirmed that population in rural areas has increased more in the 'leading' rural regions[7] than in mostly urban centres between 1980 and 1993 and the trend has continued in the wealthier EU member states (OECD, 2006). The OECD claims that most successful strategy is an amenity-based development and the creation of an 'urbanised countryside', a countryside that despite low population density offers services at a similar level as in urbanised areas, allowing numerous entrepreneurial activities.

Thus, there is a possible problem presently in generating the best value added in rural regions through this policy. The role of the rural development policy as a 'nearly' stand alone sub-heading in the budget is still not completely defined. Eligibility criteria for funds are not refined depending on the objectives. There is also still a certain level of confusion between the role of rural development funds and structural funds in regions where they coincide.

4.2. Distribution of support to territorial objectives

Table 1 shows the distribution of rural development funds by objective in 2003. Very few funds can be considered as targeting territorial development. Some improvements will occur with the new regulations for rural development, but these demand still only a minimum of 10% of the funds to be directed to holistic non-farm oriented rural development actions. This is an important change, but still a modest one.

The agricultural sector still plays a very important role in the rural areas, undoubtedly as land manager. Its socio-economic situation has also to be taken into account when devising rural policies. However, a fully fledged rural development policy should concentrate on all social goods, such as environmental protection, and as investment funds to develop economic activities in lagging rural areas.

This is just a reflection of the origin of the rural development policy strongly linked to the need to fit farm support into the WTO compliant green box and a tax payer acceptable support for farming. Thus initially it kept the distribution among beneficiaries close to the direct payment distribution. However, as mentioned earlier, rural development comprises many needs and economic sectors and soon the substitution of direct payments by an equivalent increase in rural development support has been challenged. If the aim is to generate value added, financing agricultural practices which have been followed anyway or are mandatory is highly questionable.

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[7] These are regions which show higher employment growth

Table 1. Funds distribution by function in 2003, EU-15

Function	**EU funds (mio €)**	**% share**	**Total public expenditure**	**% share**
Sectoral agriculture	4084	89,22	8929	88,01
Territoral, semi-sectoral and forstry	494	10,79	1158	11,98
Territorial and forestry	*568*	*12,42*	*119*	*11,73*
Territorial only	*314*	*6,86*	*346*	*7,71*
Total	4578	100	10746	100

Source: European Commission (2006), breakdown in the annex.

This link to agriculture is also responsible for the limits imposed on the distribution of rural development support, which in fact require the share of rural development funds modulated from direct payments to remain largely in the region they originate (80%). As a consequence, funds will still fall on the areas with the most productive farms, which are mainly the richest regions. This is likely to cause rising tensions in the future budget negotiations, as modulated funds from direct payments in considerably wealthier regions of the EU are several times higher than in the poorest rural areas of the EU.

Finally, apart from the distributional problems, there is a clear limitation. It is difficult to conceive to create a rural development budget comparable in size to the CAP or the cohesion funds. Furthermore, the co-financing needs for rural development are already a serious problem. This calls for a hard rethinking of the role of direct support and rural development, if value added of the interventions for the EU is be maximised.

The future allocation of rural development could be dominated strongly by net balances of the overall EU budget, which has fundamentally affected budget allocations in general. Maximising value added of the policy and improving its functioning can only be achieved if such non policy specific considerations can be isolated.

It is important that areas which had lower agricultural yields decades before, are not penalised with lower rural development funds. Those low yielding regions are on average the poorest and often located in the new member states.

To maximise the value of expenditure and policy rationale for direct support or rural development, the redistribution of support between countries, regions, rural areas and farmers should be possible.

4.3. Evaluating the Rural Development Measures

The rural development policy offers a large number of measures. This section is not going to evaluate each and every one of them, but discuss the performance of the main measures. This analysis draws from a variety of sources, but draws heavily on the full evaluation of the specific contribution of measures by the mid term evaluations for rural development of the 2000-2006 programmes performed by Agra CEAS consultants (2005a and b) for the Commission. One of the important points which the documents reveal is that the quality of evaluations nationally is very variable, making it difficult to reach conclusions. The new guidelines for this financial perspective period have been improved in the common monitoring and evaluation framework[8] and this should also allow for better policy decision-making in the future.

4.3.1. Improving the competitiveness of the agricultural and forestry sector

Investments in agricultural holdings

These measures aim at increasing productivity and quality through restructuring and can therefore be useful, especially in the new member states where labour productivity is very low. New measures targeting the improvement of food quality standards are important for the new member states and continue the measures that were used under SAPARD.

The mid term evaluation of the measures comes to the conclusion that there are indications that the measures have had positive impacts in labour productivity and their profitability. Unfortunately, and particularly for guidance funds, many countries were unable to assess the impacts of the measures. Nevertheless, the results are encouraging in having preserved employment and having improved the quality of farms in relation to animal welfare, working conditions, environmental impacts and quality.

The evaluation was unable to ascertain if there have been deadweight loses, i.e. if the farms would have invested in the absence of the support. In some regions under Objective 1 (guidance), the investments seem to have had a considerable impact on incomes (e.g. Greece and Italian regions). However, the investments are not a panacea, and in areas were certain farm sectors are in crisis, investments do not seem to have resulted in noted improvements in farm performance. This may be an indication that investments are not always undertaken to efficiently restructure where needed, and that investments to increase efficiency for certain products may not bring a solution to the farm. In many cases, however, it was noted that investments start with a negative impact in incomes, due to the farm investment costs associated and that positive results take a few years to materialise.

The reports mention the inability to ascertain deadweight costs, the availability of support across the sector in all regions indicate that there is a considerable probability that the assistance is offered to farms where it is not needed or where other financial mechanisms are available, in particular for well performing farms in wealthier areas. The existence or not of a private financial market is ignored by the measure. Substitution of private financial markets should be avoided when possible to ensure that additionality is higher, and intervention may not be addressing a market failure. The

[8] http://ec.europa.eu/agriculture/rurdev/eval/index_en.htm

value added of such an intervention is then lost. There is a need to reconsider if this measure should not have an element of territorial targeting, i.e. concentrate in less prosperous areas.

Improving processing and marketing of agricultural products

This measure is designed to improve the competitiveness and added value of agricultural products. The support requires that investments go beyond improving the competitiveness of the products, but should be in line with the need to improve the situation in the sector and of the suppliers. The mid-term synthesis evaluation by Agra CEAS does provide evidence that on balance the effects have been positive, but for some countries impacts were inconclusive, mainly due to possible deadweight costs. Support may not have been necessary. The evaluation, however, notes that for smaller enterprises the support was important and would not have been possible without the support.

Investments in rationalising processing procedures and marketing channels are considered to have improved the competitiveness of the agricultural sector. It has also helped in the differentiation of products and assisted in the needed processing channels for organic products, which complements the agri-environmental measure in this respect.

The weakness of the programme is the lack of targeting, and the evaluation pinpoints that while some beneficiaries clearly benefited from the support, for others it paid for investments that would have been undertaken anyway.

Early retirement and support for young farmers

The new regulation retains the early retirement and support for young farmers' schemes. These aim to accelerate the restructuring of the farming sector and to reduce the rate of ageing of the farming community. The few evaluations performed on these interventions are discouraging. A study for Northern Ireland (Caskie et al., 2003) reveals that most farmers ready to join the early retirement scheme are those who were soon going to transfer the farm to their descendant. In another of the few evaluations available Zografia (2007) confirms these findings in a study of Greece, Ireland and France. According to this evaluator, after reviewing the literature on the parameters which determine farm transfer it concludes that financial incentives of this kind will unlikely affect farm transfer or retirement decisions. Retirement behaviour appears also to be determined by regional traditions and not farm structures. The Agra CEAS evaluations seem to reach a similar conclusion, unable to show important impacts either for Objective 1 areas or other areas. Early retirement support seems to affect farm structures little. Thus, no significant structural change occurs, not in a substantial time lag in any case, deadweight losses of the measures risk being considerable. Farmers who do not have descendants are not interested in joining the scheme to avoid losing the land.

Actual compliance of the term of early retirement is difficult to monitor. It is traditional in many family farms to transfer the land officially to younger generations at retirement age, but the retired farmer may well continue fully or partially active in the farming activity, and land may be transferred to a family member who is already working in the farm. Thus even when there is an effect on the time of the transfer effects may be very low. Nevertheless, the scheme may be more successful in the new member states, as the payments are considerably more generous than national retirement schemes. It may induce older farmers without descendants to effectively sell the farm off. It is too early to determine this as no conclusive evaluations have been performed yet. For the EU 15 however, the value added of the schemes seems faint, offering a financial grant to existing behaviour.

Results of the support for young farmers are few. This support is supposed to be used in coordination with early retirement scheme, but they only coincide in four countries in the EU 15. The evaluations, however, consider that in Spain it was important to safeguard employment, even if causality is not fully clear.

Training

Training is very important and skills acquisition a pillar for productivity growth. It is a central tool to improve employment opportunities in rural areas, particularly in the new member states. The training measure provided by the rural development programme is mainly directed to assist in the implementation of other measures for rural development according to the Agra CEAS synthesis of evaluations. Unfortunately, there are very few evaluations and data on the uptake of the measure is apparently only recorded for the guarantee section, which excludes the objective 1 regions. The evaluation shows some positive benefits, but evidence seems scant or ambiguous.

However, training is crucial in rural areas, but not in the restrictive scope of the measure. There is a need to foster alternative employment in general in rural areas, while it remains restricted to agriculture and farm related skills. It thus excluded non-farming rural inhabitants, who have difficult access to other support. Structural operations often do not include small towns and villages, which fall under the rural policy programme, but not under the structural funds, even in convergence regions.[9]

The new regulation expands the scope. The slight difference in the wording of the vocational training measure allows for learning of innovative practices, which could allow the acquisition of cross-sectoral skills such as IT or skills responding to labour market demand more amply. However, the measure is still oriented towards farmers, while other groups in rural areas would also benefit from employment oriented training. Skills in IT, to generate new market opportunities are not only needed in farms in many rural areas.

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[9] In some countries, small towns and villages which can benefit from rural development funds are excluded from structural fund operations. De facto creating unequal treatment between EU citizens.

4.3.2. Improving the environment and the countryside

The objective of this group of measures is to preserve the landscape of the rural areas and their environmental quality. The two main instruments of the EU are the Less Favoured Area (LFA) payments and agri-environmental actions.

Support for Less Favoured Areas

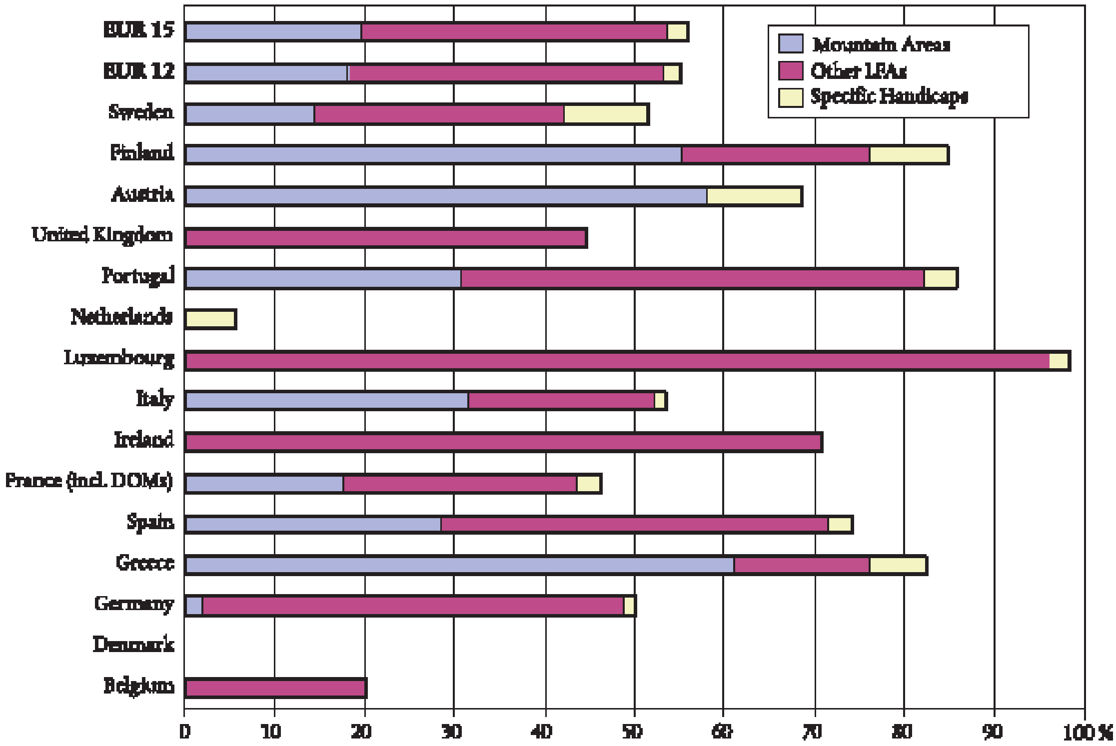
LFA support is considered as an environmental and cultural conservation programme. It provides support payments which are loosely linked to actual farming conditions and costs. The environmental component of the LFA payments absorbs less than 1% of rural development funds while the remaining LFA payments reach a 21% share.

The most problematic aspect of the LFA is the very high flexibility in the determination of beneficiary areas and the lack of appropriate justification and monitoring of the support. The Court of Auditors (2003) has criticised the LFA payments severely, exactly because it is not possible to understand the value added of such actions.

LFAs are areas either in mountainous regions (high altitude, steeply sloped regions or areas over the 62° and thus climatically cold regions) and areas where land faces abandonment in which agriculture is important, culturally, socially or economically. The environmental payments are targeted to areas, where due to environmental problems farming faces additional costs.

Figure 2 presents the proportion of the different LFA measures applied on the total UAA (Utilised Agricultural Area) and Figure 3 maps the distribution of LFAs at NUT 3 level during the 2000 to 2006 programming period. The area covers a substantial share of the EU's agricultural land, which indicates that eligibility criteria are most likely weak. Support is granted to 55.8 % of all agricultural holdings. Noticeable and pinpointed by the Court of Auditors, 98 % of the agricultural land of Luxembourg was considered as LFA, most of it under the socio-economic and cultural category. There are thus indications on a lack of targeting. The Court complains that member states have not provided appropriate justification for the aid, nor have monitored the impact.

Figure 2. LFAs as a proportion of total UAA per member state

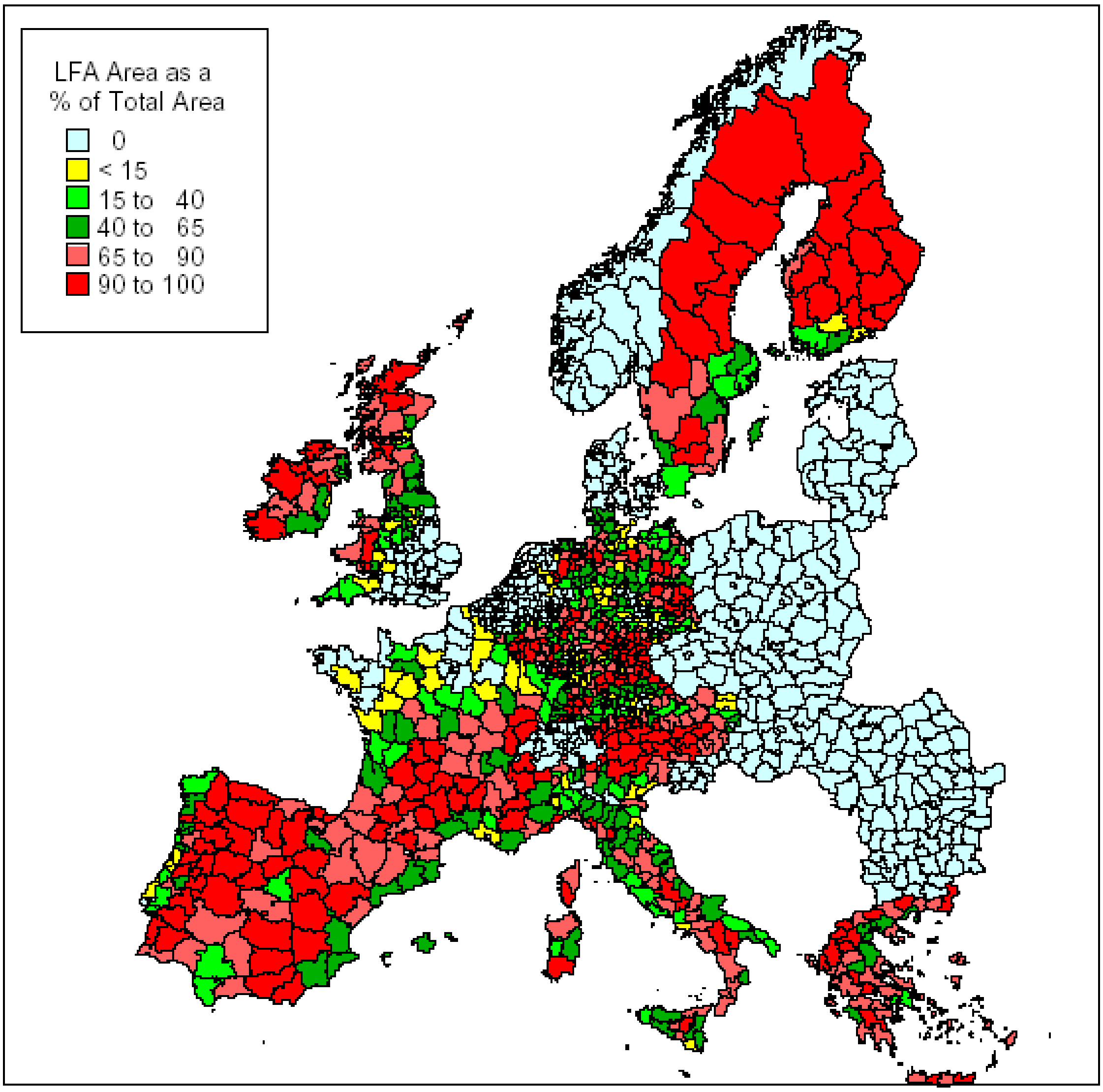


Source: Court of Auditors (2003)

The support has probably been suffering from a high deadweight cost (Núñez Ferrer, 2004). Even for mountainous areas, there is no strong rationale for automatic public support, particularly in those areas which are wealthy major tourist centres and may have high levels of off farm incomes. There is also no sufficient consideration of the need to maximise land use efficiency and to question the need and opportunity costs of certain production structures in LFAs which may have originated due to subsidies (e.g. CAP) in the first place and may even be environmentally undesirable.

Despite the imbedded socio-economic objectives of supporting less favoured areas, the consistency of the support with cohesion objectives is poor. ESPON (2004) indicates that LFA payments are not more intensive in areas with lower GDP level or higher unemployment.

Figure 3. Distribution of LFA areas in the EU



Source: ESPON (2003)

The mid term evaluation for LFA support for the 2000 to 2006 programming period (IEEP, 2006) has a more positive view of the policy as it considers that it has reduced the abandonment of agricultural land. It nevertheless finds effectiveness suboptimal and variations in support between regions unrelated to needs. LFA payments seem to fail to place resources in the areas were public goods are most apparent and the hazards of land abandonment are the highest.

The LFA area distribution seems “political” rather than needs based in nature, and the flat rate nature of payments may have created an element of over-compensation in areas where disadvantages compared to non-LFAs were minimal, and one of under-compensation in the most severely disadvantaged regions. The ESPON and IEEP studies nevertheless suggests that in some countries the LFA payments helped to retain some low income cattle and sheep production in marginal areas, but this does not provide sufficient grounds for continuing the policy unchallenged. In apparent contradiction to many claims that the policy helps small farmers, the average size of farms benefiting from LFA payments in non-mountainous areas is larger than the average. Impacts of measures are also not properly evaluated and there is a high risk of overcompensation to farmers.

In response to the Court of Auditors and the weak justification for the support, the Commission proposed important changes. The first was that the use of LFA for specific handicaps other than those caused by geographical and soil features (altitude, very low fertility) was to be limited territorially to 10% of the area of the member state. The vaguely defined LFAs for socio-cultural reasons (depopulation risks, etc.) were removed form the proposed regulation. Unfortunately, the Council decided not to touch the eligibility criteria for LFAs. The Council agreed nevertheless to review this measure in 2008 with a view to reform it in 2010.

Agri-environmental measures

ESPON (2004) considers the agri-environmental schemes overall positive for the environment and cohesion. In 2002 some 20% of the Utilised Agricultural Area was enrolled under agri-environmental schemes. Evaluations on the impacts, however, have not been performed to the standards the guidelines the Commission requires, making an assessment difficult. Many assessments lack quantification (Agra CEAS, 2007b). Some agri-environmental schemes also require years to generate a clear impact, which makes evaluations difficult.

Some schemes have been very successful in their uptake. The agri-environmental Öpul in Austria has been adopted by 78% of farmers and is a model case (see Darnhofer and Schneeberger, 2007) where the agri-environmental programme is used for the 'ecologicalisation' of agriculture rather than focusing on environmentally sensitive areas. The problem with the Austrian approach is the reported financing of by and large existing farming practices, thus generating overcompensation and deadweight costs. This programme also seems to have undermined measures for organic farmers (Lampkin et al., 1999).

Generally, the European Commission (2005) is rather positive of the impacts on pollution levels and biodiversity preservation. It considers, however, that the uptake of several measures is too low in some areas to create and effect. For water conservation, the results have been disappointing.

Agri-environmental measures receive in general favourable evaluations, but still questions remain on the lack of targeting of actual environmental needs in specific areas. The cost base approach is weak and the payments are at times accused of being offered to farmers who by tradition follow practices in line with those standards. Thus, farmers can de facto be compensated for costs they never incurred, losses they never had and paid an incentive they never required. The payments have been credited as operating as an indirect income support policy. It is a political matter if the payment is for costs incurred (which is the official line of the policy) or for practices adopted, regardless of costs. The payments are also permanent, for as long as the agri-environmental method of production is maintained. This creates a situation of possible overcompensation.

4.3.3. The quality of life and diversification of the rural economy

The group of measures aiming at the quality of life and diversification of the rural economy are the most crucial for the development of the rural areas, but interventions are quite limited and have attracted only a fraction of the rural development funds. One measure targets the economic diversification of rural areas, by supporting farm diversification, tourism development and encouraging business development. The following measures target the general living conditions of rural areas, one for rural services and infrastructure and one for village renovation. Other two measures are related to training and skills development.

The measures for the economic diversification of rural areas are still very restricted. They concentrate mainly on activities close to agriculture to provide multiple activities or alternative incomes. Those can be used for marketing purposes of new or non-mainstream crops or livestock products, or the conversion of agricultural buildings to new non-agricultural uses and non-farming activities on the farm. The new rural development regulation also encompasses measures for the development of other economic activities by other rural actors, but it is limited to micro enterprises. This is partly due to the complications to delimit competences between the rural development funds and structural funds. However, under a tender procedure there is a likely bias against applications from remote rural areas for structural fund support. These projects are likely to be less successful than applications from urban areas. The support is still too restrictive and does not fit a holistic approach to development.

The encouragement of tourist activities have been widened compared to the past, it no longer focuses exclusively on farm tourism, which is a very welcome adaptation. Evidence by the mid-term evaluation of the 200-2006 programme indicates that tourism related activities have had the largest impacts on rural incomes and also farm incomes. Impacts in general have been limited, due to the small scale of projects.

4.4. Leader

The leader pilot programme of the EU has been included as a 4th axis in the new rural development regulation. The Leader approach was introduced as a pilot programme in 1991 and has been growing in significance ever since. It approach is multisectoral, in which territorial association create programmes of rural development. The particularity of this programme is its holistic nature, differentiating it from other rural development measures, which are concentrated on the agricultural sector alone.

Given its holistic participatory approach, it is more in line with the overall needs for rural development. The approach is territorial and not sectoral, emphasising partnership in a bottom up approach. The ESPON (2004) evaluation praises the successes of the programme.

According to the latest evaluation the Leader programmes have been successful (ÖIR, 2006). Contrary to the more single farm specific project system for other rural development measures, Leader is based on a strategy based on the endogenous growth potential of the areas it is adopted. Farm and non farm investments are combined to develop the most promising sectors of the area. The Community aspect of its projects has wider effect on the rural areas as it encourages and motivates further actions beyond those in the plan.

One of the main results of the programme has been to pinpoint the elements which are necessary for fostering endogenous growth. Leader programmes are not easy but generate innovative strategies to development. It can be widened to encourage cooperation between the rural areas or between rural and urban areas.

Its strategy based approach has a higher chance to generate lasting improvements compared to a sectorally based policy. The leader programmes are attributed considerable increases in employment. The policy is still in its infancy and the coordination with other rural development policies need reinforcing. Funding and the integration of Leader into mainstream rural development is very weak. Also the coordination between the main rural development measures and Leader measures still weak.

4.5. Increasing the value added for the rural development programme

The rural development programme aims at protecting the rural areas and developing their economies. Successes with considerable value added can be found in the agri-environmental programmes and in the Leader programmes, with more mixed results for other measures. Funds to reach EU standards are important, especially in the new member states, where standards are still bellow the necessary levels. The rural development programme is also developing into an interesting instrument to help the rural areas find their endogenous growth potential.

Academic research and work by the OECD (1996, 2001, 2003 and 2006; Saraceno, 2003) indicate that a successful rural development policy aimed at the encouraging the endogenous economic potential of rural areas cannot be achieved through a sectoral approach. Most studies consider that rural development is better achieved by holistic actions targeting all activities in the rural economy. Even in the most rural of all regions of the EU, employment in agriculture does not match employment in services and industry. The decline in the rural areas is generally attributed by the aforementioned studies to the decline of infrastructure quality and services in rural areas, not farming.

As funding is limited, increasing holistic approaches can only be done by reforming the direct payments distribution and transferring more funds to rural development and/or by changing the existing financial allocation within the axes of the rural development policy. An increase in importance of the leader approach and more measures to increase the overall human capital of the rural areas would increase the value added.

For specific measures, value added generation is hampered by the lack of better targeting of areas or specific groups in need. To increase the value added potential of the policy, fund design should correspond more to the objectives and the target groups. Needed reforms for the LFA policies are an important case. Weak output obligations and lack of clear controls, means that their effect is sometimes reduced to a pure financial transfer with little value added, while opportunity costs are high.

Maximising value added requires to review eligibility criteria of the measures and see how to target specific areas and groups better. This means introducing clearer criteria and different ones for measures aiming at different groups. This means that while agri-environmental measures should be open to all farmers across the EU, other investments should concentrate more on specific territories and groups.

Protecting the environment, increasing the quality of food products, fostering the tourist value of the rural areas and developing their endogenous growth have a reasonable claim of generating a European value added. The mechanisms to do so have to be fine tuned.

5. CONCLUSIONS

The analysis presented in this paper does not give a magnitude of the value added from the CAP and rural development, for this would require specific studies of the impact of different interventions. Given the heterogeneity of the agricultural sector, the impacts are also location and problem-specific. Evaluations of the policies as performed today are still not rigorous enough to get such an answer.

Value added from public interventions is generated when a policy is devised efficiently to tackle market failures or to generate desired social goods, based on actual needs and avoiding unnecessary opportunity costs. Each public expenditure constitutes a loss of opportunities in other spheres.

Some aspects have to be improved considerably to be able to ensure an increase in quality of policies and their value added:

- Targeting of policies
- Widening the scope of intervention to non farm activities
- Evaluation quality

A review of the literature and an analysis of the policy structure reveal that many measures could be improved to increase their value added and that direct support is highly inefficient and detrimental in terms of efficiency and value added the way they are designed. For direct payments the reason is simple: the stated objectives and the policy design are unrelated. New aims and objectives have been added onto payments that are not devised to address them. Payments intensity and distribution are based on yields nearly two decades ago, routinely relabelled and with obligations added to them without any cost based approach. Benefits that may accrue from the policy are overshadowed by the over- or even under-compensation for costs incurred to implement the cross-compliance obligations. By being unrelated to objectives and uneven across areas, farmers (read EU citizens) are also treated unequally.

To the question of whether the CAP and the rural development policies generate the potentially highest value added in the areas in which they intervene, the answer is negative for the CAP direct payments, and variable for rural development, depending on the measure. For both the value added could be increased considerably by improving the rationale and targeting of support.

The question of whether the value added generated in terms of economic returns is sufficiently high in comparison to the opportunity costs, the answer is globally negative even if for specific measures it is not. A better devised policy could achieve the same results at a fraction of the costs, allowing for other important investments. For the same cost, the results could be much improved.

This paper does not challenge the EU's budget role or the multifunctionality of the agricultural sector and the need to support it. It questions the maintenance of a support system based on claimed objectives with instruments that are not designed to address them or that are too loosely targeted. The present and future problems of the agricultural sector and rural areas require serious attention and a policy able to respond to them.

The way forward is to link the support to the actual problems addressed, ending the remaining link of support to historical yields. CAP and rural development funds should be free to be redistributed according to modern needs of the sector and the rural areas, concentrating funds where needed. Payments should be targeted at specific objectives and based on costs of implementation. This means separating and the income support component from the basic cross compliance funds or other objectives, and basing payments on territorial and farm holding needs basis. If direct payments are used for income support, those should be devised as such, targeting farm households in financial difficulties and regularly reassessed. Payments for specific farming practices should have a better relation to the costs of those practices. It is also questionable if good farming practices which are statutory should be financed for farms with large turnovers.

Rural development policies are moving in the right direction, but targeting the endogenous growth potential of rural areas requires much more support to non agricultural activities. The redistribution of resources between the direct payments and rural development should be increased and the shares of funding between the 4 axes of the policy changed.

The new evaluation guidelines for rural development should improve policy decision-making in the future. The present quality of national evaluations is too variable.

It will not be possible to demonstrate unequivocally that the agriculture and rural development expenditures today and in future do or do not generate a European value added superior to some policy alternatives or vice versa. Much will be based on social values and circumstances of the moment. Nevertheless, it is clear that the policy is very inefficient in achieving its objectives, thus to maintain the support Europe's agriculture and the rural areas. The measures should be better targeted to the very real challenges that exist in the food sector and rural areas and redeploy the existing means efficiently.

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Annex. Financial allocation of rural development funds by measure in 2003

Title	Measures	Function	EU funds (000) / share		Total public(000)/ share	
Investment in Agricultural Holdings	General investments	Sectoral – agriculture	308008	6.73%	936304	9.23%
Setting up of Young farmers	Setting-up aid	Sectoral – agriculture	123466	2.70%	262755	2.59%
Training	Vocational training support	Sectoral – agriculture	27881	0.61%	68657	0.68%
Early Retirement	Pension income support	Sectoral – agriculture	69630	1.52%	186038	1.83%
Less Favoured Areas and Areas with Environmental Restrictions	Compensatory Payments for less-favoured areas	Sectoral – agriculture	947945	20.71%	2344320	23.11%
	Compensatory Payments for areas with Environmental restrictions	Sectoral – agriculture	3835	0.08%	7279	0.07%
Agri-environment	Support for environmentally friendly practices *and animal welfare*	Sectoral – agriculture	1761190	38.47%	3249440	32.03%
Breeds in danger of being lost to farming		Sectoral – agriculture	14545	0.32%	23147	0.23%
Improving processing and marketing of agricultural products	Investments to improve processing and marketing channels	Sectoral – agriculture	247337	5.40%	517992	5.11%
Forestry	Improve forest management	Territorial	153087	3.34%	379150	3.74%
	Afforestation of Agricultural land	Sectoral – agriculture	254430	5.56%	406977	4.01%
Promoting adaptation and development of rural areas	Land Improvement	Sectoral – agriculture	8043	0.18%	17310	0.17%
	Land reparcelling	Sectoral – agriculture	93072	2.03%	232906	2.30%
	Setting up of farm relief and farm management services	Sectoral – agriculture	5843	0.13%	13528	0.13%
	Marketing of quality agricultural products	Sectoral – agriculture	35667	0.78%	66818	0.66%
	Basic services for rural population	Territorial	65779	1.44%	128148	1.26%
	Renovation and development of Villages and protection and conservation of the rural heritage	Territorial	95461	2.09%	275565	2.72%
	Diversification of agricultural activities and activities close to agriculture to provide multiple activities or alternative incomes	Semi - sectoral – close to agriculture	61591	1.35%	163262	1.61%
	Agricultural water resources management	Sectoral – agriculture	74475	1.63%	245679	2.42%
	Development and improvement of infrastructure connected with the development of agriculture	Sectoral – agriculture	76096	1.66%	163923	1.62%
	Encouragement of tourist and craft activities	Semi-sectoral – close to agriculture	35176	0.77%	79826	0.79%
	Protection of the environment in connection with agriculture, forestry and landscape conservation as well as with the improvement of animal welfare	Semi-sectoral – agriculture	83042	1.81%	190162	1.87%
	Restoring agricultural production potential damaged by natural disasters and introducing appropriate prevention instruments	Sectoral – agriculture	31603	0.69%	185812	1.83%
	Financial engineering	Sectoral – agriculture	1309	0.03%	805	0.01%
		TOTAL	4578008		10146307	