

Towards a Common Agricultural and Rural Policy for Europe

Report of an Expert Group

**Convened by
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The present report is the result of a study carried out for the Directorate General of Agriculture of the European Commission by a group of experts from 9 countries of the European Union.

The Group, in total, contained expertise in agricultural economics and rural sociology, environmental economics and rural development, market analysis and political economy.

The report is published with authorization of the European Commission as a contribution to the ongoing debate on the future of the Common Agricultural Policy. It does not necessarily reflect the opinion of the Commission services and in no way prejudices the Commission's official position in this matter.

Participants of the Group of Experts

Allan Buckwell <i>Chairman</i>	Professor of Agricultural Economics, Wye College, University of London, UK, on secondment to the European Commission, DGVI/01, 11/95 to 07/96.
Jan Blom	Deputy Director, Agricultural Economics Research Institute LEI - DLO, the Hague, Netherlands.
Patrick Commins	Rural Sociologist, Rural Economy Centre, TEAGASC, Agricultural and Food Development Authority, Dublin, Ireland.
Bertrand Hervieu	Sociologue, Directeur de Recherche au CNRS, Fondation Nationale des Sciences Politiques, CEVIPOF, Paris, France.
Markus Hofreither	Professor of Economics, Universitaet fuer Bodenkultur, Wien, Austria.
Heino von Meyer	Environmental Economist, Independent Researcher/ Consultant, Hamburg, Germany.
Ewa Rabinowicz	Agricultural Economist, Department of Economics, Swedish University of Agricultural Science, Alnarp, Sweden.
Franco Sotte	Professor of Agricultural Economics and Politics, Dipartimento di Economia, Ancona, Italy.
José M Sumpsi Vîna	Professor of Agricultural Economics, Universidad Politecnica de Madrid, Espana.

This report is the collective work of the group. It was written in stages by Allan Buckwell over the period of the group's work and substantially moulded and commented upon by the whole group. Assistance from many colleagues too numerous to list is very gratefully acknowledged.

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Acronyms and abbreviations used

AMS	Aggregate Measure of Support
CAP	Common Agricultural Policy
CARPE	Common Agricultural and Rural Policy for Europe
CBA	Cost Benefit Analysis
CEECs	Central and Eastern European Countries
CEC	Commission of the European Communities
COPs	Cereal, Oilseed and Protein Crops
CMO	Common Market Organisation
CPCs	Crop Protection Chemicals
DGVI	Directorate General VI of the European Commission - Agriculture and Rural Development
EC	European Communities
ECLP	Environmental and Cultural Landscape Payments
ECU	European Currency Unit
EMU	Economic and Monetary Union
EU	European Union
FEOGA	Fonds Européen d'Orientation et de Garantie Agricole
GATT	General Agreement on Tariffs and Trade
LFA	Less Favoured Area
MS	Market Stabilisation
MGQ	Maximum Guaranteed Quantity
MTN	Multi-lateral Trade Negotiations
NGO	Non-Governmental Organisation
PPP	Polluter Pays Principle
RDI	Rural Development Incentives
TAA	Transitional Adjustment Assistance
URAA	Uruguay Round Agreement on Agriculture
WTO	World Trade Organisation

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PREFACE

Following the widespread debate on the implications for agricultural policy of enlargement to the east, by the autumn of 1995, two things had become clear. First, that the post-MacSharry Common Agricultural Policy (CAP) would have to evolve further as economic and political circumstances changed and, second, that the nature of this evolution should be further in the direction started by the 1992 reforms. The challenge would be to reconcile the dual approaches of improving the competitiveness of EU agriculture (on world markets) with the growing move towards a coherent, integrated and sustainable rural policy.

It was in this context that the Directorate-General for Agriculture of the European Commission invited me to bring together a group of experts who, through working together on an analysis of the inconsistencies and problems inherent in the existing CAP, would endeavour to define a series of principles and elements which could form the broad outline of a new integrated rural policy. The group of 9 assembled for this task between them shared a wide and varied expertise in agricultural and environmental economics, rural sociology, rural development, market analysis and political economy, and a direct knowledge of all the broad regions of the European Union. This report presents the results of our work.

The report starts with the diagnosis. Unless the problems of the CAP are well defined and agreed, it will prove very difficult to find acceptance for policy changes to resolve the problems. Successful diagnosis should take us a very long way towards prescribing the appropriate changes in policy, because the best treatment is usually clear once the problems are correctly identified. The report goes on to spell out the broad principles of a more integrated rural policy, aimed at tackling the identified problems. Some of the practical issues of implementing and financing the proposed policy are examined, as well as how it could apply to the enlarged EU expected early next century. It is stressed throughout that rural development and rural policy involve more than agriculture and agricultural policy alone.

This report is thus concerned with the contribution that could be made to integrated rural policy by a reformulated Common Agricultural and Rural Policy for Europe (abbreviated as CARPE in this report). It was felt necessary to concentrate on the general principles of a more integrated policy and not on the details of how to transform or adapt the existing Common Market Organisations and structural and environmental measures. This task could only be approached once the principles of the proposed new scheme had been widely discussed and agreed.

Allan Buckwell

SUMMARY

1¹ Introduction: Why the common agricultural policy has to continue to evolve

European society has developed to the extent where food expenditure accounts for less than one fifth of average household expenditure. Agriculture now contributes less than two percent of EU-15 gross domestic product and employs just over five percent of the work force. Social priorities for agriculture have therefore changed.

Four decades on from the Rome Treaty, EU food supplies are under no threat. European farmers and the food industry increasingly see a role in supplying food on a commercial basis to the high-growth parts of the world which have a poor land base - most Asia. It is well recognised that the temperate climate and fertile soils of Europe, farmed by a technically skilled and well educated farm work force, drawing on internationally competitive agricultural supply industries and serving the innovative food industries of Europe can be a major force in global food markets. Meanwhile, as the majority of farmers are pluri-active, earning incomes increasingly from non-agricultural sources, average farm household incomes in most Member States are on a par with non-rural incomes.

Society can therefore afford to become more concerned with the way its food is produced, the quality and variety of that food, the environmental effects of food production systems and the balanced development of rural areas. Agricultural policy must adjust to these new social priorities and channel much more of its attention to the twin challenge of international competitiveness and environmental awareness. These objectives are not necessarily in contradiction. Policy change can be envisaged which can release European farmers from the constraints of supply management to discharge their core function of supplying food, and also direct land managers to achieve environmental goals and rural development.

This report summarises the work of a group set up to explore how this more market orientated and integrated rural policy could be achieved. The origins of the working group and the report followed work done in the Commission to consider the agricultural implications of the further enlargement of the EU to embrace the ten associated Central and Eastern Europe Countries (CEECs). The Commission's 1995 Agricultural Strategy Paper concluded that further changes in the CAP are necessary. The explanation of this conclusion is therefore given first.

¹ The section numbers of the summary mirror those of the main report.

However, it would be a gross error to think that the challenge of enlargement is the only, or even the most important, reason for considering further changes in the CAP. Many agricultural, consumer and rural interest groups consider that the post-MacSharry CAP has still not achieved the correct balance of operational objectives and instruments. In particular, the increased focus on farmers' role as guardians of the landscape and nature, the desire to switch emphasis from quantity to quality and to better integrate agriculture in the rural economy are inexorably pushing the CAP away from being a sectoral policy for agriculture to become part of a set of territorial policies for rural areas. These are the recurring themes throughout the report.

2 The challenge for the EU of Eastern enlargement

From the perspective of the economic interests of the CEECs, the present CAP is unsuitable with its relatively high prices, its cumbersome and distortive supply management and inappropriate compensation payments. Furthermore, if these judgements are ignored and the CEECs are invited to adopt the CAP in more-or-less its present form, there is clear potential for increasing the EU net surpluses at the current price and support levels. To avoid the problems of surplus disposal in a world committed to eliminating export subsidies, this would have to be met by the application in the CEECs of strict supply control. If this is the approach adopted, it will be difficult to persuade the potential new Member States that it is not in their interests to boost their production of cereals, oilseeds, sugar, beef, sheep and milk as soon as possible to ensure they negotiate their 'quotas' from the highest possible base.

There is a real problem of credibility here. Unless prospective EU Member States can see tangible evidence that the CAP is changing prior to their accession, why should they plan on any other strategy than to capitalise on the market support systems the EU has created for itself? These arguments point to the necessity of further reform of the CAP towards a more market-oriented agricultural system, which will simultaneously reduce the consumer burden and eliminate the need for export subsidies and supply management.

At the same time there is a big challenge in the CEECs to accelerate their own agricultural restructuring and to create competition in their food processing and distribution sectors. This would spur the improvement of standards and efficiency in those sectors. It is also clear that CEEC agriculture has a great deal more adjustment to make in improving labour productivity. This will inevitably involve a further, and perhaps quite large, outflow of labour from the primary sector. It may well be more cost effective to help stimulate rural activity and employment than to deal with the problems of large numbers of disaffected, unemployed people migrating to towns. This points to the necessity for comprehensive rural development actions in these areas. It is also the case that there are significant environmental improvements required in CEEC rural areas. Some have suffered serious industrial pollution which creates a backlog to be cleared, and large-scale collectivised agriculture itself left a legacy of environmental damage to be dealt with. It turns out that there is no contradiction between the

needs of both the CEECs and the present Member States for a new emphasis in agricultural and rural policy.

3 Domestic dissatisfaction with the CAP

3.1 Farmers

Farmers do not have a single, uniform view. In the mid 1990s many are enjoying a period of prosperity, but others still struggle with their poor resource base in difficult conditions. Three concerns with the CAP since the 1992 reform are: nervousness about the uncertainties surrounding the compensation payments to arable and livestock farmers; the constraints imposed by supply management; and a continuing frustration with the complexity of the CAP. The compensation payments are vulnerable on five counts: their sheer visibility, justifying perennial payments for a once-off policy change, there is no relation between injury and compensation, they are not fully decoupled, and they continue to reward most those with the largest farms with most wealth. The response of some farmers' groups to this vulnerability has been to seek alternative ways of justifying the payments. One possibility is to refer to them as payments for stewardship of the countryside. If this is not part of an explicit and carefully thought-out environmental policy, it is a dangerous path which will satisfy no one.

3.2 Food Consumers

Food Consumers bear the burden of higher prices caused by the CAP although this rarely surfaces as a political issue. Of more concern to consumers is the perception that the CAP is a policy which has encouraged over-intensification of crop and animal production which has caused farmers to focus on quantity rather than quality. There is a suspicion that the incentive for greater and more intensive production is itself a threat to food integrity, and that if this is done at the expense of food safety, nature conservation and animal welfare, and all to produce surpluses of farm produce, it adds up to a strong case, at the very least, to eliminate the incentive to overproduce.

Budget costs have on a number of occasions been an important pressure for forcing reform of the CAP reflecting the general European concern that agricultural policy was absorbing a disproportionate share of EU resources. In the early days of the EC, the CAP was undoubtedly seen as a force for European integration and cohesion. As its appetite for budgetary funds grew, especially for the purpose of disposing of excess production, the political credibility of the CAP has been eroded. Now, in many if not most Member States, it is commonplace to find, outside farming interests, a ritual condemnation of the wastefulness of the CAP, its mal-distribution of benefits which accrue disproportionately to the wealthiest producers, and its alleged encouragement of over-intensive farming. These general criticisms take on added force as the political priority in the EU focuses on unemployment. It is difficult to defend why the EU should spend over half its budget, a sum of 45 BECU, on a group in

society, about 7 million farmers, who have jobs and often considerable assets, at the same time as about 11% of the EU workforce, or over 18.5 million people, are without jobs, or productive assets. This is reinforced in the run-up to the final stages of Economic and Monetary Union. Almost all Member States are finding it difficult to adhere to the Maastricht conditions, particularly concerning public deficit. This has translated in most Member States into searching examination of all public programmes to find ways of cutting expenditures to reduce deficits. In such circumstances, when cherished educational, health and social security programmes are under scrutiny and suffering cuts, it is difficult to argue that agricultural programmes should be exempt from this process.

3.3 Environment and cultural landscape

That there are environmental problems caused by agriculture is beyond dispute. There is a fundamental conflict between many systems of intensive crop and animal production and many aspects of the environment. In the post World War II rush to improve agricultural productivity much environmental damage was done. However, allocating responsibility to the CAP for observed environmental damage is difficult. As essentially the same technical developments have occurred in all the developed countries with similar environmental consequences, the rather different systems and intensity of farm supports which have been pursued cannot be the dominant explanatory factor. However, there is a *prima facie* case that the high price supports, the particular balance of supports between products and some of the structural support measures under the CAP have had damaging effects on the rural environment. The avoidable damage has mostly resulted from an over-expansion and over-intensification of agriculture. However, it is a mistake to assume that the CAP has only had negative environmental impacts. The schemes introduced on the basis of the Agri-environmental regulation (2078/92) and some environmental provisions in the Objective 1 and 5b structural measures, are playing a positive role in environmental protection. Also, it is claimed that the CAP enables continuation of production in some farming systems, which may not have survived under world market conditions, with important consequences for preserving treasured environmental and landscape features.

3.4 Incoherence and inconsistencies in the CAP

The CAP is an imbalanced policy. The imbalance at the broadest level is its gross over-dependence on the use of market policy at the expense of structural, environmental and rural development measures. The incoherence also shows up between elements of the policy: between structural policy and market policy, between market and environmental policy, and between structures and environmental policy. This is also evident within each of these three strands of policy. Many of the inconsistencies are the result of years of adding and elaborating measures to deal with successive problems encountered. Rarely have categories of instruments or regulations been removed altogether, almost always new regulations were

added to the existing ones. This is usually done in politically balanced packages of measures in which there are enough decision variables to allow differentiation and exceptions enabling each Member State to achieve some of their own interests. However, this political balance has been obtained at the cost of an extremely complicated and increasingly incoherent policy.

4. The movement to more liberalised trade

Under the Uruguay Round Agreement on Agriculture (URAA), the EU has made a comprehensive set of commitments on market access, domestic supports, export subsidies and sanitary and phytosanitary regulations, which are now a real constraint on policy choice. Apart from the undoubted significance of the specific commitments, the URAA is important because it marks an agreement by all contracting parties to WTO that they will work together progressively to reduce measures which restrict and distort agricultural trade. The incorporation of agriculture into the WTO is also significant, because it means that it will no longer in future be possible to overlook the Article 24 requirement that free trade areas must refer to 'substantially all trade' in the countries concerned. The EU is proliferating such preferential trade areas, for example with Turkey, the Mediterranean and South Africa. Sooner or later, a timetable will have to be set to permit access to the EU market of agricultural products from these regions. The strengthened dispute settlement procedures of the WTO make this more than an empty threat.

It is generally presumed that the CAP can survive for the duration of the URAA without major changes (although the collapse of the beef market in 1996 following the BSE scare in the UK necessitates earlier reform of that sector). However, in the next decade, even without Eastern Enlargement, but with the anticipated further reduction of import protection, domestic supports and allowable subsidised exports, further changes in the CAP will be necessary. The arable compensation payments which are clearly not decoupled from planting decisions may also come under fire. Even if these payments were to be completely decoupled from production it is argued they cannot last for more than a transitory period. Permanent transfers can only be justified if they are payments for some legitimate public good provision. The most obvious categories of such public goods and services are in the form of the rural environment, the cultural landscape and rural development. This turns the attention towards defining these public goods and ensuring that the payments do relate to their creation. A great deal of international attention will no doubt be focused in future on agri-environmental payments and indicators. The green box will have to be truly green.

The stiffest challenge from the WTO to the continuation of the current CAP is posed by the volume and value constraints on subsidised exports. The Union has only two options to avoid accumulating stocks which cannot be sold: either to accept that its days as a significant exporter of grains and dairy products are over, and to employ tighter supply constraints; or to reduce prices to international levels to avoid the need to subsidise exports. These problems are taken extremely seriously by the largest farmers in the export oriented Member States and

also by the European food industry. This industry foresees opportunities for food exports to the far East and simultaneously can see that the tightening constraints on subsidised exports constitutes a real threat to its ability to share in this market growth. If it cannot achieve the solution of removal of these constraints it will presumably seek to relocate food manufacturing and raw material sourcing outside the EU with consequential loss of employment in the Union.

5 Summary - of the reasons why the CAP must continue to evolve

The legitimacy of the CAP is in danger. Over the years the CAP was accepted by consumers and taxpayers because of the feeling that farmers were a deserving group in society who worked hard, ensured the security of our food supplies, produced in all weathers and looked after the countryside. However, gradually, memories of food shortages have been replaced by anxiety about food health scares; shortage has turned to surplus; farmers themselves have turned from peasants to entrepreneurs and 'pluri-active households' and in the process have often developed farming in a way which has damaged the rural environment. When agricultural productivity, food market stability and security were seen to be the major problems it made some sense to base agricultural policy around the common organisation of markets. These agricultural problems have largely been solved. The European Union has grown to be the world's largest industrial and services supplier with a free internal market. It has also developed into the world's largest player in international food markets. For a major agricultural exporter to arrange its domestic prices higher than its competitors is clearly unsustainable.

It is vital that potential new Member States understand these pressures for change in the CAP. It would be enormously disruptive for them to create expectations amongst their farmers that they will join a Union with the open-ended supports of the classic CAP of the 1980s. It has been argued that none of the three main elements of even the post-MacSharry CAP suit the CEECs. The high support prices for many commodities, the supply controls and the compensation payments should all be substantially modified either before enlargement or certainly before any transition period is over.

6 Objectives and principles of a Common Agricultural and Rural Policy for Europe, CARPE

6.1 Objectives

The objective of a Common Agricultural and Rural Policy for Europe is to ensure an economically efficient and environmentally sustainable agriculture and to stimulate the integrated development of the Union's rural areas.

Each of these three elements are based on European Treaties, Article 39 of the Rome Treaty, Article 130a of the Treaty of European Union (Maastricht).

The desired new policy should be more integrated in several dimensions. First, the three elements: efficient agriculture, environmental sustainability and rural development should be more equally balanced than in the past. In this way, agriculture will be less antagonistic and better integrated with the rural environment. Such a policy would also be freer to support local people - farmers and non-farmers as well as collectives like community organisations - to create sustainable economic activities in rural areas, rather than one which overemphasises a sectoral perspective. Second, the intention of the CARPE is also to remove many of the distortions and imbalances within agriculture which have over-stimulated some sectors at the expense of others and pushed farmers away from producing high quality, differentiated products. Third, it should enable European agriculture to be better integrated into the world food system from which it has insulated itself in the past.

The principles which should guide CARPE are *consistency* with general EU goals and *subsidiarity*. Its measures should be *targeted* and, where relevant, *decoupled* from agricultural production. The switch from CAP to CARPE should try to achieve a *simplification* of policy definition and implementation.

6.2 The main elements of CARPE

A policy which sets out to achieve the objectives defined above starting from the present CAP will require four elements:

- | | | |
|---|---|--------|
| 1 | Market stabilisation | (MS) |
| 2 | Environmental and Cultural Landscape Payments | (ECLP) |
| 3 | Rural Development Incentives | (RDI) |
| 4 | Transitional Adjustment Assistance | (TAA) |

Under the proposed policy, market price support through the CMOs is expected to shrink further as prices are reduced to world market levels. What is left of this policy is solely Market Stabilisation (MS). The present agri-environmental and structural policy components of CAP should be transformed respectively into Environmental and Cultural Landscape Payments (ECLPs) and Rural Development Incentives (RDIs). These elements could grow rapidly in importance and in their share of budgetary resources, signifying that much of the present market support can be re-channelled into one or other of these categories to reflect the real justification for support. The rate at which this can be achieved will depend greatly on the capacity of regions to define and defend legitimate targets for such supports. The other major change suggested is that the compensation payments introduced in the 1992 reform are transformed into Transitional Adjustment Assistance (TAA) and are gradually reduced as the remaining support switches increasingly to environmental payments and rural development.

The four new policy elements are described in progressively more detail. The first element, market stabilisation (MS), aims to provide a safety net for commodities subject to uncontrollable market fluctuations. The environmental and cultural landscape payments (ECLPs) are offered to protect against damage and depletion of rural resources and the cultural landscape of rural areas, and to encourage enhancement of these resources and the social fabric of rural areas. In principle, it should cover the whole territory. This proposal is made with a very important proviso. The aids are called payments not subsidies or transfers, because they are paid from the public purse to those who contract to supply public environmental services. They are payments for a service, not a charitable transfer. For this reason the service must be delivered or the payment will not be made. This means that the ECLPs have to be objectively defined and justified in relation to specified targets and must include built-in monitoring. The third element, the rural development incentives (RDI), is concerned with all aspects of rural development, including agricultural development, but whose emphasis is on stimulating opportunities for non-agricultural uses for farm resources and opportunities for resources released from agriculture. The fourth element, the transitional adjustment assistance (TAA), is to facilitate the transition from an agricultural to a rural policy.

The first three elements (MS, ECLP and RDI) can be expected to be enduring elements of policy. The last (TAA) as its name suggests should be a declining source of transfers. Whilst market stabilisation remains a sectorally and commodity defined element, the environmental and cultural landscape payments and the rural development incentives should be territorially defined and administered. Much discussion is required in deciding whether the transitional adjustment assistance should remain on an historic crop area and livestock headage basis or whether it should be related to individuals; farmers and other land managers.

The proposed policy does *not* offer direct income support to farmers. Rather it tries to encourage and enable people engaged in farming to earn decent incomes by supplying private and public goods, and by undertaking other economic activities in rural areas. Farm incomes will be enhanced in many ways. Those farmers in a position to do so, will be freed from the production constraints which prevent them producing for expanding world markets. Others will find that in the course of adapting their farming systems to supply the public Environmental and Cultural Landscape goods (in return for ECL payments), they may also be able to market their regionally differentiated, high quality products at premium prices. To do this, they may be assisted to improve their productivity and marketing. In addition, some farm resources - labour or land - may be used to earn income from non-agricultural rural activities (RDI). Finally, for a while at least, in order to bring about these changes in attitude and activity, farmers may benefit from transitional adjustment assistance (TAA).

7 The four elements of CARPE in more detail

It is proposed that the process started in the 1992 reform of significantly reducing institutional prices be continued. For the major arable crops, the 30% cut over the period 1993-95 has indeed closed the gap between EU and world wheat and barley prices. Having closed the gap in this way, action should be taken to ensure that it does not systematically re-open in the coming years. This means explicitly linking intervention prices to the international price. It should also be accompanied by eliminating set-aside, and reducing import tariffs. Given current expectations for grain markets, it is possible that these actions could be taken without too much pain. The real test is whether the same approach will be used for the milk, beef and sugar sectors. Approximately the same orders of magnitude of institutional price change will be required for milk as was implemented for cereals in '92, viz. a thirty percent price cut, a somewhat smaller institutional price cut would be required for beef and a larger one for sugar. To ensure a balanced overall policy, it is furthermore assumed that the reform of the fruit and vegetable regime, which are indeed broadly in line with the philosophy of these proposals, are agreed and implemented. This leaves several other sectors, wine, olive oil, tobacco and cotton to receive comparable treatment.

7.1 Market stabilisation (MS)

These moves will open up the EU markets to greater instability than in the past. It is argued that agriculture has a unique combination of characteristics which justify some public support to manage the risks it faces. Whilst there are many actions farmers can and should take to manage these risks, there is a role for public assistance too. European society would not accept a dramatic shortage of basic foodstuffs and thus extremely high prices, and equally if a sudden market collapse caused widespread farmer bankruptcies (which would of course spread beyond farming). In the poorer parts of the EU, and in prospective new Member States where food expenditure is often a third or more of total expenditure there can also be a macroeconomic concern about the effects of surges in food prices. Thus, some publicly assisted stabilisation measures are justified.

The three general approaches available are, short term market management using domestic intervention purchasing and border measures, medium term supply management, and revenue or income insurance schemes. From the EU perspective there is a strong presumption in favour of the first two approaches. The Union has the instruments and a great deal of experience in using them. However, if it is decided to continue with these tried and tested instruments, it is vitally important that there are built-in safeguards to ensure that stabilisation will not slip again into systematic support and protection. An answer is to amend regulations so that the price stabilisation objectives are clear, and also to redefine the intervention prices in clear relation to world prices. For example, the single grains intervention price could be a fixed proportion of the moving average of the international price for grains. The intention should be that market intervention is an exceptional event, taking place only rarely to limit the

worst falls in price. Border measures can also play a part in domestic stabilisation. It was agreed in the Uruguay Round that countries may defend their domestic markets against sudden surges of imports or collapse in import prices by the use of safeguards, i.e. higher tariffs, in well defined ways. This is therefore an internationally agreed tool of market price stabilisation.

Despite the attractions of the insurance approach, it is not used as a central part of policy in any country. Where it is used it is confined to the producers of the major field crops and is not a general facility available to all farmers. Its applicability to EU conditions should not be ruled out, but this requires further study. The longer term question of international market instability, global food security and stocks for famine relief are extremely important, the more so as European and US agricultural policy have backed away from policies which accumulate large stocks. However, they are not treated in this report. They involve questions far beyond the CAP and its successor and require much international consultation and agreement.

7.2 Environmental and Cultural Landscape Payments (ELCP)

The principle of this programme of the CARPE is that farmers provide goods and services for which they are not rewarded by the market, and this programme is designed to provide the appropriate inducements and rewards for these services. In its purest form, these payments are offered to avoid the possibility that there is an under-provision of environmental and cultural landscape services. They are not entitlements to receive money if the provision of the services do not impose additional costs on farmers. The proposal is to take a multi-tier approach to achieve environmental and cultural landscape goals.

At the base level, **Tier zero** are conditions which farmers and all land managers must respect without payment. These are legally defined environmental standards. Society insists on certain basic property rights in clean air and water, well husbanded soil and healthy food and humanely cared for animals. Beyond this, there is a recognition that property rights are with the landowner or farmer and if society wishes land managers to produce environmental and cultural landscape benefits, then it is reasonable that the suppliers of these services should be paid. To do this, two further tiers of support are proposed. Such schemes will apply to all ecosystems and landscapes requiring greater care than defined under the Tier zero obligatory legislation and to other 'public' environmental services (including access) rendered by farmers and other rural land managers.

These schemes are based on pluri-annual, purchaser-provider contracts. The purchasers, regional authorities, contract with suppliers, farmers and land managers, for the preservation or enhancement of defined habitats, landscapes, and provision of other rural features and services. The first, **Tier 1** is directed to farming systems which provide high nature value. These systems and thus payments may well cover large parts of the European territory. The second, **Tier 2** is concerned with specific environmental management practices; these will

generally involve more restricted areas, and more intensive action on the part of the land managers in order to preserve or create environmental effects of greater significance.

In order to reflect the diversity of environmental conditions and problems in Europe and also the spectrum of concern about these problems, the ECLP programme has to be regionally based. All regions will be required to create the institutional arrangements to bring together the main rural land owning, land management and environmental interest groups together with competent regional authorities to create regional land use programmes. This will of course be integral with rural development programming discussed in section 7.3. Part of this procedure will involve selecting from a menu of EU ECLP schemes, those pertinent to the region. The EU framework will define the principles and requirements for obtaining EU financial support; within these rules, the definition of precise targets, indicators and payments will be determined locally. The operation of Tiers 1 & 2 ECLP will then be based on multi-annual contracts between the regional authority (the purchaser) and individual or groups of land managers (the providers) to supply certain benefits and receive agreed payments. To satisfy the principles enunciated in section 6.1, the farmers or other land managers will be paid in proportion to the goods and services they contract to supply. Such payments should be decoupled from production decisions. There should be explicit targets for these environmental schemes and in-built indicators and provisions for monitoring. Non-compliance with the terms of the contract or non-delivery of the environmental services should result in sanctions.

The common EU framework is necessary for two reasons. First, to ensure that there are no abuses to competition policy, and second, because it is envisaged that for reasons of cohesion, there may have to be a high degree of EU financing of these measures in some Member States or regions. EU funding implies some degree of EU control. An element of member state financing and preferably regional financing too, will be required from all Member States to ensure a strong degree of national interest in devising sound schemes. Provided that there are secure mechanisms to ensure competition is not distorted, there could also be nationally funded top-ups to the schemes for Member States who have stronger preferences, and the ability to pay for higher standards and more environmental goods.

7.3 Rural Development Incentives (RDI)

Just as rural is not synonymous with agricultural, rural development is much wider than agricultural development. Thus, a common rural policy is not just about farmers and agriculture. Agriculture was at one time the dominant industry and employer, but this is no longer true. A CARPE, of course, will include farmers, agriculture and food related activity; these will always be very important parts of rural areas and policy, but it must go considerably beyond them. By the same token, CARPE cannot deal with all or even a majority of the issues relevant to rural areas. Its role is to contribute to those aspects of rural development which relate directly or indirectly to land use questions. In doing this, it sits alongside general

governmental policies for health, education, housing, transport and social security and infrastructure as they affect rural regions.

One important function of the rural development component of CARPE is to stimulate institutional development in the poorest regions. It is no accident that the most developed regions and Member States manage to gain a large share of the EU's structural policy funds. They have the best regional and local organisation, as a result they are better informed about the procedures and requirements for taking advantage of national and EU development assistance. A purposeful action programme is required to stimulate the bringing together, training and encouragement of local authorities, regional authorities, interest groups such as farmers and land owners, and relevant NGOs. The aim is to learn from the models of the best organised regions, where possible, by bringing-in information and expertise from these regions to train the locals. Some of the lessons learned from the EU LEADER programmes and their associated Observatory have much to contribute.

Much of this activity can focus around concrete tasks. The most important initial task is to elaborate a regional development plan. This should be a comprehensive exercise embracing all aspects of regional development. From it will flow the choice of programmes from CARPE which can be implemented. This will include the Environmental and Cultural Landscape programme, the elements of the Rural Development Incentives and any relevant nationally funded schemes. Thus the programming is done at the regional level with the appropriate involvement of national authorities. The implementation of most of the elements of the programmes is then done at the local level. The very process of constructing regional development plans has the capacity to be integrative as far as economic and environmental development in the region and between the various levels of government, local, regional, national and EU is concerned. It also gives concrete expression to the ideas of partnership between these agencies and groups involved and shared responsibility. Once it is in place, there will be a process of continual monitoring and evaluation of the effectiveness of the elements of the CARPE programmes.

The programme of Rural Development Incentives will build on and integrate actions currently available under Objectives 1, 5a, 5b and the LEADER programme. This will enable a more comprehensive, integrated - and simplified - approach. RDI should in principle cover the whole European territory. The actions available to each region are determined within an overall EU framework. This element of top-down administration is necessary to ensure that competition is not distorted between regions. Thereafter, the policy becomes mostly bottom-up.

Within the RDI programme, there will be actions available both for agricultural development and for wider rural development. In principle, there is no distinction between these two elements except the beneficiaries of the former are farmers. It should be an instructive signal in itself for farmers to see that they draw on exactly the same programme as non-farming interests in rural regions. It is expected that the Rural Development Incentives will be an

enduring part of the CARPE, the kind of problems they are designed to tackle are deep-seated and recurring. However, once the institutional apparatus is in place and the initial rural development plans elaborated, local groups, individual farmers and others assisted by the programme will generally only be assisted once or sporadically, but certainly not continuously. The kinds of help offered are to get these groups or individual businesses over a threshold, or beyond a critical point from which it is intended and hoped they can be independent, thriving enterprises.

7.4 Transitional Adjustment Assistance (TAA)

Changing circumstances require both physical adjustment and a mentality which is willing to accept the need to change and to prepare for it. Change creates uncertainty and anxiety and these impose costs. In the special case of agriculture, it is the scope and scale of these adjustments which matter. Moving labour out of the sector is a massive and deeply cultural matter and it is now recognised because it alters the nature of farming, it has important environmental implications too. So, even if most if not all of the old reasons used to justify support to agriculture have gone, it takes time for this to be realised and accepted. These are the justifications, in a humane society, for adjustment assistance. This is not a new or fanciful concept, Article 39 2 (b) of the Treaty of Rome recognised that "account should be taken of the need to effect the appropriate adjustments by degrees".

It is therefore proposed that the compensation payments introduced in the 1992 CAP Reform are transformed into Transitional Adjustment Assistance. Two important consequences flow from making the switch from 'compensation' to 'transitional adjustment assistance'. First, the TAA is forward looking and not backward looking. A major criticism of the present arable and beef headage payments is that they are based on the past. This is very explicit in the regulation, they are *compensation* for revenue expected to be lost following the large cut in institutional prices. On the other hand *transition or adjustment* refers to the future, it is an attempt to reorganise resources so that farms are capable of surviving unaided in the future. Making this switch away from compensation instantly offers legitimisation of these supports. Second, and following on from the forward looking nature of transition assistance, it should not be necessary 'for ever'. If people and businesses are helped to adapt, then after such help they should be self reliant. This is the purpose of the adjustment, it is positive, it is trying to achieve something. Thus, transitional adjustment assistance will both help the transition from one policy environment to another and be transitional itself. This means that TAA, unlike the present compensation payments must be degressive and time-limited.

There should be no illusions that such TAA, especially if it is widely applicable for farmers across the EU, can be explicitly channelled into concrete adjustment activities. To the extent that these can be created, they should be done explicitly under the other support programmes. ECLP and RDI. Much of the transition assistance is to provide a cushion whilst farmers receive and digest the message that society will pay market prices for the marketable

products, and reasonable prices for the non-market services they provide but not more than this. This message has to be repeatedly explained, and emphasised by making it clear that adjustment assistance is indeed transitional whilst farmers prepare to change their businesses and, if necessary their lives. For many, especially those over 50, the truth is that their chances of finding new full-time employment outside farming are limited and thus the adjustment assistance is *de facto*, early retirement. In short, the message to the recipients of TAA is that society recognises that they have been encouraged, maybe even trapped, in certain forms of agriculture which are fundamentally non-viable. Therefore they are offered some cash to help them rearrange their resources and life, but are warned that it is finite and time limited, so they should make the best use of it as they see fit.

TAA should be *decoupled* from production, it should be *non-distorting* as regards competition, and recipients should respect *environmental conditions*. The basis for calculating the initial amount of TAA will inevitably relate to past prices, income and production. This does not necessarily contradict the principles of TAA being forward looking or decoupled. To ensure the latter, once determined, the payment per hectare, per farmer or per annual work unit - however it is calibrated and paid - should in no way relate to current decisions about production, resource use or current prices. It should not even depend on whether the recipient is still farming. The second principle of TAA which should follow from its decoupled nature is that it does not distort competition. This will be easier to achieve if a range of present price supports are cut and TAA is therefore paid across a wide spectrum of farms and not confined mostly to one particular 'type' of farm. The third principle concerns what recipients do with their TAA. Society is not indifferent to what happens to the land, and the landscape as a result of these payments. A well integrated policy cannot provide one sum of money to improve the rural environment and another sum which leads to environmentally destructive outcomes. Therefore, there must be some environmental conditions attached to TAA.

In summary, transitional adjustment assistance is the necessary psychic and political oil to ease the friction of moving policy from where it is to a preferred state. Such payments should be decoupled, should not distort competition, and may have environmental conditions attached. For political reasons their initial level will have to relate to reduction in supports, but it is urged that there should be some modification with respect to the difficulty of adjustment which confronts the recipients. The minimal such differentiation would be to offer more assistance to especially disadvantaged groups (e.g. younger farmers with high debts) to enable them to cope with the changes in policy. Beyond that, it is more important that they should be degressive and time limited than modulated. Within these general principles there could be some latitude for Member States to determine precisely how they pay TAA to farmers. The proposed schemes should be approved by the Commission in order that there can be no question of distortions to competition, but whether they give it uniformly or non-uniformly, monthly, quarterly, semi-annually or annually can be nationally determined.

8 Further elaboration of CARPE and how to achieve it

This final chapter briefly reviews a range of issues raised by the proposed policy change. First discussed are the changes, which will be required in attitudes and in political and administrative institutions, to implement a CARPE. This is followed by an exploration of how CARPE offers the chance to better integrate policy elements and thereby simplify policy delivery. The next three sections mention some issues of financing the CARPE, how it suits the CEECs and some distributional issues.

8.6 Concluding comments

We should not get carried away on a council of perfection. The CAP is deeply entrenched, long enduring and very large scale in every dimension - budget, regulatory scope, people effected, interest groups balanced and bureaucracies involved. Given EU decision making procedures which make progress by majority voting by farm ministers on balanced packages of measures, it may take some time before a large reduction in support given through the CAP can be achieved. It will be a test of the maturity of political institutions in the EU to achieve a reform of one of its major policies without the crisis atmosphere of previous reforms. This report attempts to show how large scale changes could and should be made which steer the CAP in the direction of a more rational use of scarce EU funds and political capital, to produce more of what society wants with fewer undesirable side effects. Developing a Common Agricultural and Rural Policy for Europe will be an iterative, learning-by-doing exercise. The best guarantees of success are transparency, open monitoring and involvement of Europeans through their local democracy.

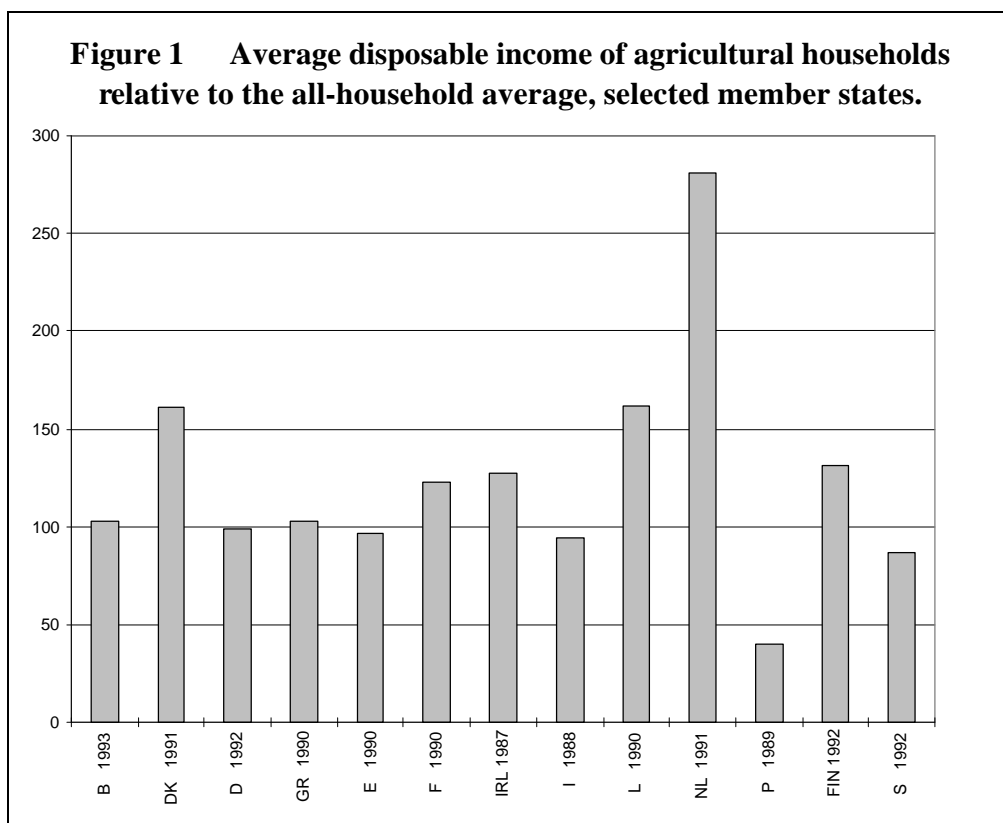
1 INTRODUCTION: WHY THE COMMON AGRICULTURAL POLICY HAS TO CONTINUE TO EVOLVE

Society in Western Europe has developed to the extent that expenditure on food accounts for less than one fifth of average household expenditure and where agriculture contributes less than two percent of EU-15 gross domestic product and employs just over five percent of the workforce. Social priorities for agriculture have changed. The post-war emphasis reflected in the famous objectives of the Common Agricultural Policy (CAP), spelled out in Article 39 of the Treaty of Rome, focused on raising living standards of rural people by improving productivity, and on ensuring the security of food supplies and stability of markets.

When agriculture accounted for 20% of the workforce, as it did in the EC-6 in 1960, and when there were nearly twice as many farmers in the EC-6 (over 14 million) as there are today in the EU-15 (7.8 million), an agricultural policy based on price supports could, broadly speaking, serve the purposes of being a social policy, a food supply policy, an agri-industrial policy and even a rural policy. The CAP was an essential part of the economic compromise embodied in the European Economic Community, it was certainly seen as a critical element in the process of European construction. However, as early as 1968, the implications of the technical revolution in farming and the rapid development of European society were becoming clear.

In his famous 'Memorandum on the reform of agriculture in the European Economic Community', Agricultural Commissioner Sicco Mansholt warned that "market and price support policies alone cannot solve the fundamental difficulties of farming" (para. 16) and that "Our prices are too high to enable us to export on satisfactory terms" (para. 38). His advice on the need for restructuring agriculture was, broadly speaking, followed. However, his proposals on cutting prices were somewhat less bold and were not followed. After preparing readers for significant change, "...such price reductions would have to be considerable if it were to have the desired effect.." (para. 56), his principles for price policy were rather timid (even remembering the price inflation which was just taking off at that time), "Those products of which there are structural surpluses are subject to steady pressure on prices; it would seem their prices cannot be raised in the near future..." (para. 57). The result was that it was not until 1992 by which time the problems of structural surpluses predicted by Mansholt had been in evidence for a decade, that the, much larger, European Union found the will to cut farm support prices significantly.

Today, four decades on from the Rome Treaty, EU food supplies are under no threat. European farmers and the food industry can now see the increasing possibility that they have a role in supplying food on a commercial basis to the high-growth parts of the world which have a poor land base - notably Asia.² It is well recognised that the temperate climate and fertile soils of Europe, farmed by a technically skilled and well educated farm work force, drawing on internationally competitive agricultural supply industries and serving the innovative food industries of Europe can be a major force in global food markets. Meanwhile, the majority of farmers are pluri-active, earning incomes increasingly from non-agricultural sources. The result is that average farm household incomes are, in most Member States, on a par with the all-household average income, see Figure 1.³



Society can therefore afford to become more concerned with the way its food is produced, the quality and variety of that food, the sustainability and environmental

² There may also be an increased role for supplying food on a concessional basis to the low-growth parts of the world subject to periodic food shortage. Section 7.1.2 takes up this point.

³ Only in Portugal is there a significant deviation as revealed by this data. Of course average incomes are not the whole picture, there may be a long tail in the low income end of the distribution, however it is plain that market price support has little power to deal with this problem.

effects of food production systems and the balanced development of rural areas. Society, clearly, *is* concerned about these issues, and shows a willingness to provide perhaps considerable public resources in furthering these objectives. In these circumstances, there is a clear danger that without further change the CAP could adversely affect the European construction.

Agricultural policy must adjust to these new social priorities and focus much more on the joint challenge of international competitiveness and environmental awareness. These twin objectives are not necessarily in contradiction. Policy change can be envisaged which simultaneously could release European farmers and the food industry from the constraints of supply management and subsidised exports to discharge their core function of supplying food, and also direct land managers to the achievement of environmental objectives and rural development.

This report summarises the work of an expert group set up to explore how this more market orientated and integrated rural policy could be achieved. The immediate origins of the working group and this report directly followed work done in the Commission to consider the agricultural implications of the further enlargement of the EU to embrace the ten associated Central and Eastern European Countries (CEECs). The conclusion of the Commission Agricultural Strategy Paper (European Commission, 1995b) was that further changes in the CAP are necessary. The explanation of this conclusion is therefore given first.

However, it would be a gross error to think that the challenge of enlargement is the only, or even the most important, reason for considering further changes in the CAP. There are powerful reasons within the EU-15 why many agricultural, consumer and rural interest groups consider that the post-Mac Sharry CAP, whilst a considerable advance on its predecessor, has still not achieved the correct balance of operational objectives and instruments. In particular, the increased emphasis on farmers' role as guardians of landscape and nature, the desire to switch emphasis from quantity to quality and to better integrate agriculture in the rural economy are inexorably pushing the CAP away from being a sectoral policy in agriculture to becoming part of a set of territorial policies for rural areas.

These are the recurring themes throughout this report. Curiously, these 'internal' pressures for reform will in due course become important parts of the 'external' international debate on agriculture. The recognition that agriculture and environment are inextricably linked has important implications for agricultural trading relations which are only beginning to be addressed.

In addition to these 'sectoral and regional' pressures, there is a continued, more general, pressure in the Union arising from the move towards a more liberal trade regime both for intra-Union trade and international trade. This is manifest as the 1992 completion of the

internal market and the EU support for the achievements of the 1994 Uruguay Round - which significantly for the first time included a comprehensive set of commitments for liberalising agricultural trade.

The trend towards a more liberal trade regime will continue with the next round of multilateral trade talks under the World Trade Organisation (WTO) in 1999, and it is further propelled by the development of customs unions and free trade areas which in future will have fully to embrace agriculture. It is misleading to depict these, as they so often are, as 'external' pressures implying that the EU is somehow forced to adopt them by other trading partners. This not the case. As the largest economic and trading bloc in the world, the EU has a strong *internal* imperative that the fullest benefits of freer trade are achieved for its citizens. Its agriculture has stood for so long outside this movement, but is now irrevocably and beneficially part of this world wide trend.

Listing the reasons why the CAP has to continue to change in this way of course may generate the impression of massive policy failure. There are failures. However it would be far from the truth to suggest that the CAP is *only* a mass of contradictions and inconsistencies. Whatever one thinks of the CAP, it is an extremely complex set of interlocking regulations and directives, governing the operation of dynamically evolving commodity markets for a large range of products, which has evolved through a delicate political balancing process over thirty years, withstanding the major shocks of four enlargements, monetary crises, commodity market crises and budgetary crises. There are many examples, both within and between the Common Market Organisations (CMOs), structures and agri-environmental measures, of harmonised instruments working well together (given the objectives pursued).

The CAP market regimes have indeed stimulated productivity and have provided stability and security of food supplies. Not all developmental structural measures work against market policy. Of course, many structural improvements were (and still are) necessary on farms, and enable formerly inefficient businesses to develop into viable enterprises which can survive in open market conditions. There will be a considerable need for precisely this sort of development in many of the prospective new Member States. Likewise, the LEADER Programme is a model initiative trying to address problems of rural development primarily by creating new, bottom-up, institutional structures for economic development in rural areas. This, it is hoped, will lead to stimulation of new enterprises, thereby providing new employment, diversifying away from traditional commodity production and developing local specialities based on the characteristics of the regions.

These and many other examples partly explain how the CAP has survived since the mid-1960s. If it was not the case then the CAP could not have survived so long. Such longevity is testimony to the fact that it has served important political and economic interests.

It has to be admitted that there are other explanations for the longevity of the CAP. An alternative interpretation, preferred by its severest critics, is that its survival is explained by the power of the lobbies of those who have captured the benefits of the CAP, and that it is a sign of the political failure of EU policy decision, institutions, and procedures. Such critics view this as a prime example of a democratic deficit in the EU, in which a policy which has indefensible distributional impacts and is ineffective in delivering desired objectives has survived so long. Whatever the judgement, just as the CAP has always evolved to take account of new concerns and priorities, this must continue in the future.

The first five chapters of this paper will explore three categories of pressures for reform: the challenge posed by enlargement, internal dissatisfaction with the CAP and its inconsistencies, and the pressures generated by the liberalisation of agricultural trade. They all lead in the same direction. The CAP does indeed have to be transformed. It should change from being essentially a centralised commodity policy to becoming a major component of more comprehensive, integrated and decentralised rural policy. Chapters 6-8 spell out the elements of such a policy, what it seeks to do, how it could do it and finally, some of the issues involved in making the transition from the present to the preferred policy.

2 THE CHALLENGE FOR THE EU OF EASTERN ENLARGEMENT

2.1 Political background

In one of those challenging twists of history, no sooner had the Council of Agricultural Ministers agreed the historic 'Mac Sharry' reforms of the Common Agricultural Policy on 21 May 1992 - which itself paved the way for agreement in the Uruguay Round of trade talks under the GATT - than it became necessary to start thinking about the next round of reforms. The primary reason for this was the historic sequence of events which took place in the late summer and autumn of 1989 leading to the opening of the Berlin Wall on November 9th of that year and the subsequent collapse of Soviet Union domination of Central and Eastern Europe. At the same time, the European Community was itself taking an historic step by preparing and signing, on 7 February 1992, the Treaty of Maastricht to create the European Union.

Events moved quickly. By the end of 1991, it was clear that the changes in the CEECs were irreversible, especially with the collapse of the Soviet Union itself in the summer of that year. The newly independent states of Central Europe indicated their decision to switch to parliamentary systems of governance and to the mixed market economic systems of the West. They saw their future as full members of the EU and NATO. These feelings were reciprocated in the West. Our economic, political and security interests were seen to be served by creating the fastest and closest ties with these transition economies.

The first manifestation of this was the communiqué of the European Council at Copenhagen in June 1993 which was followed, over the next three years, by the signing of Association agreements with ten Central and Eastern European Countries⁴. These defined the ultimate goal as the possibility of full membership of the Union and paved the way for the opening of trade between the signatories⁵.

It was quickly realised that these developments were highly significant for the development of agriculture in Europe. The sheer scale of the prospective Eastern Enlargement, ten countries with 110 million people, and their relatively greater dependence on

⁴ These took varying lengths of time to prepare and sign. In most cases interim agreements entered into force earlier enabling progress in implementing the trade provisions. The countries involved are: Bulgaria, Czech republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovak Republic and Slovenia (whose association agreement was completed in 1996).

⁵ The provisions for opening trade in agricultural products were much more restrictive than for other sectors, Tracy (1995) describes the workings of the Association Agreements for the agricultural sector.

agriculture stimulated concern in the EU. Initially, during 1992 and 1993 the concern was mostly about the social consequences of the alarming disintegration of agriculture as prices were liberalised and the sector began restructuring⁶. But as signs of recovery were detected, the concern switched to the consequences for the EU and especially for the CAP of Eastern enlargement⁷.

The Commission itself studied these issues closely. In July 1995, it published individual studies and a summary report for the ten CEECs (European Commission, 1995a), in which the policy and agricultural developments post-reform were summarised, and an attempt was made to 'get a feel' for the magnitude of the potential net agricultural trade position of these countries by the end of the century. This was followed in December 1995 by the publication of the 'Agricultural Strategy' paper which was received by the Madrid European Council and the Agricultural Council.

2.2 Agricultural policy issues of enlargement

The December 1995 Agricultural Strategy paper set out the challenges posed by enlargement. It reviewed the likely development of the CAP, particularly as the Uruguay Round Agreement on Agriculture was implemented over the period 1995 - 2001. It considered in some detail the effects on the major commodity markets of the adoption of the current CAP by the CEEC-10 over the period 2000-2010. It examined three options for dealing with this enlargement: (1) to keep the status quo, to squeeze the CEEC-10 into the existing CAP, adjusting the current set of instruments, prices, quotas and set-aside to deal with any problems which arise; (2) radical reform, to dismantle the support arrangements under the CAP; and an intermediate option (3) to continue the 1992 reform process, move to a more integrated rural policy and at the same time achieve a simplification of agricultural policy.

The paper itself concluded that in order that "the agricultural and agri-food sectors of the Community are to participate fully in favourable world market developments and expansion of world trade..." and "to strike a more sustainable balance between agricul-

⁶ This shows up clearly in the report prepared for the DGVI of the European Commission by Nallet and Van Stolk (1994).

⁷ This change in emphasis is clearly seen in the four 1995 studies requested by DGI, of the European Commission, Buckwell *et al* (1995), Mahé *et al* (1995), Tangermann and Josling (1994) and Tarditi and Marsh (1994).

tural activity, other forms of rural development and the conservation of natural resources, and featuring the multi-functional role many farmers can play in this context..." Option 3 was clearly the preferred strategy. Option 1 obstructs the achievement of international competitiveness; Option 2 insufficiently recognises the role for public policy in nature conservation and rural development.

The initial political reaction to this document was quietly favourable. It was received by the Madrid Council and received by the Agriculture Council in December 1995. Since then, no significant group has suggested that options 1 or 2 would be preferable or that there is fourth possibility significantly different to the direction indicated in Option 3. The strongest comments to date are that the difference between Options 2 and 3 was overstated, that there is not much detail about what Option 3 really is, and that there is no defined timetable of reform.⁸ This paper is therefore an attempt to spell out what Option 3 means. In particular, it tries to provide more detailed arguments for changing the emphasis and balance of agricultural and rural policy, and to define the principles for the set of measures which will help achieve the kind of food production system and rural environment European society desires.

2.2.1 Budget costs

Pressure from taxpayers to limit the costs of agricultural policy has been a major factor in past changes in the CAP. This issue is discussed from an EU-15 perspective in section 3.2.3 below. It is therefore unsurprising that most commentators assume, given the importance of agriculture in the EU budget and the greater share of agriculture in the economy of the CEECs compared to the EU-15 that the budgetary costs will be a major consideration in the context of enlargement. However, contrary to this popular wisdom, the principal problem for the EU of extending the present CAP to the CEEC-10 is *not* the budgetary cost.

The Commission's calculation of the order of magnitude of this cost put it at 12 BECU, considerably less than the figures estimated by other analysts. Whilst accepting that this was a carefully calculated figure following quite detailed analysis of the likely developments of CEEC commodity markets, it is important to remember that there is a great deal of uncertainty inherent in such figures, and historically, there has been a tendency to underestimate the supply response of farmers rather than overestimate it. Taking the figure at face value, the interpretation of this sum is that it is, of course, a considerable amount to be raised from EU taxpayers especially in the context of Maastricht-constrained public finances. It will not be easy.

⁸ See House of Lords (1996) report on the Agricultural Strategy Paper and Marsh and Tangermann (1996) in their paper for the European Parliament Land Use Food policy Inter Group, LUFPIG.

Also it is recognised that the figure quoted is only part of the cost of enlargement, it does not include the costs of applying the structural and cohesion measures or other European Policies. However, it is within the estimated financial guidelines for agriculture, and it is judged to be politically manageable. It is well recognised that there is bound to be a significant budgetary expenditure associated with enlarging the EU to include so many countries which are both poorer and more agricultural than the existing EU-15, and that this will be an important aspect of the review of the financial perspectives after 1999. But it is also recognised that there are considerable economic opportunities offered by the integration into the Union of what is hoped and expected to be an economically dynamic part of Europe. Eastern enlargement is not solely a matter of costs to the EU.

2.2.2 The problem of high prices

The real problems of extending the current CAP to the CEECs concern the internal economic effects of the CAP on those countries and the feasibility and wisdom of applying the present panoply of prices supports, border protection, supply management and compensation payments. Even after the 1992 reforms, the EU maintains farm-gate food prices which are significantly above those found in the CEECs. The Commission estimated the gap in 1994 to be of the order of 20% - 40% varying by commodity and country.

This is not a static situation. Protection in the CEECs has risen since the early years of liberalisation, and may rise further, partly closing this price gap. However, this process is limited by the desire not to raise food costs for the population.⁹ On average, the share of expenditure on food in these countries is over thirty percent. There is considerable variation around this figure with much higher shares for pensioners and others on low and public sector incomes. Policies which raise food prices can cause considerable hardship and social stress; and also will have a detectable effect on wage costs to the detriment of the competitiveness of these economies. The burden of EU food price levels on CEECs would thus dampen their ability to grow rapidly; inflicting a heavy cost on them, and reducing the benefits of enlargement to the Union.

2.2.3 The problem of supply controls

The second problem of applying the current CAP to the CEECs is that it would involve implementing the detailed farm-level, supply control measures which are an integral part of the CAP cereals, oilseeds, milk, sugar, beef and sheep regimes. Whilst the CEECs previously had a very rigid system of farm level plans and controls on production, this whole system has been abandoned in the last five years. It is inherently undesirable to

⁹ The rise in protectionism in CEECs is also limited by the budgetary resources available to agriculture in these countries and their own URA commitments.

invite the CEECs into a market-based, free trade area, and then to explain to them that it is necessary to plan and restrict their production of some of three of the most important sectors of agriculture: grains, milk and sugar.

The present pattern of farm structures, and formal and informal land leasing arrangements in the CEECs (which vary from country to country) could create difficulties for implementing and enforcing arable set-aside and milk quotas. For the former, whilst much of the grains land is still *farmed* by quite large co-operatives, much of this land is owned, usually in small and fragmented parcels, by non-farming landowners. For example, there could be a temptation and opportunity to try and arrange the application of the set-aside so that much of the land is entered by the owners into the simplified scheme thus avoiding the need to take land out of production. If this came about, it would reduce the effectiveness of the measure and create further tensions in the operation of the scheme in the Union. Similarly, the application of milk production quotas could pose practical difficulties.

Milk production in the CEECs was previously extremely concentrated on a few very large holdings. Initially, post-reform, it contracted drastically by, on average, about 25% and now in many CEECs, it is very fragmented. The combination of these two features could make it difficult to apply quotas. The CEECs would be very reluctant to curb their milk production for all time, based on the low levels of output achieved after the dislocation of the transition process. Thus the political will to comply would be lacking. In these circumstances, the policing of quotas on a highly fragmented dairy system would pose practical problems - the incentives to avoid their effects would be immense.

Thus, the CAP supply control measures, which are an explicit and vital part of the price-raising apparatus, pose problems of both principle and operation. No doubt, with the ingenuity demonstrated down the years as the CAP has evolved, the practical difficulties of implementing supply management could be overcome. However, the principle that they would damage the interests of CEEC consumers *and* producers suggests that it would be preferable to avoid this.

2.2.4 *The compensation payments under the CAP*

These create a very difficult dilemma. The Commission Strategy document recognised that there could be no justification for making the 'compensation' payments to CEECs if they did not suffer the institutional price cuts which justified the payments. But equally, it was recognised that it is inconceivable that in a permanent regime, in a *common* agricultural policy half of the farmers (generally the richer ones) are in receipt of significant direct payments and the other half (the poorer ones, from the CEECs) are not.

If faced with the choice between preserving the 1992 system of compensation payments or seeking equity for old and new Member States, the latter is clearly the priority. However, it would be most unwise simply to extend the present system of payments to CEEC arable and livestock farmers. Given the size of the payments in relation to current levels of gross margins in CEECs, they would be extremely distortive. They would underwrite land values at levels much higher than justified by local conditions, adding to the difficulty of achieving the necessary rationalisation of farmland ownership.¹⁰

Compensation payments would also cause administrative problems in the CEECs where the production co-operative is emerging as a dominant production structure. To whom would the money be paid? How would it be distributed amongst the various claimants - the land owners, co-op members supplying labour and those supplying capital, and the non-member employees (who in some countries are relatively disadvantaged non-land owning groups)? To the extent that the payments accrue to land owners, part will escape from the rural areas because the land restitution process has returned land to families who long-ago left the land for the cities. Resolving this distribution problem will, of course, be a task for the CEECs themselves, but it could create difficult social tensions. Furthermore, how could it be justified in the villages of the CEECs that those engaged in cereals, oilseeds and protein crops and beef production are recipients of very generous payments from the EU budget, whilst other farmers and unemployed rural industry workers receive no such payments? It would be socially divisive and potentially destabilising.

Of course, as argued in section 3.1 below, some of these same difficulties exist within the EU-15. The conclusion is clearly that, from an enlargement perspective, the basis for making long-term direct payments to farmers has to change from the current compensation payments. One option is for such payments to cease by the time the CEECs are fully adjusted to the CAP. If this is not the case, then the ultimate aim must be a harmonised basis for payments which applies equally to the whole, enlarged, Union.

The word 'ultimate' was included in the last sentence because the Commission argued that for a period after accession, instead of receiving compensation payments, the CEEC agricultural and food industries "could probably make much better use of the money available for compensation payments after accession (or, at least part of it) for additional programmes of structural improvement in agriculture (e.g. modernisation of holdings) and downstream sectors directly linked to it (processing, storage, marketing, services to agriculture) as well as for integrated rural development in more general terms (improvement of standards of living in rural areas, including housing, improvement of rural infrastructures, diversification of activities, environment, education, professional training etc. ..)." (Commission: Agricultural Strategy Paper p26). This would better enable them to survive and thrive in the fierce competition of the single market. Without being

¹⁰ See European Economy (1996) for a more detailed discussion of these distortionary effects.

explicit, the implication was that the period from now to the end of such a transition period provides time for the EU-15 to further reform the CAP and get into place the preferred integrated rural policy which can be applied throughout the enlarged Union.

2.2.5 Respecting the Uruguay Round Agreement on Agriculture

This also poses a significant problem for applying the current CAP to the CEECs. Not all CEECs are yet members of WTO, but it is presumed they will be by the time of EU accession¹¹. All CEECs will therefore bring to the EU their own schedules of import tariffs, minimum access volumes, subsidised export values and volumes and their aggregate measures of support (AMS). One part of the accession arrangements will be the harmonisation and aggregation of these schedules with those of the EU. This could cause difficulties with all of the commitments. The problems of harmonising-up or -down the tariffs will, no doubt, be complex and protracted. It may even involve agreeing compensation for third countries who are injured by loss of access to CEEC markets.

However, these matters are the very stuff of international trade relations and can presumably be settled within the normal process of negotiation. It is the volumes and values of subsidised exports where it is anticipated that the most difficult problems could arise. If, as expected in the absence of reform, EU prices are in their usual position of being above world market prices, and furthermore, if CEEC prices upon accession are below EU prices, then two consequences arise from the accession when CEEC farmers and consumers face the higher EU price levels. First, the effect on the markets is to increase the net export surpluses. Second, given the assumed price relationships, to dispose of these surpluses will require export subsidies. The magnitude of this problem is hard to assess. It requires difficult assumptions about EU, CEEC and world prices, it requires judgements about the rate of technical progress and supply responsiveness of CEEC farmers, and about the rate of economic and consumption growth in the CEECs and the evolution of their agricultural and trade policy during their pre-accession years.

The Commission (and others) have made such assumptions and calculations, and the results all point to the accumulation of export surpluses of cereals, milk products and beef far in excess of the likely aggregate 'volume' commitments of the EU-25, (Commission: Agricultural Strategy paper, pp18-20). Furthermore, these calculations relate to the current Uruguay Round commitments. By the middle of the next decade, it is likely that tariffs will be negotiated down. Domestic supports and subsidised export volumes and

¹¹ By July 1996 as Bulgaria completed its entry negotiations, seven of the 10 CEECs were members of WTO, the three Baltic States were at various stages of negotiating entry.

values may be also further reduced by the first WTO round. This would make it even more difficult to enlarge the EU and remain within international commitments. The problems of over-production could of course, be resolved by increasing set-aside or reducing production quotas, but it has been argued above that such an approach is not practicable or sensible for the CEECs.

2.3 Summary of the challenge of enlargement.

From the perspective of the economic interests of the CEECs, the present CAP is unsuitable with its relatively high prices, its cumbersome and distortive supply management and inappropriate compensation payments. Furthermore, if these realities are ignored, and the CEECs are invited to adopt the CAP in more-or-less its present form, there is clear potential for increasing the EU net surpluses at the current price and support levels. To avoid the problems of surplus disposal in a world committed to eliminating export subsidies, this would have to be met by the application (in the CEECs) of very strict supply control. If this is the approach adopted, it will be difficult to persuade the potential new Member States that it is not in their interest to boost their production of cereals, oilseeds, sugar and milk as soon as possible so as to ensure they negotiate their 'quotas' from the highest possible base.

There is a real problem of credibility here. Unless prospective EU Member States can see tangible evidence that the CAP is changing prior to their accession, why should they plan on the basis of any other strategy than to capitalise on the market support systems the EU has created for itself? To make this point more bluntly, why should Poland deprive itself of a subsidised sugar industry if all other Member States have one? Furthermore, applying the CAP with the current arable and beef payments will cause large distortions and social inequities in the CEECs. These arguments point to the necessity of further reform of the CAP in the direction already started; that is to move to a qualified market-oriented agricultural system, which will simultaneously reduce the consumer burden and eliminate the need for export subsidies and supply management.¹²

At the same time, there is a big challenge in the CEECs to pursue their own agricultural restructuring and to create competition in their food processing and distribution sectors. This would spur the improvement of standards and efficiency in those sectors. It is also clear that CEEC agriculture has a great deal more adjustment to make in improving labour productivity. This will inevitably involve a further, and perhaps quite large, outflow of labour from the primary sector. Given the pressure on urban employment and public services, it is probably more cost effective to help stimulate rural activity and employment than to deal with the problems of large numbers of disaffected, unemployed

¹² The market system is 'qualified' by recognition that there are extensive market failures relating to rural areas and which justify special action to correct.

people migrating to towns. This points to the necessity for comprehensive rural development actions in these areas.

It is also the case that there are significant environmental improvements required in CEEC rural areas. Some have suffered serious industrial pollution which creates a backlog to be cleared, and large-scale collectivised agriculture itself left a legacy of environmental damage to be dealt with. It turns out that there is no contradiction between the needs of both the CEECs and the present Member States states for a new emphasis in agricultural and rural policy. The limitations and inadequacies of the CAP, as seen within the EU, is the subject of the next chapter.

3 DOMESTIC DISSATISFACTION WITH THE CAP

The intended beneficiaries of the CAP are farmers so it is natural enough to consider first their dissatisfaction. Although there is a deep dissatisfaction amongst some of the most (conventionally) productive farmers, it would be a mistake to characterise farmers in general as agitating for change. Paradoxically, many small farmers who derive a relatively small share of the benefits of the CAP often defend it vigorously. It is the biggest farmers who have been the main beneficiaries of the major commodity support programmes who have been most adept at defending their position.

The biggest critics of the CAP are those representing national finance ministries, and those representing the interests of consumers, the environment and general rural development. But, there is also considerable dissatisfaction amongst farmers and administrators with the complexity of the CAP, and the inconsistencies which have developed as it has grown. The dissatisfaction from the perspective of each of the interest groups will be considered in turn before looking at the CAP from the point of view of its own internal incoherence. The purpose of this review is not to score points criticising the CAP, but to identify the nature of the problems of the policy in order to see better how they could be avoided in the future.

3.1 Farmers

There was considerable nervousness on the part of farmers about the direction of the 1992 reforms. Initial refusal to contemplate such a comprehensive package of measures, involving significant cuts in nominal support prices and the introduction of a quasi-compulsory set-aside, was a major factor in the delay in both the CAP reform and also the settlement of the Uruguay Round to which it was informally but firmly tied. Since the reform, most farming interests have been surprised by the ease of the adjustment they had to make. In fact, compared to the average of 1989-91, real farm incomes had risen by 12% in 1995 for the EU-15, see Table 1. This has not been a uniform process. Incomes rose (in descending order) in the UK, Ireland, Germany, Spain, France, Denmark and Italy, fell most in the Netherlands, Belgium and Luxembourg and was more or less unchanged in Portugal and Greece.

The reasons for this relatively easy transition have partly lain outside agricultural policy. For several countries (Italy, Portugal, Greece, the UK, Spain and Ireland) the collapse of the European exchange rate mechanism on Black Wednesday, 16 September 1992, brought, in its approach and its wake, several currency devaluations and thus significantly smaller falls in the (ECU denominated) institutional prices and rises in the

payments and aids. In addition, the curbs on grain, and beef production, and the management of the other major markets meant that EU stocks declined rapidly.

Table 1 Indices of agricultural incomes in the European Union

	Index 1989 to 1991 = 100
Belgium	88,8
Denmark	115,1
Germany	123,9
Greece	100,7
Spain	116,2
France	115,9
Ireland	127,2
Italy	107,8
Luxembourg	93,8
Netherlands	86,7
Austria	115,8
Portugal	98,5
Finland	82,4
Sweden	88,5
United Kingdom	133,7
European Union - 15	112,4

Income indicator 1, real net value added of agriculture at factor cost per annual work unit.

Data Source: EUROSTAT, New CRONOS

At the same time, lower production of some products in major exporting zones and accelerated consumption growth, for example of coarse grains in Asia (especially China), boosted world market prices for many products. By autumn 1995, and completely unpredicted, the EU was no longer subsidising wheat and barley exports and thereby depressing the world price, but taxing exports and thus causing the world price to rise further. Wheat, coarse grains and oilseeds prices by spring 1996 were at record levels. Some implications of these extraordinary world market developments for further CAP reform are discussed in section 7.1.

It is clear to some farmers that the 1992 reforms are not complete and there is pressure for further reform action. Particularly vulnerable are some heavily protected sectors which have not been reformed at all (eg. sugar, milk and wine). But even amongst the reformed products, there is considerable unease. Why? First and foremost, whilst nearly all farmers welcome the receipt of their compensation payments and, naturally, would like them to continue indefinitely, many realise they are political and thus precarious.

It is well known that the fall in market prices (averaging 16% between 1992 and 1996 for soft wheat) has been much lower than the 30.6% cut in institutional prices. Thus when the compensation payments (per tonne) are added to the market prices, the effective returns per tonne over the same period have risen in nominal terms by about 16% for cereals on average, varying from just 6% for common wheat, through 20% for barley, to 55% for durum wheat. Therefore, on average, grain farmers have been over-compensated. The magnitude of this apparent over-compensation is of the order of 2.0, 4.2 and 5.0 BECU for the three years 1993/4 to 1995/6,¹³ see Table 2.

Paradoxically, the payments introduce an additional element of uncertainty. Will they continue or not? Is it worth using them to make investments for greater production? In some circumstances, they encourage a further simplification of farming systems, and they are certainly having effects on land prices which are disadvantageous to new entrants.

Second, the size of the payments is very visible and the distribution rewards most, those who produce most. This latter effect occurred by design because the payments are revenue compensation payments and therefore those who were expected to lose most, justified greatest compensation. Of course, a powerful counter-argument to this approach was that part of the reason for the reduction in prices in 1992 was the inequity of the high price policy, so if the distribution of the previous benefits was considered undesirable, there was no sense in continuing it through the direct payments.

Even though the mal-distribution of the benefits of the price support was explicitly part of the justification of the 1992 reform, evidently this argument did not win the day. The proposal by the Commission to 'modulate' the payments, precisely to deal with the equity issue was fiercely and successfully resisted by those Member States with the largest cereal farmers. The consequence is that it is the largest farmers who now worry most about the vulnerability of these payments. The total cost of these direct payments is high, 16 BECU for 1995.

Public discussion of the distribution of the payments is quite common in many Member States. The visibility of the quite small number of extremely large payments is clearly a cause for concern. Farmers can see that there was initially some degree of public acceptance that the payments were a necessary price to achieve an important change in the CAP (the price reductions) paving the way to the settlement of the Uruguay Round. But as time marches on, it is hard to justify permanent fixed-rate compensation for a

¹³ These figures are calculated by comparing the average market prices plus average compensation payments per tonne for each year with the price in 92/93. The logic of the nominal compensation payments was that the average, nominal return per tonne would not fall. Thus the over-compensation is measured as the increase in this nominal return since the base period multiplied by the production level. This is termed an *apparent* over-compensation because it does not take into account changes in input usage or costs, nor the varying experience of price changes in national currency terms in each member state.

once-for-all change in policy.¹⁴ In time the real value of these fixed, nominal payments will fall, but while inflation is historically low, this erosion is slow, and definitely smaller than the rise in real returns from grain farming during periods of high world prices, such as during the 1995/96 marketing year.

Table 2 Extent of overcompensation of cereal producers, EU-15, 1992/3 to 1995/6

(1)	1992/93	1993/94	1994/95	1995/96
Coupled' price in market ECU/tonne (2)				
C wheat	160,4	164,6	167,3	170,0
D wheat	322,9	438,6	517,2	499,6
Barley	155,0	160,2	175,4	186,4
Maize	163,0	174,2	187,1	200,6
Rye	158,8	170,6	183,0	188,2
Oats	164,0	189,0	206,1	207,0
Ave rye/oats	161,4	179,8	194,6	197,6
Production 'ooo tonnes				
C wheat	78.764	76.989	77.423	79.433
D wheat	9.086	6.966	7.950	6.958
Barley	47.194	47.392	43.743	43.429
Maize	31.136	31.335	29.662	28.973
Other cereals	12.685	15.746	15.228	15.980
	178.865	178.428	174.006	174.773
Overcompensation MECU (3)				
C wheat		321	533	761
D wheat		806	1.545	1.229
Barley		243	890	1.362
Maize		350	716	1.090
Other cereals		290	505	579
Total		2.009	4.189	5.021

Notes:

- (1) Marketing years
- (2) The coupled price is the EU average farm price plus the compensation payment per tonne.
- (3) Over-compensation is calculated as the difference in the nominal coupled price from 1992/93 multiplied by the volume of production each year. The logic is that the policy was to compensate the average producer for the nominal revenue loss as a result of the cut in institutional prices.

¹⁴ Some farmers already understand this message, but it has to be noted that some others fought hard to ensure there was no time limit stated in the regulation for the compensation payments, they considered the payments insufficient to begin with and thus only accepted them on the basis that they are permanent. That said, founder members of the Community are wise enough to know that even if the regulation had said the payments are indefinite it would not make them less vulnerable to soundly based criticism. Political decisions can always be changed.

The payments are also vulnerable in the context of the WTO. A critical part of the Blair House accord, which paved the way to the Uruguay Round Agreement in Agriculture (URAA), was that the EU compensation payments are accepted ('Blue Box') and unchallengeable for the period of the Peace clause, ie. until 2003. It is accepted that these payments are not fully decoupled. The lower support prices reduce the incentive for higher yields, but farmers have a strong incentive to sow all their eligible area with cereals and oilseeds, irrespective of the price of these products, in order to collect the maximum 'area' payments. Thus there is a disincentive to reduce sown areas. However, at least the total eligible area is fixed. Now that the US has moved to more decoupled payments with the 1996 Farm Bill, it must be expected that the EU compensation payments will be challenged in the next WTO round.

Thus the present payments are vulnerable on five counts: their sheer visibility, how to justify perennial payments for a once-off policy change, the fact that there is no relation between injury and the compensation, the fact that they are not fully decoupled, and the fact that they continue to reward most those with the largest farms, and thus it is assumed, most wealth. The response of some farmers' groups to this vulnerability has been to seek alternative ways of justifying the payments. One possibility is to refer to them as payments for stewardship of the countryside. If this is not part of a very explicit and carefully thought-out environmental policy, it is a very dangerous path. These issues are taken up in sections 3.3 and 7.2 below.

The second problem with the CAP reform has been the extension of supply management into the major field crops in the form of the arable set-aside schemes, and to a lesser extent, to beef and sheep production. Set-aside has proved to be a flexible tool of policy and the rate has been changed several times; always downward so far, from an initial 15% in 1993/4 and 1994/5 to 12% for 1995/6, 10% for 1996/7 and 5% for 1997/8 (marketing years). Farmers, especially large farmers in the most important production areas, have regarded it as a gross infringement of their freedom to farm. In the first two years of implementation, there was a large outcry against what was seen as the excessive bureaucracy associated with defining the base areas and eligible animal numbers, and the detailed information requested before the area and headage payments could be paid. However, it has to be said that, predictably, this was mostly an adjustment problem and there is far less discontent with the 'red tape' than initially.

There are complaints that the administrative costs of the new payments system are still very high, but there is no systematic data to verify this. However, there is still a great discontent that at a time of world market shortage and extremely high prices, European farmers are being held back from producing and exporting more. Such feelings will no doubt subside somewhat as markets return to the more usual situation where EU exports can only be sold with subsidies. But even then, there is deep dissatisfaction with a policy which requires productive land being removed from production by the quasi-compulsory,

set-aside scheme.¹⁵ Of course, these feelings are not uniformly held amongst the Member States.

The major differences of view are between the net importing countries who wanted set-aside in the first place as a way of institutionalising the high price regime and the net exporters particularly France which is concerned with the erosion of what it terms its 'vocation' to export.¹⁶ This erosion occurs partly because the set-aside helps bolster internal prices necessitating export subsidies which are being curbed, and partly because with some land out of production, less is produced.

Some of the same dissatisfaction with set aside is also expressed for the other commodity with the tightest supply management, the milk sector. Similar arguments are used. Milk quotas inhibit the most efficient producers from expanding; in the absence of national schemes to reallocate quota to new producers, they impose substantial additional costs for young new entrants; and they prevent the EU from sharing in the expansion of dairy markets in the net-importing areas of the world, particularly Asia. However, most small dairy farmers do not see these arguments. They clearly enjoy the artificially high prices and security offered by the quota system. Regionally defined quotas are defended as having desirable environmental and cultural landscape benefits (this is discussed further in section 3.3.3). They are seen as the control mechanism which ensures that milk production remains in regions, generally those either distant from markets or where communications are difficult (hilly and mountainous areas).

It is evident from these listed farmers' dissatisfactions that there is not a homogeneous farmer viewpoint on the CAP. Indeed, one of the main consequences of supporting farmers through market prices has been that farmers do not benefit uniformly but in proportion to the volume of supported produce they supply. This means that benefits are skewed heavily to the minority of farmers who produce most. This in itself is a further source of dissatisfaction.

¹⁵ Strictly speaking, set-aside is voluntary, but a farmer who wishes to avoid set aside has to forgo the arable payments on his whole COPs area, this provides such strong incentive it can be called quasi-compulsory. If this condition (the almost compulsory nature) were absent there would presumably be less farmer dissatisfaction. If the scheme was voluntary without the penalty of forgoing the compensation payments, or if the least productive areas could be repeatedly offered for set-aside, it would reduce this discontent. It might also offer more possibilities for environmental benefits. However, these modifications would also significantly reduce the effectiveness of the measure in reducing production which is the prime purpose of the scheme.

¹⁶ When set-aside was first introduced in the 1980s Germany was one such grain net-importer strongly in favour of set-aside. She remained a supporter of the extension of set-aside in the MacSharry reform despite switching, post reunification, to being a net exporter of grain. Her position more recently is becoming equivocal.

Finally, farmers are frustrated at the complexity of the CAP and the seemingly contradictory messages given by its components. These inconsistencies are taken up in section 3.4.

3.2 Food Consumers and society generally

3.2.1 Food costs

Economists are fond of pointing out the consumer cost of the CAP which they calculate based on the theoretical concept of 'consumer surplus', which values the loss to the consumer of paying the higher cost of agricultural raw materials at CAP prices rather than at international price levels. A crude version of this measure is the Consumer Subsidy Equivalent (CSE) measured by the OECD. The total 'consumer cost', based on the CSE of the 12 commodities included in these calculations at its high point in 1986-88, was measured to be 52 BECU (EU-12). Following the cuts in grains, oilseeds and beef prices in the 1992 reforms and subsequent changes in world market conditions, it fell to 43 BECU for the EU-15 in 1995.¹⁷

Calculations of this kind have been in circulation for many years. In order to try and capture the public imagination they have been quoted in terms of the annual cost 'per man, woman and child', the cost per citizen has been compared to the subsidy per cow and so on. The fact that this cost impinges most on the poorest in society, because they spend a larger proportion of their income on food, has also been pointed out and calibrated.

But all this has had little or no political impact. In no national or European Parliamentary elections has the food price issue made more than a very marginal appearance.¹⁸ Despite the publicity campaigns against the consumer cost of the CAP, the lack of impact is partly because of ignorance. It is partly because the whole population is affected, but each to such a small, and (relatively) declining, extent that the benefits for an individual of doing anything about it are too small in relation to the costs.

Another explanatory factor is that the effect of the high farm-gate prices of agricultural produce on the final consumer is diluted by the high and rising share of retail prices accounted by the processing, packaging, transportation and distribution of food. It might therefore be expected that the food processing industry, which is becoming an ever more

¹⁷ The source of these figures is OECD (1996). The fall in the nominal, total consumer subsidy equivalent for the EU-12 from 1986-88 to 1994 was 11%

¹⁸ It is interesting to note that high food prices were a public issue in the Swedish agricultural policy reforms of 1990. Of course prices were particularly high in Sweden, and removal of some food subsidies caused them to rise further in the late 1980s sensitising consumers to agricultural policy issues.

concentrated industry might have the incentive and power to lobby for access to cheaper priced raw materials. To some extent they do, but not as part of the public debate.

Another factor in Europe is that there is considerable farmer involvement in much of the first-stage food processing industry, which divides and weakens the food industry lobby. Also some of the processors of agricultural raw materials have built up capacity based on the past volumes of subsidised production. Such business is threatened by a more rational policy. A prime example is the production of bio-fuels from non-food set-aside which is now a lobby which resists proposals in the EU to remove set-aside altogether. The combined effect of these complex factors is that the undoubted impact of the CAP on raising food prices has not been a significant pressure for reform.

3.2.2 *Food quality*

In fact, it has been just as frequent to hear the CAP described as a 'cheap food' policy as one which artificially raises food prices. At first this seems perverse. It is incontestable that European farm and food prices are higher than in comparably developed countries which subsidise farmers less - USA, Canada, Australia and New Zealand. However, for many continental Europeans, perhaps a more familiar point of reference is the even higher prices in those countries which subsidise farmers more - Switzerland and formerly, Austria and Scandinavia, (now just Norway). This might partly explain the cheap food notion. But another explanation lies in the perception that the CAP has encouraged a focus on food *quantity* at the expense of encouraging diversity and *quality*. The epithet 'cheap food' therefore partly refers to low quality rather than low price. There may be some truth in the proposition that the CAP focuses attention away from quality. The intervention mechanisms for grains, meat, dairy produce and wine have indeed created markets for 'government' purchase of bulk commodities at so-called guaranteed prices (actually the buying-in prices, themselves based on intervention prices). This may have had a strong disincentive effect on farmers to aim at quality and product differentiation.¹⁹

Over the years, the Commission has made numerous attempts to raise quality standards for intervention, both to try to avoid the accusation just made, and also to restrict the volumes bought into intervention. But these efforts have done little to discourage the frequent attitude amongst farmers that it was their job to produce as much as possible and the EC's job to take care of the resulting output. This is the antithesis of a market system where a supplier differentiates his produce to segment the market and extract the maximum by selling specialised high-value products.

¹⁹ There is some evidence from New Zealand to support this as the range and quality of their produce have both increased since deregulation.

Of course, it is far too simplistic to blame the intervention support system of the CAP for all the alleged evils of mass-produced, bulk-marketed, low-quality foods. Over the last four decades - roughly the period of the CAP - there have been massive changes in society and in the technology of food processing. The principal changes in social structures and life styles have been: higher incomes, later marriage, more divorce, both partners working out of the home, smaller families, fewer family meals, fewer multiple-generation households, and more leisure activities. The changes in food technology have been equally far-reaching affecting the farm, food factory, transport system, supermarket and home. The interaction of these factors has transformed food and eating habits.

Rising living standards and the experience of international travel which exposes the population to a far wider range of cuisine have encouraged much greater interest in food variety and quality. For an increasing proportion of the population, eating is more to do with gastronomy rather than nutrition or 'refuelling'. Paradoxically, these social and technical changes have created both a much greater awareness and a greater ignorance of food and the processes involved in its production. In certain circumstances, for some age groups and amongst some groups of the population, there is no interest whatsoever in what is being eaten. At other times, and amongst other groups in society, there is enormous concern about the provenance and treatment of food. This of course provides a marketing opportunity for farmers to produce high-quality, well presented and marketed local foods sold on the basis of their appellation d'origine at premium prices. At the same time it provides a contrast with the undifferentiated bulk products, despised by some and allegedly encouraged by the CAP. The same complaints about dull homogenised, low quality foods could equally be made in other countries, for example the United States, where similar social and technological changes have occurred but without a CAP.

The accusation is that the CAP has encouraged intensification of production. It is undoubtedly true that, other things being equal, higher product prices maintained over a long time period encourage more land to be in production, a slower rate of outflow of labour than otherwise,²⁰ greater mechanisation of agriculture and a greater use of variable inputs - feeds, fertilisers and plant and animal disease control inputs. The result is indeed higher ratios of capital to labour and capital to land, and as a result, higher output per animal, per unit of land and per unit of labour than would be the case with

²⁰ This proposition is often questioned, but there are strong theoretical and empirical grounds for it. Theoretically, higher prices mean that higher cost, usually smaller and more labour intensive holdings are retained in production. Empirically, it can be seen in Italy where average farm size has changed little in 30 years, in Greece likewise and a negligible effect of the CAP on average farm size. The UK experience pre-EU entry is another supporting case, it had much lower support and prices and a much faster increase in farm size and labour outflow.

unsupported, lower prices.²¹ Whether this has resulted in lower quality food is much more difficult to answer.

The principal production systems where it is alleged that the CAP-induced intensification has reduced quality is for livestock production, and fruit and vegetables. The main alleged 'problem' in the livestock sector is the move to larger, more concentrated and specialised units in which production is more intensive with higher growth rates, less feed per unit of output, shorter life spans, lower intervals between reproduction, and greater use of animal health products. The proponents of such systems argue that the conditions in which animals are bred, fed and housed are better designed and built than ever before, and that the high performance could only be achieved if the health status of the animals is high. Opponents are concerned that the animals are under too much physiological stress and that these systems are vulnerable to breakdown with potentially catastrophic consequences for human health.

In fruit and vegetable production; the criticism is that the industrialisation of horticulture has resulted in standardised, beautiful-looking, long-keeping specimens but which are uniformly tasteless. Here, the concern is the loss of variety, and fears that the uniformity and blemish-free qualities are brought with a higher risk because of the pesticides used to achieve these results. The counter argument is that the qualities mentioned above are those selected by the consumer. These examples serve to demonstrate that food quality is perceived differently by different groups in society.

The role of the CAP in these debates is far from clear. The problems referred to mostly relate to production technology which has been internationalised and appears to have little relation to the agricultural policy implemented: chickens, pigs and cows are treated in much the same conditions in all developed countries, intensive apple and strawberry production looks much the same in most countries. Besides, the same agricultural policy applies across the EU, and yet the quality problems do not appear uniformly across the Union.

An example of this point is the 1996 BSE crisis. Some tried to explain the change of cattle feed manufacturing, which is generally agreed to be the cause of the BSE epidemic, as being part of the CAP-induced intensification of agriculture. This seems a most unlikely connection. The incentives to reduce the costs of animal feed or to create saleable by-products from animal offal are not increased by having *higher* prices for beef or milk. If anything, it might be expected that lower price regimes might induce more

²¹ It may seem pedantic, but the concept of intensity must relate to ratios of this kind. All too frequently the hopelessly vague term 'low-input' is used to describe what some see as a more desirable farming system, unfortunately the phrase does not indicate which inputs should be 'low' (labour, land or capital?) and whether it is an absolute or relative concept.

'corner cutting' than when fatter margins might be possible. Also, the CAP-induced intensification argument does not explain why it only occurred in the UK.

The same problems related to a negative image of food are to be found in other countries which have both higher (e.g. Japan) and lower (e.g. USA) protection than in Europe. Whatever the explanations, and whatever the science and coldly rational economics of the situation, consumers' perceptions and fears about the production systems in use are real. Addressing these concerns is more to do with food safety controls and appropriate welfare and environmental standards and than agricultural market policy. However these concerns certainly lend further weight to the arguments to re-balance the objectives and methods of food, agricultural and rural policy away from production volume goals.

In short, economists and consumer groups campaign against the inequity of CAP-induced high food prices. However the greater concern of individual consumers is the perception that the CAP has encouraged an emphasis on quantity at the expense of quality. There is a suspicion that the incentive for greater and more intensive production is itself a threat to food integrity, and furthermore if this is done at the expense of nature and animal welfare and all to produce surpluses of farm produce, it adds up to a strong case at least to eliminate the incentive to overproduce.

3.2.3 Budget costs

The traditional pressure for reform of the CAP has been budgetary pressure. This resulted from four factors: most expenditure under the CAP is obligatory, the annual EU budget has a fixed ceiling with no capacity for borrowing, much CAP expenditure depended on uncontrollable factors such as world market prices and the exchange rate between the ECU and Dollar, and the open-ended nature of CAP supports provided the incentive and means for rapid growth in CAP expenditure. These features resulted in the Community lurching from one budgetary crisis to the next, on each occasion taking only sufficient action on the CAP to get through the immediate crisis.

Containing the growth of budgetary expenditure became an explicit goal of policy, and was achieved partly by putting fixed quantitative limits on the production eligible for support - the so-called maximum guaranteed quantities²². Two notable such occasions were the 1984 introduction of milk quotas, and the 1988 reform introducing the 'stabilisers'. The 1992 reforms took stronger action to control the future growth of the

²² Strictly speaking this device, introduced in 1988 was part of the budgetary stabiliser whereby if production exceeded a given volume by 1% then support prices would be reduced by a corresponding percentage. However if the idea is interpreted in a slightly wider sense of a volume limit on the application of full supports, it can still be seen operating for many products, sugar, milk, beef and sheep, wine, olive oil tomatoes. Only in the cereals sector has the MGQ been abolished.

budgetary costs of the CAP. This was done by reducing price support and substituting direct, compensation payments.

There are two extremely important effects of this, latter, change in support. First, it switched a significant part of total support to taxpayers from consumers. This makes the transfers much more transparent and open to regular scrutiny by finance ministries, who should challenge wasteful or unjustified expenditures. The purpose of the payments will be repeatedly questioned, the public will ask why so much money goes to farmers, what are they doing with it and how is it distributed amongst them. Second, the change brings a great deal more certainty to the budget costs of the CAP. The payment rate per hectare and the eligible hectares were defining variables of this scheme, so this has had the effect of making about half of the FEOGA guarantee budget entirely predetermined. For these reasons, the CAP is currently now much less likely to run into short term budgetary crisis than in the 1970s and 1980s. How long this situation will last is addressed in section 4.1 on the Uruguay Round Agreement of the GATT.

The fact that the budget has been such an important instrument for forcing reform of the CAP is a reflection of the general European societal concern that agricultural policy was absorbing a disproportionate share of EU resources. In the early days of the EC, the CAP, as well as the policies on coal and steel, was undoubtedly seen as a force for European integration and cohesion. As its appetite for budgetary funds grew, especially for the purpose of disposing of excess production, the political credibility of the CAP has been eroded.

Now, in many if not most Member States, it is commonplace to find, outside the farming interests, a ritual condemnation of the wastefulness of the CAP, its mal-distribution of benefits which accrue disproportionately to the wealthiest producers, and its alleged encouragement of over-intensive farming. The advent of set-aside has intensified these criticisms; it is very easy to claim that it represents payments for doing nothing. On a higher moral plane, as discussions of world food shortages, starvation and malnutrition surface from time to time, it is very difficult to explain why in a hungry world, Europe's farmers are induced to idle significant parts of some of the most fertile and best-farmed arable land in the world and why grain exports may be taxed.

These general criticisms take on an extra dimension as the political priority in the EU switches to the problem of unemployment. To be spending a sum of 45.2 BECU on a group in society²³, about 7 million farmers, who have jobs and often considerable assets, at the same time as about 11% of the EU workforce or over 18.5 million people are without jobs, or assets is hard to defend. This is given even further force in the run-up to the final stages of Economic and Monetary Union. Almost all Member States are finding

²³ In 1996 53% of the Community budget of 84.5 BECU was allocated to FEOGA (guarantee plus guidance), note that has fallen from 72.8% in 1976.

it difficult to adhere to the Maastricht conditions, particularly concerning public deficits. This has translated in most Member States into searching examination of all public programmes to find ways of cutting expenditures to reduce the deficits. In such circumstances, when cherished educational, health and social security programmes are under scrutiny, it is difficult to argue that agricultural programmes should be exempt.

To make this point more sharply, the 1996 direct payments to arable and beef farmers are expected to be not far short of 20 BECU, this represents about one-sixth of the mid-1996 total excess of public spending in the EU-15 compared to the 3% Maastricht limit, a sum of 128 BECU. To compound the case, when the additional resources in agriculture are perceived to stimulate environment damage, it further destroys the credibility of the CAP. It is to this aspect that the story now turns.

3.3 Environment and Cultural Landscape

3.3.1 Has the CAP market support damaged the environment and would lower support lead to less damage?

That there are environmental problems caused by agriculture is beyond dispute. There is a fundamental conflict between many systems of intensive crop and animal production and many aspects of the environment. In the post-World War II rush to improve agricultural productivity by actively encouraging the uptake of the fruits of the mechanical, chemical and biological 'revolutions' in agriculture, much environmental damage was done. Initially practitioners, and many in the ancillary (commercial and governmental) organisations serving agriculture, including many agricultural scientists²⁴ denied the existence of the environmental problem. It was nothing less than a cultural shock to discover that the evident 'success' of agricultural science could be seriously criticised. Over time as the real evidence - and the real damage - mounted, the awareness of these problems and their acceptance by the agricultural establishment increased.

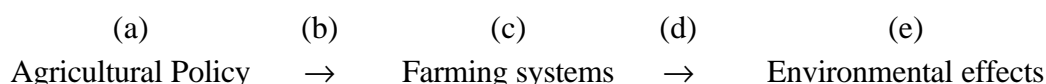
The official recognition that the problems exist, and that it is European policy to reduce the problems and where appropriate to rectify past damage and, in future to enhance the rural environment is enshrined by the Single European Act into the Treaty of Rome (Article 130r) and this was reinforced by making agriculture one of the five target sectors of the 5th Environmental Action Programme, the Commission's agenda for environmental policy.²⁵ In turn, these are concrete manifestations of the EU's contribution to wider International environmental action as a signatory of the Rio Treaty and Agenda 21

²⁴ Which includes agricultural economists too.

²⁵ European Commission (1993) Towards sustainability, A European Community programme of policy and action in relation to the environment and sustainable development.

which, in chapter 14, sets out the principles for sustainable agriculture and rural development.²⁶

The existence of agri-environmental problems is now well documented. There has been a great deal of work in trying to understand the links {(b) and (d)} between the three points in the chain {(a), (c) and (e)} shown below:



Such is the complexity of the physical, biological, economic and social interactions creating these environmental problems that considerably more research will be needed fully to understand the processes at work. However, a great deal is already known about the desirable and undesirable environmental effects. Likewise there is now a large, and also rapidly expanding, body of literature on the connection (d) between farming systems (c) and their environmental effects (e).²⁷ However, less understood and agreed is the relationship (b) between agricultural policy (a) and farming systems (c). Surrounding these problems of the lack of detailed technical knowledge is a broader analytical difficulty in establishing causation between policy followed, the CAP, and observed environmental effects. The reasons for this difficulty, is that, by definition, it is only possible to observe the policy actually followed, and the changes in agriculture and in the agri-environment which occurred at the same time.

Establishing causation requires judgements about what the policy would have been in the absence of the CAP. There is no simple and single answer to this problem. The intellectually clearest counter-factual policy is the complete absence of policy interventions, ie free-trade. The actual policy in force or proposed policies can be compared to this alternative and thus compared to each other. However, using the free trade option in this way is prone to misunderstanding, as it is sometimes taken as advocacy of no intervention. This would only be relevant if it is considered that there are no market failures or imperfections necessitating some kind of collective or public intervention. This is clearly not the case for environmental problems which are the most important class of market failures.

An alternative counterfactual policy is the optimal set of interventions to correct these failures and imperfections. However, this is much easier to state than define, so it is not a practical option. A third approach to examining the environmental effect of the CAP is to conjecture what policy would have been in the individual Member States in the absence of a common European policy. There are good historical reasons to expect that agricul-

²⁶ Report of the United Nations Conference on Environment and Development, Rio de Janeiro 3-14 June 1992, Vol. II, pp71-102.

²⁷ The letters refer to the three variables (a), (c) and (e) and two relationships (b) and (d).

tural policy would have been equally protective in at least some Member States. Each of these counterfactual policies would have had quite different effects on agriculture, and on the environment. So it is far from simple to describe what is *the* environmental effect of the CAP.

Within this confusing situation, economists, at least, consider that they know the relationship between output and input prices and the intensity of crop and livestock production; *ceteris paribus*, the higher the output price the greater the incentive to utilise such variable inputs as fertilisers, crop protection chemicals (CPCs), concentrated feeds and various animal productivity enhancers. There is no doubt that the use rates of these variable inputs does have an important impact on environmental features of concern. However this is only part of the problem. Other things are never equal and the interactions between the appearance and uptake of new technology, farm structural change and the use of these variable production factors is very complex and poorly understood. The regional and local effects are also vitally important, yet the broad economic analysis enables us to say very little about these effects.

Other more detailed approaches to the problem of detecting the effect of policy on the agri-environment are to focus on specific changes in the CAP, and to try and trace their impact, or to compare different regions in which CAP supports were higher and lower or where specific measures were employed or not, or to compare Europe with other countries or blocs where policy was different. Such work has not yet developed sufficiently to enable accurate answers to two commonly asked questions. (1) Has the CAP, and in particular the market price supports, on balance been a force for environmental damage? (2) Would a CAP which had lower (or no) market price support be beneficial or neutral to the environment?

Environmentalists are often shocked that the first question can even be asked. For them, the answer is plainly, 'yes'. Confusing for policy makers is that their answer to the second question is, generally, 'no'. This suggests that the operation of the CAP market regimes is damaging to the environment, but removing them does not help either! Such answers are not necessarily in contradiction. There are positive and negative environmental effects of policy change, also some of the economic and environmental relationships have asymmetric responses (that is, a different response when price goes down than when it goes up) and some relationships are irreversible. Such is the complexity of both the agri-environment and the CAP, that these questions are really too broad to stimulate helpful answers.

In short, ascribing responsibility to the CAP for observed environmental damage is an extremely tricky task. A great deal of the environmental damage caused by agriculture is related to the post-war production technologies. As essentially the same technical developments have occurred in all the developed countries and consequently similar environmental problems have followed their use, the particular agricultural policies

pursued cannot be the dominant factor. The most helpful approach might therefore be to concentrate on recording the environmental indicators of concern, and the changes in farming structures and systems, and observing how these are changing and if they indicate improvement or worsening in the rural environment.

3.3.2 *Environmental concerns and agri-environmental pressures*

The environmental problems may be considered under five headings: (i) pollution of water, (ii) pollution of air, (iii) pollution, erosion and other damage to soil and the hydro-geological equilibrium, (iv) loss of bio-diversity both on the farmed land and its surrounds, and (v) the systemic effect of all the above on the rural landscape. For many regions and for many observers, this list represents a rather too narrowly defined view of the environment; a more general concept of the 'cultural landscape' is preferred which would add to the above list many aspects of the human cultural heritage of rural areas such as vernacular architecture; man-made landscape features such as field boundaries; villages; local traditions, cuisine, dress, art and literature and even language. Whilst not in any way wishing to diminish the significance of these features, most of what follows in discussing the connection between the CAP and the environment refers to the 'natural' or 'semi-natural' environment.

To discuss the extent of these environmental problems, the damage they create and to enable the setting of policy objectives and monitoring of their achievement, it is necessary to compile environmental indicators. There is considerably more work to be done on this, but much thought has been devoted to describing the principles involved and developing lists of indicators for the problem areas summarised above.²⁸ There is no uniquely applicable schema for classifying these problems; the above concept was to consider the three 'media' soil, air and water and then to add bio-diversity and landscape. An alternative approach is to classify themes which embrace environmental problems:

- Protection of ecosystems against the entry of nutrients and plant protection products,
- Maintenance of agricultural landscapes and wildlife diversity,
- Maintenance of agricultural plant and animal genetic resources,
- Reduction of gases relevant for the change of the climate, and
- Sustainable water management.

²⁸ One of the most comprehensive catalogues of the state of the European Environment including the effects of agriculture on soil, water, air, landscape and bio-diversity is Europe's Environment: The Dobbris Assessment, (1995). As far as developing environmental indicators is concerned, the OECD is active in this field, see OECD (1997).

This classification highlights explicitly the concept of sustainability,²⁹ the global dimension of some of the problems (eg. contribution to the greenhouse effect), the concern for resource depletion and loss of genetic resources. Whichever way the problems are characterised, it is clear that they are multi-dimensional, they are often highly specific to local circumstances and they have many difficult temporal and spatial characteristics -some show up quickly and locally, others with a long time lag and diffusely, some cumulatively others not, some irreversibly and other not.

The links between agricultural production activities and these environmental problems are also not easily classified uniquely. One way of considering the environmental pressures brought to bear by farming systems is to distinguish them according to whether they arise via:

- technical change, (through mechanisation, chemical, biological, biochemical, biotechnological changes and even via micro-electronics)
- increased intensity of crop production, (fertiliser and crop protection chemical use)
- increased intensity of animal production, (stocking density, housing, feeding and waste treatment systems)
- changes in enterprise rotations, (specialisation, geographical concentration of production)
- changes in the physical land structures, (farm and field consolidation and enlargement, irrigation and drainage development)

Each of these in turn has complex economic, institutional and technical causes, but each is thought to have impacts on the environmental problems categorised above. This is not the place to examine these relationships, but again, whilst there is of course much more to discover, a good deal is known about how changes in farming systems under each of these headings bring about environmental problems.

3.3.3 *Environmentally damaging effects of CAP*

With all these qualifications stated, there are generalisations which are commonly made, and accepted, suggesting how the CAP has been responsible for rural environmental degradation. First, the risk-reducing effect of high and relatively stable price levels has

²⁹ The very concept of sustainability is a difficult one. Its intention is clear enough. It is concerned with economic and social objectives and the idea that pursuing these objectives now does not compromise our ability to pursue them in the future. This involves a fundamental trade-off between current economic production objectives and protecting the environment as necessary to enable those objectives to be met in the future. In this rational concept of sustainability, resource saving technical progress plays a vital role. A practical problem which weakens the usefulness of the concept is that we lack the knowledge of the necessary conditions for achieving it.

encouraged agricultural investment and the greater use of the kinds of variable capital inputs listed above. This more capital intensive agriculture bring in its wake environmental problems of all the categories listed above. The intensification occurs in two forms, greater capital : land ratios on existing land area, and also the bringing into production of land which would not be profitable at lower prices by virtue of its location, climate or fertility.³⁰

If more fertiliser, feed and CPCs are used, then it is likely that there will be a higher risk of pollution of water, air and soil from their use.³¹ Higher investment in ever-larger machinery facilitates this tendency and also creates its own environmentally destructive momentum: for example, more soil compaction, the bringing into cultivation of marginal, more fragile soils, and the drive for larger fields and farms. These have impacts on soil erosion, on habitat diversity and the loss of habitats. The impacts themselves are site specific and vary enormously according to the natural conditions (soil type, climate, site aspect and slope), and the degree of care in employing these various technologies. In the right circumstances, they are not necessarily damaging, but on fragile soils in hilly regions the same technologies and monocultures can, for example, lead to erosion, landslides, floods and thus irreversible damage.

Second, the uneven support for certain products (which is highest for the bulk commodities cereals, oilseeds, sugar, beef and milk, and less for speciality products, generally fruit and vegetables) encourages specialisation and concentration on the supported products at the expense of others. Rotations are changed to have fewer crops and therefore shorter intervals between the same crop. These effects are seen most clearly for the large scale arable crops, 'les grandes cultures'. The environmental impact of this tendency to monoculture is reduced bio-diversity, but the effects are hard to disentangle from the problems listed in the above paragraph, as the move to specialisation generally accompanies the intensification described above.

The changed relative prices also affects the balance of feed ingredients in the livestock sector, particularly, but not exclusively, the intensive livestock sectors, pigs, poultry and milk production. These latter tendencies are complex. The higher cereal prices in the EU have stimulated the use of cereal substitutes (various domestically produced and imported protein sources such as oilmeals and maize gluten, plus cheaper, mostly imported, sources of carbohydrate such as manioc). Because of the dependence on imported feed ingredients, this has encouraged the concentration of intensive livestock

³⁰ That both of these forms of intensification occurred is beyond doubt. They are most easily demonstrated in later entry member states for example the UK where the cereal area and production increased 6% and 38% respectively from 1970-1972 to 1981-1983. There is little doubt that part of this increased area and intensification of production was environmentally damaging.

³¹ Of course there is not a simple one-to-one relationship, environmental impacts vary greatly according to the timing, technology and conditions of use of these inputs.

production in areas close to ports such as the Netherlands, Belgium (Rotterdam and Antwerp), N Germany (Bremen/Hamburg) and Denmark (Copenhagen). The comparable concentration in Bretagne in France is not so much 'port related' but based on the abundant availability of a well organised farm work force plus favourable conditions for forage maize.

There is no doubt about the existence of environmental problems (particularly the imbalance in nitrogen) in these regions, nor the source of the problem in relation to the farming systems employed. However, the policy responsibility is much less clear. Suppose that cereal prices were reduced to world market levels (as they were by late 1995 and during 1996), and suppose this encouraged a switch back to using cereals for intensive animal production, would this change the intensity of pig and poultry production? Would it change the concentration, the specialised nature and the location of this production?

The answer is most probably, 'no'. The intensification of pig and poultry production was, by and large, not stimulated by high protection. It was driven by the technological changes leading to better understanding of the nutrition and optimal conditions for the rearing of these animals, plus demand pressure created by the trend to 'healthier' diets based on more white meat. If grain prices fell to their levels of the early 1990s, and if as a result, the EU became a net grain importer, the pig and poultry sectors would remain intensive and would still find it advantageous to be clustered around the ports.³² These are examples where so-called autonomous technical change and structural change are more important than relative prices in determining production system and environmental impact. The agricultural policy effect is thus muted.

The situation in relation to dairy production is different. High milk prices have undoubtedly stimulated both an increase and intensification of production, and there is evidence of the same tendency for milk production to become more specialised and concentrated. However, policy cause and effect, and the environmental issues are even more complex. Structural and technical change in dairying has been partly autonomous, and partly driven by the need to expand herds to utilise fully the 'fixed' input of the ever-more-expensive cow-man. The environmental problem of nitrate-overload from concentrated dairying based on imported feeds is clearly visible, and so too the demands placed on water in affected zones.³³

An additional environmental dimension with ruminants is their contribution to greenhouse gases, in particular methane. It has been estimated that 34% of anthropogenic

³² With its proximity to the main grain production region in Europe, Bretagne would not be affected by these arguments.

³³ Note that the feeds are not necessarily 'imported' into the intensive livestock regions from abroad, but from other areas of the EU. However, the environmental effect is the same.

methane emissions in Europe are from agriculture, mostly from animal production where 70% of the methane is emitted by ruminants and 30% from manure. As about 48% of EU cattle are dairy animals, the dairy sector appears to be contributing about 16% of anthropogenic methane in Europe.

Has the CMO for the dairy sector been a force for environmental damage or the opposite? As an analytical exercise, it is interesting to conjecture the environmental effects of simultaneously eliminating the milk price support, the milk quotas and the supports on feed prices. With lower support, there might be less milk production in total and thus fewer cows, hence less imposition of N and CH₄ and a smaller demand for water.³⁴ These seem to be potential environmental gains. However, the changed relative prices of milk, cereals, cereal substitutes and forage could stimulate lower feed intensity, more grass-fed milk, lower yields and thus more animals to produce a given volume of milk.

The impact on regional location of production in a deregulated market could also be profound and have noticeable environmental impacts. Protagonists of high milk prices plus milk quotas defend them as a way of preserving production in regions where milk production would not survive at international market prices. If true, and if upon the removal of dairy supports, the dairy cow population of various remote or upland areas fell, there would be a reduction in the negative effects of the cattle in these areas, but a reduction of the positive aspects too. It is likely that some land would be switched to extensive cattle or sheep fattening (perhaps increasing CH₄) or some abandoned from grazing and thus farming altogether. These changes would undoubtedly affect biodiversity and soil erosion and have a negative impact in both the narrow and wider cultural landscape concepts of environment. It is very difficult *a priori* to anticipate the balance of these effects, and thus to formulate any overall view on whether present policy can safely be described as environmentally benign or harmful.³⁵

³⁴ Even these gains are in doubt. Given both high prices and binding milk production quotas, it is not axiomatic that total milk production would fall in the absence of price support and with quotas removed. It would fall in some areas, but could well rise in those areas which can profitably produce at international prices. The balance between these effects is hard to predict.

³⁵ It is a worrying thought that we do not know what the overall effects of the kind of package of support changes discussed would be on the nature and extent of different farming systems nor on the balance of the environmental impacts. But also, it is not very clear that we have the research techniques to answer these questions even if given the necessary time and resources. Research can no doubt be helpful in understanding the kind of adjustments possible to certain farming systems, but modelling the aggregate environmental, economic and social impacts of such a complex series of changes is not much more than systematic guesswork. This is not to denigrate such efforts, nor to create a sense of despair. However, it does suggest a certain amount of humility in offering judgments about the likely outcome of the reforms, and it also lends weight to the concept that CAP reform is a process not an event. The reform process takes place in phases over a period of years; as problems arise which are not handled by existing instruments, then new instruments must be developed.

In short, there is a *prima facie* case that the high price supports, the particular balance of supports between products and some of the structural support measures under the CAP have had damaging effects on the rural environment. This damage has mostly resulted from an over-expansion and over-intensification of agriculture.

3.3.4 Beneficial effects of CAP on the environment

The cultivated landscape in Europe is a nature conservation resource of great value which has been created by continuous agricultural land management, often stretching over many centuries. During this time, complex ecological relationships have been developed between plants, invertebrates, birds and mammals, resulting in the dependence of many highly specialist species on a stable, albeit man-modified environment. In addition to contributing to the maintenance of biodiversity and the cultural value of the rich European landscapes, the continuation of well adjusted farming systems is, in some areas, specifically in the Mediterranean regions, a precondition to avoid desertification and erosion.

Farming systems, well adjusted to site-specific environmental requirements, maintain important habitats both on the cultivated or grazed land (for example, cereal steppes and semi-natural grasslands) and in features such as hedgerows, ponds and trees, which historically were integrated with the farming system. Examples of High Natural Value farming systems include livestock farming such as keeping sheep, goats and beef animals, especially on semi-natural grasslands, lowland wet grasslands, moorlands and heaths, mountain pastures, wooded agro-pastoral land, and Mediterranean scrub; it also includes dairy cattle grazing high alpine pastures and coastal marshes.

It is not only some livestock production systems which can have these desirable features; some arable and permanent crops offer them too. These are predominantly systems with low yields and, characteristically, extensive land use which can have positive effects with respect to maintaining biodiversity. This holds true specifically for some permanent crops, especially tree crops such as evergreen oaks, old orchards and olive trees.

Where agriculture faces difficult conditions such as poor soils, harsh climates and unfavourable structures, or if economic pressure encourages farmers to switch to more harmful farming practices, provision of high nature value is not guaranteed as a joint product of agricultural activities. In such circumstances, the long-term viability of the environmental functions of land use and the continued provision of environmental benefits from agriculture require payment of farmers for the provision of such environmental goods and services.

In many cases, neither avoidance of negative effects nor stimulation of positive ones can be achieved at a satisfactory level, on the basis of market activities alone. Environmental

goods and avoidance of environmental damage often have the character of so-called public goods. While these public goods are consumed jointly by society, the individual contribution to their supply is difficult to enforce. Therefore, the environmental effects of agriculture have become the subject of both environmental and agricultural policies.

Even before the explicit supports for agri-environment introduced in the MacSharry reforms in the form of the accompanying measure 2078/92, there were a number of other ways in which it can reasonably be claimed that the CAP played a positive role in environmental protection. The first is that in some regions, supports provided by the CAP under commodity market programmes have maintained production where it would otherwise have disappeared. Were it to disappear, then the presumption is that this would have significant effects on biodiversity, it would change the landscape, it could in some circumstances lead to more soil erosion and poorer water conservation. It is also argued that a prosperous agriculture is one which has the resources, including management time, to take care of the environment; thus the CAP which transfers resources to agriculture contributes positively in this way. These are the general arguments. Some maintain that they have extremely wide application, that the CAP maintains production on 'two-thirds' of the current land area which would 'disappear' if the supports were eliminated³⁶. Such arguments can only be settled with reference to specific examples and by close study. Two examples will be discussed, dairy quotas and less favoured area (LFA) payments.³⁷

The argument that CAP has ensured the survival of farming in certain areas is made with most conviction for dairy quotas and for LFA payments. In each case, the proposition is that without support, the outflow of people from, respectively, dairying and cattle, sheep and goat farming in LFAs would have been much higher, and perhaps for some regions catastrophically so (both for the regions of emigration and immigration).

The preservation of dairying and LFA farming is said to be important for both nature and for the cultural landscape. The grazing eco-systems are long-established, semi-natural habitats with considerable environmental value. If, without the support provided by the dairy regime or the LFA payments, these livestock activities largely disappeared, this would be regarded as a significant environmental loss. In the worst case, the loss takes the form of a complete change in the ecology as permanent grassland is replaced with scrub influencing the flora and fauna of the uplands, changing the landscape and altering the accessibility of the land. If dairy quotas and LFA payments were terminated with no

³⁶ These are exactly the terms in which debate is conducted, using broad-brush estimates of the vulnerable proportion of the land area or farms and strong terms such as 'abandonment' and 'disappearance' of farming. These magnitudes are, of course conjecture, and they are extremely difficult to estimate systematically using available models.

³⁷ This does not refer to all LFA payments, but to those made, for example, in upland areas for cattle and sheep production.

remedial measures, it is presumed there would be a significant change in land use, a significant reduction in intensity and perhaps even some abandonment of land from agricultural production and a decline in the agricultural population. It is argued that all these would have a deleterious effect on the environment. This sketches the 'environmental case' for these instruments of the CAP. How convincing is it?

Several points are worth making about this. First, there has been a large outflow of labour even with these policies in place. There is some evidence that the outflow is less rapid in LFAs compared to non-LFAs, although there is a great deal of difference between Mountainous areas and other 'simple' LFAs.³⁸ This could be interpreted that the policy has 'worked', and has inhibited the process of restructuring. Second, it should be noted that there has been no significant abandonment of land despite the large outflow of labour. Thus the land : labour ratio has risen steadily.

This should give pause for thought about the necessity of preventing further labour outflow. Is there a threshold beyond which any further labour loss causes collapse of the farming system and widespread land abandonment? Or is a better model that there is a continual adjustment process in which farm size and the technology employed accommodates to the economic circumstances, and thus some farming would survive in these areas even without the protection of the milk quotas and LFA payments? Of course there could be negative environmental effects in such restructuring. With respect to the environmental benefits of these regimes, the third point is to ask whether these instruments are the best way of achieving these benefits. Neither the milk price regime nor the LFA system were explicitly designed for environmental purposes³⁹, *a priori*, it seems reasonable to suggest that more targeted agri-environmental policies would better achieve such aims.

A third regime of the CAP which affects a significant proportion of the agricultural area is the set-aside scheme introduced under the 1992 reform of the cereals, oilseeds and protein sectors. This provides another example of a regime in which the primary purpose was not to create environmental benefits but for which it is claimed that significant such benefits are, or could be, generated. A very small proportion of the set-aside area has

³⁸ Eurostat data show a general outflow of total agricultural labour and also full time labour of 14% over the period 1987 to 1993. At the same time the total labour in LFAs declined by only 5% and the full time labour actually increased 3%. However within the LFAs there was a faster outflow of total and full time labour from Mountain areas than the so-called simple LFAs.

³⁹ There were three main motivations for the LFA payments: offsetting the effects of permanent natural handicaps in production costs, protection and maintenance of countryside and environment, and combating large scale rural depopulation and land abandonment. In practice, the achievement of the second of these was more by accident than design as there were few explicit environmental measures built into the scheme beyond a rather ineffective limit on stocking density for animals eligible for payments (but not total animals).

been explicitly designated for environmental protection under the 2078 agri-environmental measure.

For the bulk of the set-aside area, environmental benefits include some additional biodiversity (compared to monoculture of cereals or oilseeds); the fallow in the rotation represents a reduction in production intensity with perhaps some saving in application of fertilisers and CPCs over the whole rotation. However, there can be some offsetting negative effects. For example, if green cover is not established soon enough or thoroughly enough, there can be erosion problems; also the accumulation and then ploughing-in of organic matter can cause more nitrate release than continuous arable cropping.

Of course, as with all forms of cross-compliance, i.e. the achievement of some environmental objective as a secondary goal of an instrument designed primarily for something else, as soon as the need for set-aside diminishes, the environmental benefits diminish too. This again illustrates the principle that if society wishes its agricultural policy to achieve environmental objectives, this will best be achieved by using environmental instruments targeted on these objectives.

The other environmentally positive aspects of the CAP are schemes under the structural policies in objective 1 and 5b regions for improving, maintaining and enriching rural landscapes, and more recently, under regulation 2078/92, the agri-environmental accompanying measure introduced with the 1992 reform. To some extent, these measures are an illustration of the conflicts inherent in the CAP: the commodity regimes give incentives for farmers to intensify and increase production, and one purpose of the environmental protection schemes is to undo the damage caused. A better integrated policy would avoid this 'double action'. These schemes certainly have the potential for achieving environmental benefits. They will be discussed at greater length in section 7.2 below.

The environmental case against the CAP can now be summarised. First, it was stressed that general arguments linking CAP high-price supports and environmental damage should be treated with caution, as the causation between Policy - Farming System - Environmental damage is complex. Many other factors have contributed to the changes in agricultural systems and technology which have proved to be environmentally damaging. That said, the over-stimulation of agriculture has undoubtedly had some damaging impacts. However, there are some offsetting effects to the extent that the CAP has moderated the rate of labour outflow from agriculture and thus protected some farming systems compared to the situation without such support. The balance of these positive and negative effects is impossible to summarise in a single index.

Before moving on to consider further dissatisfaction with the CAP, it is worth noting that in addition to consideration of the natural environment, there is a wider concern, in the words of the 1988 Commission Paper 'The Future of Rural Society', for the preservation

of the fabric of rural society. This embraces the widest definition of the rural environment and cultural landscape (see the first paragraph of section 3.3.2, page 31) but it also goes considerably beyond agriculture. It raises the question of the role of agricultural policy in rural development. Plainly, as agriculture shrinks in its relative importance to economic life, even in rural areas, then the capacity for agricultural policy to contribute to the income, employment and other social problems of rural areas becomes more and more limited. These issues are taken up in section 7.3 below.

3.4 Incoherence and inconsistencies in the CAP

3.4.1 *The general imbalance in the CAP*

Within the general problems of the CAP discussed above, there are a large number of more specific difficulties concerning the objectives, instruments and implementation of the complex mix of measures which make up the CAP. The objectives of agricultural policy have always contained and are likely to continue to contain some fundamental conflicts. It has proved very difficult simultaneously to satisfy the income aspirations of farmers with the desire for low price food for consumers. The rational development of agriculture through rapid technical progress helps those who can master it at the expense of those who cannot. Structural and technical development of agriculture, e.g. irrigation and drainage, may help producers but at the expense of certain aspects of the environment.

No policy can eliminate these contradictions. Acceptable policy reflects the current priorities of society, unacceptable policy results from insensitivity to changes in these social priorities or inability of the political institutions to react to these changes. These problems are certainly the case with the CAP and the decision process of European agricultural policy.

The CAP is an imbalanced policy. The imbalance at the broadest level is its gross over-dependence on the use of market policy at the expense of structural, environmental and rural development measures. So embedded has been this approach, and so important for a large share of farmers' incomes that farmers and administrators alike were not able to see that there is anything strange in a policy which leads to open references to practices such as 'farming the subsidies' and 'producing for intervention'. The incoherence also shows up between elements of the policy: between structural policy and market policy, between market and environmental policy, and between structures and environmental policy. This is also evident within each of these three strands of policy.

Many of the inconsistencies are the result of years of adding and elaborating policy to deal with successive problems encountered. Rarely have categories of instrument or regulations been removed altogether and replaced by a new measure, almost always new

regulations were added to the existing ones. This has always been done in a (politically) balanced package of measures in which there are enough decision variables to allow differentiation and exceptions enabling each Member State to achieve some of their own objectives. The other occasion on which complications and further scope for inconsistencies arise is at each successive enlargement of the Community. However, this political balance has been obtained at the cost of an extremely complicated and increasingly incoherent policy. The following five sections contain examples of these inconsistencies. These are explored with the constructive purpose of identifying ways to reduce or eliminate them in a better integrated policy.

3.4.2 Inconsistencies between CMOs and structural policy

While market policy and the developmental part of structures policy were geared to encouraging greater productivity, these two elements could be seen as complementary. However during the 1980s as the surplus problem escalated, the inconsistency of encouraging structural developments which worsen market imbalances was recognised. As a result, there has been a successive de-emphasising of the development part of structures policy confining it to commodities not in surplus and to minor infrastructural developments more to do with relieving drudgery than improving productive capacity.

These tendencies did not endear this aspect of the CAP to farmers' organisations or to Member States who had to co-finance them. However inconsistencies remain. An example occurs in some southern Member States between compensation payments and farm restructuring and modernisation. Arable area payments appear generous to landowners in Spain, who therefore tend to be much less interested than formerly in renting out land. This is an obstacle to tenant farmers who are trying to create viable farming structures. In this way, the cereals and oilseeds regime is seen to be in opposition to the aims of the structural measures of Objective 5a, and also to the aims of the early retirement accompanying measure (2079/92). Likewise, milk quotas are an obstacle and inhibition to restructuring and modernisation unless, as for example in the UK, France and Italy, there are member state schemes to allow quota markets to develop or to reallocate quota through national reserves.

Another example of inconsistency between these two broad categories of measures is provided by the conditions for receiving aid under the CMOs compared to the Objective 5a structural programmes. The conditions for the arable and beef payments are that the recipient must be farming, for example, cereals, oilseeds, proteins or beef. There are no conditions that this must be a full time activity or even a major or important activity for the farmer, and likewise no conditions on income levels. In contrast, to receive aids under most Objective 5a schemes, farmers must demonstrate that farming is a full time activity and must commit themselves to this for five years, and furthermore they must be in areas with lower than average incomes. Given the relative amounts involved, there

seems little rationale in this contrasting approach. Of the two programmes, it is the compensation payments which seem out of line. But equally, it is well recognised that part-time farming, or pluri-activity is a rational response to the small natural-resource base of many European farms, so structural policy should not artificially discriminate against this development which can be highly conducive to a balanced rural economy.

3.4.3 Inconsistencies between CMOs and agri-environment

The high prices of the CMOs actively encourage more output and more capital intensive output both of which can be environmentally damaging, and thus contribute to the problems that agri-environmental policy tries to improve or eliminate. There has been a great deal of attention given to the scope for the set-aside programme to try and soften this inconsistency. However, the primary purpose of set-aside is to control production and thus to help maintain high prices for the major arable crops.

Adding EU-wide and member state constraints to try and derive some environmental benefits from set-aside is a perfectly sensible thing to do, but at best this can only be expected to have a marginal, accidental and transient environmental benefit. Marginal, because there is no incentive for farmers to choose the most environmentally fragile land to go into set-aside. Accidental because there is no special reason to expect that the most erodible or otherwise most environmentally sensitive land in a given region is in COP production and thus might be chosen for set-aside. And transient, because most set-aside was rotational thus the environmental benefits to wildlife and habitats are lost as soon as the land returns to production.

Furthermore, if the whole set-aside requirement is reduced by a third (as has happened from 1993 to 1995) or even eliminated, then the environmental benefits are cut in the same proportion. Many environmentalists are also concerned that set-aside can damage the environment. This can happen if green cover is established too late or incompletely (there is far less incentive to get a good green cover than to establish a 'real' crop, also, the ploughing-in of green cover can be more damaging in terms of nitrate leaching and CH₄ production). If certain areas of land really are considered unsuitable for arable production, then long-term set-aside or some form of conservation reserve should be the solution. This can be done under Regulation 2078/92, but the scope of such schemes to date is limited by comparison to the COPs regime. Indeed, it was only in 1995 that the obvious inconsistency was removed in which long term set-aside was not allowed to be included as part of a farmers' annual set-aside requirement.

Comparable inconsistencies exist between the beef and sheep CMOs and the agri-environmental measures (or their objectives). These can happen 'both ways'. Under Regulation 2078/92, farmers may receive payments to convert arable land into extensive pasture. But there is no guarantee that, having done this, they can graze the land with

beef and sheep if they do not have, or cannot obtain, the necessary basic animal numbers to qualify for livestock premia. Although strictly not part of the livestock CMOs, a reverse inconsistency can come about in LFAs where the number of livestock units receiving LFA allowances is not limited. This can, and in some areas has resulted in overgrazing with damaging effects on highland pastures - reduction in biodiversity and erosion damage. These same pastures can be the subject of 2078 programmes concerned with the protection of such meadows and grassland.

3.4.4 Inconsistencies between developmental structural policy and agri-environment

Not only do the modernisation actions help increase production, but they may also encourage extension of farming into fragile areas and valued habitats, and in a manner which is capital intensive and environmentally damaging. One example is the overgrazing stimulated by the LFA payments under Objective 5a described above. Another example is provided by cases where afforestation is done in an environmentally damaging way. Others are problems linked to irrigation and drainage in unsuitable areas.

Another example which undoubtedly has had a big environmental effect is the developmental structural policy, especially investment aids. Whilst in line with the objectives to improve productivity and thus to raise living standards, actions like: drainage, irrigation development, farm restructuring through amalgamation and consolidation, and improving the capacity of livestock production enterprises, especially when they take place in areas which are more environmentally fragile, can be damaging to the environment. This represents a direct inconsistency under the CAP.

It appears that the EU can simultaneously pay people to farm in an environmentally sound way, for example by converting to organic production, but at the same time, it provides assistance for farmers to invest to intensify their production which has a high likelihood of being environmentally damaging. An example is that under Regulation 2328/91, farm level irrigation development has been encouraged, over-exploiting aquifers and polluting groundwater, and this is followed by the use of Regulation 2078 which can pay farmers to reduce their demands on water resources.

3.4.5 Inconsistencies within market policy

Within market policy, there is imbalanced support between commodities. For example, since 1992, cereal and oilseed prices have been reduced, milk and sugar prices remain very high. There is no obvious reason why farmers of different commodities should be treated differently in this way, and the differences are not in any way related to incomes, difficulty of natural conditions or any other objective factors. There are also examples of incoherence within policy for a single commodity, for example male beef headage

payments are bewilderingly complex with different rates for animals under extensification programmes, in less favoured areas and under agri-environmental schemes.

There is also a lack of coherence in those regimes which have both high prices and production quotas, or other supply management tools, eg. milk, sugar, cereals. This is often described as the 'accelerator : brake' model; the high and stable prices are the accelerator spurring investment and production, and the supply management measures are the brakes trying to reduce production. This is inherently an inefficient and wasteful approach.

3.4.6 *Inconsistencies within structures policy*

There is a deep-seated tension between trying to aid agricultural restructuring, intensification and efficiency by encouraging people to leave farming, versus trying to preserve as many people in farming by supporting those in specially disadvantaged areas, by LFA payments and helping farm diversification and extensification. The priority has been gradually resolved in favour of the latter approach. However the tension remains and will be re-emphasised by Eastern enlargement. Likewise, the emphasis of structural policy between the horizontal or sectoral approach as exemplified by the Objective 5a measures and the spatial or territorial approach of Objective 5b has been increasingly resolved towards the latter. This has led to the development of many regional designations, each with their maps showing which territory lies within zones declared by Member States as eligible for certain measures.

There are now different maps for LFA schemes, 5b programmes, the LEADER programme and zonal plans under the agri-environmental measures (2078) and afforestation (2080). When several of these schemes operate in the same area, there is great complexity and confusion both for the subjects of the measures and those trying to implement them. In some cases, the two measures are trying to achieve the same objective (e.g. LEADER and 5b working towards rural development), in other cases they may be working in conflict. In some cases, the EU programmes complement Member State activities; in others there is duplication (e.g. LEADER support for small and medium enterprises for which there are often national schemes). Some of these conflicts are deep and unavoidable, but because the schemes have grown up adventitiously to mitigate the effects of the dominant market policies, they are ripe for rationalisation and, hopefully, simplification if and when the basis of policy moves to regions rather than sectors.

4 THE MOVEMENT TO MORE LIBERALISED TRADE

The early 1990s was an extremely important period for trade liberalisation in Europe because the completion of the single market in the EU, was achieved and the Uruguay Round Agreement under the General Agreement of Tariffs and Trade was signed. Agricultural policy had no formal part of the former but was a critical element of the latter. The 31 December 1992 marked the date of the completion of the internal market. Whilst, of course, there were and remain many imperfections in achieving this aim, in principle, at least, there is free circulation of goods, services and factors of production in the EU. Formally, the Common Agricultural Policy is not regarded as an exception to the single market principle, but in effect, the existence of national quotas for milk, sugar, beef and sheep represents for these products a turning away from the advantages of a Europe without frontiers in which production can take place where it has the greatest comparative advantage.

4.1 *GATT and WTO*

The 1994 Uruguay Round Agreement on Agriculture (URAA) was part of the last, multilateral trade negotiations within the framework of the General Agreement on Tariffs and Trade (GATT). GATT has now been superseded by the World Trade Organisation (WTO) which starts its existence with the strong advantage of including all major economic sectors. The agricultural agreement was significant because it marked the full integration of agriculture into the 'rules and disciplines' of trading relationships for the first time. This was done through a comprehensive set of commitments on market access, domestic supports, export subsidies and sanitary and phytosanitary regulations.

Apart from the undoubted significance of the specific commitments, the URAA is important because it marks an agreement by all contracting parties to GATT that they will work together progressively to reduce all direct and indirect measures which directly and indirectly restrict agricultural trade. It was an explicit part of the URAA that the WTO Member States will reassemble at the end of the decade to commence a further round of negotiations to continue this process of agricultural trade liberalisation. Thus the achievement of the Uruguay Round was to solve the problem of the institutional framework for negotiating agricultural trade, the real liberalisation will occur in the next round.

There is common agreement that, for the EU, the least binding commitment of the URAA for the period until 2001 is that concerning the reduction in the aggregate measure of support (AMS), the most binding commitments are those concerning subsidised exports. The commitments on market access lie somewhere in between. The main reason that the commitment to reduce the magnitude of domestic support is not a

binding constraint is that the 1992 CAP reform converted a significant part of this support for cereals, oilseeds and proteins (COPs) and for beef, from price support which would have been included in the AMS into compensation payments which, by negotiation, were explicitly excluded from the AMS. That is they were classified as Blue Box measures (Article 6, 5(a) in the URAA) and not subject to reduction commitments. This makes these payments apparently secure until 2003 under the terms of Article 13, the Peace Clause. However, there could be much discussion on their acceptability in the future. It is likely that they will be challenged if they remain in their present form. In addition, it was argued in section 1 that it is not justified or desirable to apply these payments to the prospective new Member States of the Union. This provides two arguments that the present payments must be changed by the early years of the next century.

The legitimacy of so-called 'direct' payments is highly likely to come under increasing scrutiny by the WTO. It is already the subject of much analysis and discussion in the OECD which has pioneered approaches to the measurement and monitoring of the extent of support for agriculture. It is not just the EU which is increasingly providing supports to its farmers through various forms of direct transfers rather than measures which raise prices. If these transfers are made in ways which do not create additional incentives to increase the crop area planted or numbers of animals, or to increase yields by the use of additional variable inputs and do not act as a disincentive to consumption, then they should not distort trade and they can be classified as green-box (defined in Annex II of the URAA).

The tests of this decoupling are that the payments should be invariant with respect to current prices, the current areas planted or animals kept and thus invariant with current production. This in turn suggest that all such payments should be based on historic costs, prices, areas, numbers and yields. However, if a group of producers who were once in receipt of high price support have all this support removed, but are compensated fully and indefinitely for their lost revenue by fully decoupled payments, this can still have an effect on their production decisions.

There are many issues relating to the likelihood of decoupled payments causing distortions. In an extreme version, farmers are not required to produce anything to qualify for the payments. Such a scheme can presumably only be applied as a transitory arrangement. Society is unlikely to want to use agricultural policy to make indefinite payments to those who have not been engaged in agriculture for many years. If, on the other hand, the recipients are still engaged in agriculture, then it is unlikely that their production of the previously supported crops would drop as much as if they had no payments at all. If rational, they will adjust their use of variable factors to balance marginal costs and the reduced marginal revenues as product prices are cut, but it may be rational for them (the farmers and their land) to continue in production given the 'income

support' of the direct payment. This is the fear of those who do not receive such payments.

Pursuit of these arguments leads inexorably to the conclusion that compensation, even if apparently, perfectly decoupled, cannot last for more than a transitory period. Permanent payments can only be justified if they are payments for some legitimate public good provision.⁴⁰ The most obvious category of such public goods and services are in the form of the rural environment and cultural landscape. This turns the attention towards defining these public goods and ensuring that payments do indeed relate to their production. A great deal of international attention will no doubt be focused in future on agri-environmental payments and indicators. The green box will have to be truly green.

Because the tariffication of import protection in the EU, as elsewhere, was based on the base period 1986 to 1988, the initial tariff equivalents or maximum bindings were extremely high. So even after these have been reduced by the agreed 36% tariff reductions in the URAA between July 1995 and June 2001, the applied tariffs are expected to be well below the maximum bindings. Therefore, the tariff reductions are expected to have little effect on the domestic market for the period of the agreement. It remains to be seen how ambitious the target reductions in the first WTO round will be. Similarly, there has been little experience to date in the application of the safeguard measures, which allow countries to use tariffs to protect against sudden price collapse or surges of imports.

The real challenge to the continuation of the current CAP is thus posed by the volume and value constraints on subsidised exports. For most products, these are not currently causing a problem. The commodities for which there could be difficulties within the period of the agreement are beef⁴¹, cheese and some other milk products. Whereas it was feared that the export subsidy, value commitment could become a binding constraint, the 1996 switch from export subsidies to taxes for wheat and barley created some slack which can be taken up by exports of unprocessed and processed dairy products and products with high sugar content.

Such difficulties may not be sufficient to create pressure for immediate wholesale further reform of the CAP, but they are certainly a constraint on domestic policy. However, given continuation of the tendency for growth in yields of cereals and sugar to exceed growth in domestic utilisation, the pressures will build up steadily over time. If further reductions in the volumes and values of subsidised exports are agreed in the next Multi-

⁴⁰ Society could choose to make permanent transfers on the basis of social need, but to date this has been a matter for Member State and not EU competence. There would have to be some strong arguments to demonstrate that rural social policy for just one group of rural dwellers should be treated differently than general national social policy.

⁴¹ Exacerbated by the BSE crisis.

lateral trade negotiations (MTN) then the Union has only two options to avoid accumulating stocks which cannot be sold. The EU must either employ tighter supply constraints - more set-aside for arable crops, reductions in milk and sugar quotas and in the beef herd - or, to reduce prices to international levels to avoid the need to subsidise exports.

The above analysis of the impact of restrictions on subsidised exports is rather narrow, based on the likely development of production and consumption within the EU. There is much discussion of growth in world markets for grains, meat and dairy products. Many countries especially around the Pacific rim, have been experiencing rapid economic growth which has translated into rapidly increasing imports of some agricultural products. Much of this growth in imports has been satisfied by the United States which experienced, in the early 1990s, an unprecedented rate of growth of exports of, for example, poultry and pork to Asia. Will these trends continue? They are certainly expected to. There is massive scope for more 'catching up' of income levels, and all the signs are that consumption of meat and processed dairy products increases as incomes rise.

If European farmers and the food industry wish to share in this growth of export markets then they will have to free themselves from the 'subsidised export' constraints imposed by the URAA, and, more fundamentally, free themselves from their high cost production based on decades of support capitalised into land values. These problems are taken extremely seriously by the European food industry. It is aware of future opportunities for food exports to the far East, and simultaneously, it can see that the tightening constraints on subsidised exports constitute a real threat to its ability to share in this market growth. If it cannot achieve the solution of removal of these constraints (by reductions in domestic supports), it will seek to relocate food manufacturing and raw material sourcing outside the EU with consequential loss of employment in the Union.

4.2 *Preferential Trade Agreements*

The inclusion of agriculture in the Uruguay Round has had an important effect for the operation of Customs Unions and Free Trade Areas. Previously, it has been possible for groups of countries to create zones of free trade but effectively to exclude agriculture. Now that agriculture is part of the WTO, this may no longer be acceptable. Article 24 paragraph 8 of the GATT requires that Free trade Areas should cover 'substantially all the trade between the constituent territories'. Excluding agricultural products can hardly be interpreted as consistent with this requirement.

It is now expected that, under its many customs unions and free trade or preferential trade agreements, the EU will come under pressure to set a timetable by which the removal of barriers to trade in agricultural products should be achieved. This is a far

from trivial matter for the EU, directly and indirectly. It is of direct concern, because the Union now has such agreements with a great many countries.⁴²

- Iceland, Liechtenstein and Norway are part of the European Economic Area which includes a free trade area.
- Turkey, Cyprus, Malta, Andorra and San Marino have association agreements which include a customs union.
- Free trade agreements including free trade areas have been concluded with Switzerland and six countries of Central and Eastern Europe (Poland, Czech and Slovak Republics, Hungary, Romania and Bulgaria) and have been signed by the three Baltic States and Slovenia.
- There are 'new generation' Mediterranean agreements under negotiation including free trade with Tunisia, Israel, Morocco, Egypt, Jordan and Lebanon.
- Another such arrangement is under negotiation with the Gulf Co-operation Council (with Bahrain, Kuwait, Oman, UAE and Saudi Arabia).
- A free trade area in under negotiation with South Africa, and commercial co-operation (and other objectives) are being discussed with Mexico.
- Talks are going on with Russia, Ukraine, Belarus, and Moldova which include possible future free trade areas.
- There is a co-operation agreement with Albania and a framework agreement with Mercosur (Brazil, Argentina, Paraguay and Uruguay).
- There are the long established, preferential, non-reciprocal liberalisation agreements with the ACP countries, and Mediterranean agreements of the 'old generation' with Algeria and Syria.
- Finally, preferential access agreements are envisaged with the Former Yugoslavia.

The indirect concern is because the EU will find it politically difficult and economically disadvantageous to stand aside, if there is progress in realising the ambitions, particularly of the Australians and New Zealanders, in pushing for completely free trade in the Pacific rim by 2010 through the APEC agreement.⁴³ These are further pressures pushing the EU in the direction of liberalising its agricultural trade regime to avoid isolating its agricul-

⁴² These agreements are documented and updated in Annotated Summary of Agreements Linking the Communities with Non-Member Countries, prepared by DGIA of the Commission.

⁴³ APEC refers to the Asia Pacific Economic Community. This will be an important litmus for the EU. The Pacific rim contains some of the most agriculturally protective countries in the world (Japan and Korea, and the USA does not have an unblemished record when it comes to protecting its domestic sugar and peanut sectors for example). If these countries really do liberalise agricultural trade, it would be economically and politically difficult for the EU to stand aside from this process.

tural and food industries from world markets. Of course, similar arguments apply with respect to trade with the prospective new Member States in Central Europe, these issues were taken up in section 2.2.5 above.

5 CONCLUSIONS: PROBLEMS OF THE CAP AND MODIFICATIONS SUGGESTED

5.1 The nature of the problems with the CAP

The legitimacy of the CAP is in danger. Over the years, the CAP was accepted by consumers and taxpayers because of the feeling that farmers were a deserving group in society who worked hard, ensured the security of our food supplies, produced in all weathers and looked after the countryside. However, gradually, memories of food shortages have been replaced by anxiety about food health scares; shortage has turned to surplus; farmers themselves have turned from peasants to entrepreneurs and 'pluri-active households' and in the process, have developed farming in ways which has damaged the rural environment.

When agricultural productivity and food market stability and security were seen to be the major problems, it made some sense to base agricultural policy around the common organisation of markets. Whilst productivity improvement is never completed, such strides have been made that the justification for public policy to stimulate further such improvement has evaporated. Correspondingly, the security of EU food supplies is no longer in doubt. The European Union has grown to be the World's largest supplier of industrial goods and services, and now has a free internal market. It has also developed into the largest player in international food markets. In such circumstances, its agricultural strategy had to change as it did in the early 1990s - signing up to the process of liberalising agricultural trade, moving away from market price support, explicitly paying for public environmental goods and seeking a more balanced rural development policy. This shift in policy has to develop much further.

It is vital that the potential new Member States understand these new directions for the CAP. It would be enormously disruptive for them to create expectations amongst their farmers that they will join a Union with the open-ended support policies of the 1980s. It has been argued that none of the three main elements of even the post-Mac Sharry CAP suit the CEECs; the high support prices for many commodities, the supply controls and the compensation payments should all be substantially modified if not before they join, then certainly before their transition is complete.

At the same time as Europe is developing the confidence to accept its role as a competitive agricultural exporter, it is also taking the lead in showing how agriculture can play the dual role as a provider of both food, and rural environmental and cultural services. These twin functions have always been a feature of European agriculture. Agricultural activity occupies a larger fraction of the total land area in Europe than in N America or

Australia. This is shown in Table 3. In the EU-12, 54% of land area is classified as utilised agricultural area, compared to 45% in the United States, only 14% in Japan and 7.4% in Canada. The far greater population density in much of Europe's rural space brings agriculture and non-agriculture together in a way which can generate conflict between farmer and non-farmer, but also creates the will to assist land managers to preserve what is valued in rural areas. European citizens in urban areas are very well aware of their rural roots and greatly value the natural environment and cultural heritage of rural areas.

**Table 3 Land areas and utilised agricultural areas
1993**

	Total land area	Utilised Agricultural area	
	Hectares	Hectares	Percent
Australia	768.284	46.300	6,0
USA (1)	937.260	426.948	45,6
Canada (1)	997.610	73.930	7,4
Japan (1)	37.780	5.204	13,8
EU-15	323.480	137.557	42,5
EU-12	236.380	128.676	54,4
Belgium	3.050	1.412	46,3
Denmark	4.310	2.751	63,8
Germany	35.690	17.162	48,1
Greece	13.200	5.785	43,8
Spain (2)	50.480	26.398	52,3
France	54.460	30.217	55,5
Ireland (2)	7.030	4.450	63,3
Italy (2)	30.130	16.800	55,8
Luxembourg	260	127	48,8
Netherlands	4.120	1.997	48,5
Portugal	9.240	3.829	41,4
United Kingdom	24.410	17.178	70,4
Austria	8.390	3.482	41,5
Finland	33.710	2.610	7,7
Sweden (2)	45.000	3.359	7,5

Source: Eurostat

Notes:

(1) 1992

(2) 1991, source FAO

The major change in priorities is to down-play the political preoccupation with market support and to give increased recognition of the farmers' role as 'stewards of the

countryside'. This is not to say that agriculture and food production *per se* have become less important. They have not, and will not. But, European society, for the time being, perceives no realistic threat to its food supplies. Thus its political priorities for rural areas are that production of high quality food should continue, but farmers and land managers can and should at the same time supply other goods and services possible inherent in rural areas.

There are many such services. In no particular order they are: afforestation; rural sites for non-agricultural development - services, utilities, public administration, as well as suitable industrial development; housing for existing and new rural population; leisure and recreation, and of course, the preservation of habitats, wildlife and the rural cultural landscape in all its forms. As will be argued in section 7.2, and in economists jargon, there are grounds for believing that there is a large income elasticity for these services in European society. That is, as incomes rise, there is a disproportionate increase in the demand for these (public) services.

The CAP simply has not changed as fast towards securing this balance of objectives for rural areas as the public wishes. The CAP started in the 1960s as a sectoral policy for farmers, has evolved significantly through developments in market, structural and agri-environmental policy but not nearly far enough. It is still predominantly, sectoral, farmer and commodity oriented. The rural development aspects of the structures programme and the agri-environmental measures are bolted-on extras to the core measures which concern the Common Market Organisations. This balance has to reverse. At the same time, it cannot be stressed enough that the role of farmers and agriculture in rural development is limited. Thus the reoriented rural policy must increasingly engage other private and public actors in rural areas to support the creation of new employment opportunities.

In this transformation process, there are important questions to be addressed concerning what elements of such a policy have to be 'common', that is, operated at the EU level with an element, if not a the biggest share, of EU funding. It is reasonable to suggest that a policy, which is fundamentally concerned about rural space or territory rather than the particular activity which happens to occupy most of the space, agriculture, should be determined at national or regional level. This is especially true considering the diversity of climate, soils and eco-systems stretching from the polar north to the Mediterranean south. However, given the competition rules within the single market, the need for better cohesion and a wider distribution of its benefits, a more regionalised policy should be developed within a clearly defined Community framework. These issues are taken up again in chapter 8.

5.2 The modifications which are therefore suggested

Following the above diagnosis, the broad requirements of a policy to deal with these problems are as follows. It should rely less on market price support thereby escaping the constraints of the Uruguay Round and relieving the need for supply controls. Such a move would reduce the encouragement of over-intensification and over-production, abate some environmental damage and reduce some of the inconsistencies described in section 3.4. It would orientate farmers back to 'real' markets and provide lower food prices to consumers. It would also remove two of the three problems listed in chapter 2 above in relation to Eastern enlargement. Of course these measures alone would also have the effect of reducing the gross revenues of farmers.

However, these steps would not be sufficient to ensure the delivery of environmental and cultural landscape services, nor would they provide the needed stimulus to rural development. These require purpose-built programmes designed to achieve such objectives. Such programmes to do this can build on the experience of the EU's agri-environmental and structural policies. These activities can only be meaningfully tackled at regional level. The problems are regionally differentiated and the measures involved are defined spatially.

The process of moving from a sectoral to a strongly spatial policy opens the prospect for what the French call a 're-territorialisation' of rural policy. This means restoring to agriculture the essence of what it is: an activity bound to the earth, to regions with their particular characteristics of soil, water, landscape, and the cultural and social features which have been built up over the centuries from these resources. In other words, *integration requires differentiation*. Integration of agriculture into the rural environment requires policy to be capable of regional differentiation. Programmes designed directly to stimulate production of environmental services and payment to the suppliers will go some way to remedy the drop in farmers' revenues if market supports are cut.

Other approaches are required to tackle the problems of the low earning potential of many small farmers - and the mal-distribution of supports which has resulted from trying to do this through market price support. This will require an active rural development policy. Although a more market oriented agriculture which develops to the full the possibilities offered by regional differentiation of its produce, could increase value-added and even create employment,⁴⁴ there is no point in disguising the fact that labour will (and should) continue to flow out of agriculture. This happens as some people leave farming altogether, but also as some family Member States find non-agricultural

⁴⁴ Again, in some Member States the practice and vocabulary is more developed to describe these possibilities through the geographically broad 'indication géographique protégée - IGP' (eg. Scottish Beef) and the more restricted location and processing requirements of 'appellations d'origine contrôlée - AOC' (most used for wines and cheeses).

employment and others combine the two. One of the roles of rural development policy is to enable this to happen by improving the rural infrastructure and encouraging suitable economic development in rural areas. Such policy, as with agri-environmental policy, must be regionally defined and operated. By bringing these strands together to cover the whole territory, there is better scope for integrating agri-environment and rural development policy, and avoiding some of the inconsistencies in the current arrangements.

In addition to the possibilities offered by enlarged programmes for agri-environment and rural development, other elements of policy will have to deal with the classic instability of agricultural markets and will also have to define the future of compensation payments. How this could be done is explored in the following chapters.

It should be noted that the critique of the CAP commodity support arrangements is based on principle, but with a strong backing of empirical observation. The problems created by artificially supporting prices were predicted and have been experienced. It might be objected that the current structures and environmental measures under the CAP - which it is suggested in the following chapters should be expanded - have not been subject to the same degree of scrutiny and criticism. This is true, but there are no substantive criticisms in principle applying to these measures. There are indeed problems of defining goals for which operational indicators of success can be devised. However, these are technical problems of implementation and monitoring. They cannot be wished away, but effort can and should be expended to confront these practical difficulties and find acceptable solutions.

6 OBJECTIVES AND PRINCIPLES OF A COMMON AGRICULTURAL AND RURAL POLICY FOR EUROPE, CARPE⁴⁵

6.1 Objectives

Taking into account the above analysis of the effects of the present CAP and internal dissatisfaction with it, the likely international context for European agriculture in the next two decades and the new priorities for the contribution of agriculture to the rural environment and rural development, the conclusion is certainly that it must change. The direction of change is equally clear. Agricultural policy must continue to move away from being a sectoral policy which supports farmers through agricultural commodity markets, towards a territorially defined and more integrated policy which contributes alongside other elements of public policy to the development of rural areas.

In defining the major principles and elements of such a policy for rural areas, rather than for agriculture and agriculturalists alone, it is recognised that this must involve the co-ordination of many strands of public policy - regional, transport, housing, environmental and social. However, Europe starts from a position where the Common Agricultural Policy commands the major share of EU public finances directed at rural areas. Thus, the major task is to reshape the CAP by moving it away from support through commodity market prices and towards more direct payments for defined cultural, regional or environmental reasons. In so doing, it is essential to be clear about the objectives of the new policy, the problems it seeks to address, and the underlying principles.

The objective of a Common Agricultural and Rural Policy for Europe is to ensure an economically efficient and environmentally sustainable agriculture and to stimulate the integrated development of the Union's rural areas.

Each of these three elements are based on European Treaties, Article 39 of the Rome Treaty, and Article 130a of the Treaty of European Union (Maastricht).

The desired new policy should be more integrated in several respects. First, the three elements: efficient agriculture, environmental sustainability and rural development should be more equally balanced than in the past. This will help reduce the conflicts between agriculture and the rural environment. Such a policy would also be freer to support local people - farmers and non-farmers as well as collectives like community organisations - to create sustainable economic activities in rural areas, rather than one which over-

⁴⁵ The group considered several name changes for the CAP which would better reflect the purpose and nature of the policy. In Latin, 'carpe diem', or 'seize the day' alternatively, loosely translated as 'have a nice day', or more actively, 'Go for it', has a cheerful ring! More seriously, an integrated policy as conceived here is bound to be an iterative, learning by doing, day-by-day, trial and error, dynamic policy. It will itself evolve. It cannot be decided in one step by defining a set of political actions for all time.

emphasises a sectoral perspective. Second, the intention of the CARPE is also to remove many of the distortions and imbalances within agriculture which have over-stimulated some sectors at the expense of others and discouraged farmers from producing high quality, differentiated products. Third, it should enable European agriculture to be better integrated into the world food system from which it has insulated itself in the past. This means avoiding the damaging effects of destabilising world markets by subsidising or taxing exports; depressing world markets with subsidies and elevating them with the export taxes. More positively, it means giving European farmers and the food industry the opportunity to show they are internationally competitive, and thus have a contribution to make to the European economy by exporting innovative and high quality food and drink. In short, the new policy should ensure a better balanced agriculture which is in harmony with the rural environment and is integrated in the global economy, and should also contribute to sustainable rural development.

Before describing the elements of the preferred policy, two clarifications of the concepts mentioned above should be made. The first concerns references to the rural environment and rural development. Environment carries different meanings in different parts of the EU. It is intended, in this context, to be an umbrella term to include all aspects of the natural environment: biodiversity, habitats, and resource protection, but it also includes landscape and man-made artefacts of the countryside including field boundaries, vernacular architecture, archaeological sites and other heritage features. Rural development includes the human population, its life style, employment patterns, income structure and levels, housing conditions and provision of other services, and cultural aspects too like traditional occupations and skills, diet, language, costume and customs. Because agriculture, historically, has been the predominant economic activity in rural areas it has had a massive impact in all these areas.

Currently, even in the most agricultural regions in Europe, agriculture accounts for less than 25% of employment and economic activity. However it still occupies the majority of the territory. Thus, its importance for shaping the European countryside is not diminished by its declining share of rural employment and income. Not only has the kind and intensity of agriculture's interference with nature remained a relevant problem, its contribution to providing rural amenities, in a broad sense, including natural and cultural dimensions of our common European heritage is increasingly valued by our societies. People, whether they are living in rural or urban areas, care about the diversity of natural habitats and species, the architectural heritage of villages and the scenic beauty of the landscapes they wish to visit or live in.

Whilst there can be no presumption that every single environmental and social feature of rural areas can and should be preserved in perpetuity, it would be regarded as completely unacceptable if the most important features of our rural areas were lost. The task is to

reshape agricultural policy to assist society to find the balance which best reflects its values for the early decades of the 21st century.

Second, the terms “internationally competitive” and “economically sustainable” also deserve some amplification. It is plain that there is no text-book, perfectly competitive, free international market for agricultural commodities. International markets are distorted by domestic policies and border restrictions imposed by governments (including the EU); they are often dominated by the decisions of a small number of very influential large corporations, they are not characterised by perfect information and by freedom of entry. It is clear that international prices do not reflect the full social costs of production. In these circumstances, the concepts of 'competitiveness' and 'sustainability' lose whatever sharp edge they have in text books. However, even in the second and third best world we inhabit, it becomes operationally clear that if certain produce, year-in and year-out, require subsidies of twenty to one hundred percent of their domestic price in order to find an export market, they are not internationally competitive.

In the context of market failures, economic sustainability takes on a different interpretation. For example, if a farmer is not paid for the wild flowers in his meadows, it is not surprising that he may take actions (e.g. change his grass mix and use nitrogen fertiliser) which maximise his profits on his sheep production for which he *is* paid, at the expense of the wild flowers for which he is *not* paid. If society wishes to induce him to continue the 'traditional' farming system which includes the wild flowers, it will have to arrange to pay the farmer the income he forgoes.⁴⁶ If society willingly pays for the public good in this way, then together with the private payments for the lamb and wool, the farmer may have a system which may legitimately be termed 'economically sustainable' even though it is dependent on the public purse. The difference between the export subsidy and the environmental payment or premium is that the latter is paying for a public good and the former is not.

Before outlining the main elements of a CARPE, it is useful to set out some principles which might usefully guide the implementation of such policy. In order to avoid the problems discussed at length in chapters 2 to 4, and summarised in chapter 5, and in pursuit of the objectives set out above, the new policy should possess the following features.

⁴⁶ The vigilant will notice that there is an implicit judgment in these statements that the specific property rights on nature, here the wild flowers, are defined to be with the farmer. Thus society will have to pay the farmer to get the right outcome. This judgment is justified because the alternative of telling the farmer that he does not have the right to disturb nature but should pay for the privilege would undoubtedly be contested in the courts. In any case, it seems politically inappropriate when we are trying to transform agricultural policy from an instrument which sometimes encourages the destruction of some environmental features to one which seeks to protect those features. Of course it cannot be assumed that *all* property rights are with the farmer, he does not have the right to poison the water, soil, air or food. This is taken up in section 7.2.

Consistency: agricultural and rural policy should not conflict with general EU societal goals of economic progress, for example through the principle of the single market, undistorted competition, social cohesion, and environmental protection and enhancement. Nor should it conflict with the EU goal of being part of an open international trading system.

Subsidiarity: an EU common policy implies common goals, standards and regulations in all areas involving tradable goods and services, and where truly trans-border environmental and ethical considerations apply. This is the top-down part of the policy. Within this EU framework and, subject to fair competition, Member States are free and encouraged to stimulate local, regional and national bottom-up approaches for choosing and implementing higher or different local standards. This decentralisation and differentiation of the details and the implementation of policy is critical for those parts of the proposed policy which are territorial.

Targeted Policy Formulation: policy instruments should, as far as possible, be explicitly targeted towards named objectives with identifiable criteria for success. Thus an intrinsic part of policy instruments and implementation should be the means for their monitoring and evaluation. In a more integrated policy it is inevitable that measures designed for one target will have effects on other policy targets, such interactions should be explicitly anticipated with appropriate rankings and constraints defined whenever possible.

Decoupling: (where relevant): where it is necessary to make direct payments to farmers, these should be based upon past levels of resource use or output and related to past prices and costs, so that there is least incentive to take such payments into account in current production and consumption decisions. The principles defined here should take their lead from international commitments already made.

Simplification: it should also be an aim in switching from CAP to CARPE that a significant simplification of policy can be achieved. Reducing the complexities of the market price and supply management schemes can be a major contribution to simplification but so too, in principle, can the integration of structural and environmental measures into a unified framework of territorial schemes. Of course, the requirements of explicit targeting and monitoring, and the need for this to be defined and thus differentiated at regional level, opens up the possibility of greater complexity on the ground, but this is an unavoidable characteristic of a European policy which respects subsidiarity.

6.2 The main elements of CARPE

A policy which sets out to achieve the objectives defined above starting from the present CAP will require four elements:

1 Market stabilisation

(MS)

-
- | | | |
|---|---|--------|
| 2 | Environmental and Cultural Landscape Payments | (ECLP) |
| 3 | Rural Development Incentives | (RDI) |
| 4 | Transitional Adjustment Assistance | (TAA) |

The relationship between these four elements and the existing structure of the CAP is illustrated in Figure 2. The main features of the four elements are summarised in Figure 3. The first two histograms of figure 2 show the (actual) *shares of* budget expenditure on the major programmes within the CAP for 1990 and 1996. The next two show notional shares of the four elements of CARPE at six-yearly intervals into the future.⁴⁷

The dramatic change in the structure of the CAP, brought about by the 1992 reform is shown as expenditures on market price support measures under the CMOs, which accounted for 93% of FEOGA expenditure for 1990, is expected to fall to just 44% in 1996, and the new category of expenditure on arable and headage compensation payments has risen from 1% of the budget to nearly 42% of expenditure. There has been significant growth in both structural expenditure from 6.5% to 8.8%, and in agri-environmental expenditure from very little at all to 5.0% between these two years.⁴⁸

Under the proposed policy, market price support through the CMOs is expected to shrink further as prices are reduced to world market levels. What is left of this policy is solely Market Stabilisation (MS). Both the agri-environmental and structural policy components are shown to grow. But in this process they are transformed respectively into Environmental and Cultural Landscape Payments (ECLPs) and Rural Development Incentives (RDIs). In the figure both of these elements are shown to grow rapidly, signifying that much of the present market support can be re-channelled into one or other of these categories to reflect the real justification for support.

⁴⁷ There is no special significance in these six-year intervals. The idea is to convey the messages that the balance of CAP expenditures can change significantly over this period and that the reforms envisaged are bound to require many years to accomplish fully.

⁴⁸ The figures are quoted from the Agricultural Situation in the Community Reports for 1991 and 1995, Table 3.4.1. Direct payments includes arable payments, and both beef premia. Environment actually refers to the whole of the accompanying measures. Structural refers to all the guidance expenditure.

	Market Stabilisation 'MS	Environmenal and Cultural Landscape Payments ECLP	Rural Development Incentives RDI	Transitional Adjustment Assistance TAA
Time reference of policy	Enduring	Enduring	Enduring	Temporary
Time reference of intervention	Exceptional events	Systematic payments	Finite to individuals	Finite and declining
Sectoral/territorial	Sectoral	Territorial	Territorial	Starts sectoral and widens
Financing	100% FEOGA	Co-financed, differentially	Co-financed differentially	Some co-financing?
Share of FEOGA	Diminishing from now	Rising much	Rising	Diminishing
What is paid for	Intervention purchase in exceptional years	Public environmental and cultural landscape goods and services	Investment, training infrastructure	accepting and making change
Administration	Central - via EU	Regional & local	Regional & local	Member state
Programming & monitoring	No	Yes	Yes	No

However, the rate at which this can be achieved will depend greatly on the capacity of regions to define and defend legitimate targets for such supports. The other major change suggested is that the compensation payments introduced in the 1992 reform are transformed into Transitional Adjustment Assistance, and are gradually phased down as the remaining support switches increasingly to environmental payments and rural development.

The four new policy elements will be described in progressively more detail in this section and the following chapter.

- The first element, market stabilisation (MS), takes the CAP common market organisations back to their origins, essentially to provide a safety net for commodities subject to uncontrollable market fluctuations.
- The second element contains the agriculturally-related environmental and cultural landscape payments (ECLP) to protect against damage and depletion of rural resources and cultural landscapes in rural areas, and to encourage development of these resources and the social fabric. This will be a greatly enlarged version of existing agri-environmental and some of the structural measures, such as less favoured area payments. In principle, it can cover the whole territory. This proposal is made with a very important proviso. These aids are called 'payments' not subsidies or transfers,⁴⁹ because they are paid from the public purse to those who contract to supply public environmental services. They are payments for a service, not a charitable transfer. For this reason, the service must be delivered or the payment will not be made. This means that the ECLPs have to be objectively defined and justified, in relation to specified targets and must include built-in monitoring.
- The third element, the rural development incentives (RDI), is concerned with all aspects of rural development, including agricultural development, but the emphasis is on stimulating opportunities for non-agricultural uses for farm resources and opportunities for resources released from agriculture. This will build more directly upon existing structural measures.
- The purpose of the fourth element, the transitional adjustment assistance (TAA), is to facilitate the transition from an agricultural to a rural policy.

⁴⁹ Strictly, in English, the word subsidy is no more than a support or payment from the public for the supply of a service - in early usage, it was often for the services of an army. Nowadays, the word has been tainted with a strong pejorative or negative connotation implying that the recipients are at best receiving charity, or they are being over-paid for some service, or at worst they are undeservedly benefiting from public largesse. The flavour in other languages can be different, eg. in German, a subsidy is defined as a payment or transfer of an economic resource without the obligation of the recipient returning another economic resource of similar value (as it is in the case of buying or selling a good or service), but the distinction struck is the same.

The first three elements (MS, ECLP and RDI) can be expected to be enduring elements of policy. The last (TAA), as its name suggests, should be a declining source of transfers. Whilst market stabilisation remains a sectorally and commodity defined measure, the environment and cultural landscape payments and the rural development incentives should be territorially defined and regionally administered. Much discussion is required in deciding whether the transitional adjustment assistance should remain on an area and headage basis, as is the case for its precursor the compensation payments, or whether it should be related to individuals, farmers and other land managers.

The scope of the changes envisaged is large. It must be, in order to cope with the problems and challenges detailed in the previous chapters. The goal must be to eliminate the need for export subsidies. If this can be achieved, it removes the need for many of the other problem-causing elements of policy, particularly the supply management. But, given the precarious nature of some aspects of EU agriculture, the removal of market price supports must be tempered by the design of locally-sensitive environmental and cultural payment schemes and programmes for rural development, which enable rural areas to thrive without causing the current distortions to commodity markets or unbearable sectoral collapse and precipitous out-migration from rural areas.

Environment and rural development can only be dealt with at local and regional level; they are territorially defined. Commodity markets and policy are conceptualised at market, and thus national or international level. Furthermore, agricultural commodities are internationally tradable whilst local environment and landscapes are not. If, as has been argued, socially defined priorities for agriculture and rural areas are now, and in the future, concerned with these regionally defined issues, then much of the policy has to reorient from centralised market policy to regionalised environmental and rural development policy. It makes good sense in an era of liberalised global markets not to muddle the protection of the environment and cultural landscape with the management of commodity markets.

It should be noted that there is no *explicit* concept of direct income support for farmers mentioned here. This is quite deliberate. Agricultural policy has not been and should not become a policy in which one occupational group, farmers, are simply given direct income payments as social transfers. It was always the objective of the CAP to enhance farmers' incomes by helping them improve their productivity, and by providing a secure supply of food for EC citizens. It was never envisaged that farmers would directly get cash from the rest of society simply because they were farmers and they had low incomes. The concept of *enabling* farmers to earn fair incomes, which is embedded in Article 39, must not be undermined, especially by approaches following the current logic of schemes such as less favoured area payments or compensation payments.

To explain this logic, let us begin with a statement of the obvious. If it is too costly to produce mangoes in mainland Europe because growers are handicapped as they do not

have a tropical climate, then there is no sense in European taxpayers subsidising mango production. This is a misuse of resources; the mangoes should be imported. Few would quarrel with this idea, especially as there is no interest group already receiving mango subsidies who would furiously fight to preserve their position.

However, if the argument is switched to sheep, beef or milk production in the mountains or other disadvantaged areas of Europe, such harsh argumentation quickly provokes responses which indicate the real reasons for 'subsidising' farmers in these areas. There turns out to be two reasons. The response is that, without the subsidies, the activity cannot cover its costs and people would cease to produce and some of them, maybe most of them, would leave. From the point of view of the beef, lamb or milk consumer this does not pose a problem; there are plenty of other domestic and foreign sources of beef, lamb and milk. So there is not a product supply problem. There is a social problem. Caring societies do not pull the rug from under activities previously supported and leave people to pick up their lives unassisted. Also, there is a legitimate fear that a sudden depopulation of rural areas and influx into towns can create significant problems and thus costs in the towns. There is clearly a case for adjustment assistance here to help people retrain, re-equip and relocate if necessary. There is also a case for rural development incentives to help diversify the economic base of such areas. But in the case of hill livestock production, there is another problem.

If society decided to pay not one ECU more than the international price for its meat and milk and to assist the departure from hill livestock farming⁵⁰ of those who couldn't survive, the very nature (literally) of those areas would change. The living landscape of the hills and mountains has been moulded over centuries by livestock farming, it affects the fauna and flora, it creates the field boundaries and the architectural features in the landscape, the structure and nature of the villages, the character of the people, what they do and eat, and even how they speak. These are the environmental and cultural landscape services offered by this group. This is what society appreciates. This is the reason we are prepared to pay those who supply these services. The market is not capable of arranging for payment of such services. However, the market is perfectly capable of arranging payment for meat and milk. Indeed, if hill producers can persuade their customers that beef and cheeses produced from the grass meadows and fine hay of their region is tastier and healthier than that produced elsewhere, then the sophisticated food markets of Europe can arrange payment for this too!

The crucial conclusions of this discussion are that subsidies to hill farmers, either through direct 'income' payments or through commodity price supports, are equally inefficient

⁵⁰ It would be up to the people concerned whether they wanted to leave the hills. Some might do so, others might choose to use the adjustment assistance provided directly to them plus whatever rural development incentives were on offer, to find other activities which would enable them to remain in the region.

and unjustified. Unless the income payments are arranged on a household basis, and all household income and wealth are assessed, they have no right to their name, and in any case, a strong argument has to be advanced why the normal social benefits available to the rest of the population are inadequate for this occupational group. Providing subsidies to hill farmers via milk, sheep and beef prices is an extremely blunt instrument as most of the benefits will accrue to the lower cost, larger producers in the plains thereby stimulating overproduction. If the fundamental failures are the non-payment for environmental and cultural landscape services and lack of rural development, then the solutions are to arrange payment for such services and to provide incentives to stimulate rural development. Furthermore, it should be noted that these services are often provided jointly with well adjusted forms of agricultural production.

In their enthusiasm to try and persuade governments to move away from market price support as the main instrument of agricultural policy, some agricultural economists may have been misleading in advancing direct *income* supports as the alternative.⁵¹ It has been far from clear in most of their advice that such supports were either purely temporary aids, or payments for public goods; the very term “income supports” does not sound very temporary or public good related. The phrase “direct income supports” or “payments” is bound to give some hope to recipients that payments could continue all the while income is 'below par'. However, for the reasons just summarised, there is no justification for the rest of society giving income supplements *ad infinitum* to an occupationally defined group, who cannot compete in their chosen line of production. There have to be sounder motives for such payments than unfavourable natural conditions. Complaints that costs are high because production conditions are unsuitable rightly stimulates the response that production should not be taking place in such places.

Plainly, there are sound arguments for some support to such farmers. Farmers in these regions supply a great deal more social value than their farm products; society wants viable and beautiful rural areas in which suitable development takes place. For example, in the vast, mostly forested space in the far north of the EU, it is a profound relief to discover *some* open farmed areas.

The proposed policy does not offer direct income support to farmers. Rather, it tries to encourage and enable people engaged in farming to earn decent incomes by supplying private and public goods, and by undertaking other economic activities in rural areas. Farm incomes will be enhanced by such a policy in many ways. Those farmers in a position to do so, will be freed from the production constraints which prevent them

⁵¹ Maybe some had carefully thought through the logic of their position and were explicitly expecting such payments to be transitory - certainly the Tarditi - Tangermann (1991) bonds fall into this category. However, politicians may have some rights to complain that the concepts of temporary, adjustment assistance, or 'political oil' to gain acceptance for change were not central to the usual advice to cut price support and substitute direct income payments.

producing for expanding world markets. Others will find that in the course of adapting their farming systems to supply the public Environmental and Cultural Landscape goods (in return for ECL payments), they may also be able to market their regionally differentiated, high quality products at premium prices. To do this, they may be assisted through RDI schemes to improve their productivity and marketing.

In addition, some farm resources - labour or land - may be used to earn income from non-agricultural rural activities (RDI). Finally, for a while at least, in order to bring about these changes in attitude and activity, farmers may benefit from transitional adjustment assistance (TAA). An important part of the practical arrangements for the proposed approach is that the contracts each farmer enters into for these various services, should be as administratively straightforward as possible, and preferably consolidated into a multi-year, single package and single payment. These ideas are explored a little in section 8.2.

7 THE FOUR ELEMENTS OF CARPE IN MORE DETAIL

7.1 Market stabilisation (MS)

It is proposed that the process, of significantly reducing institutional prices started in the 1992 reform be continued. For the major arable crops, the 30% cut, over the period 1993-95 indeed closed most of the gap between EU and world wheat and barley prices. This was achieved partly by the rise in international prices. Having closed the gap in this way, action should be taken to ensure that it does not systematically re-open in the coming years. This means explicitly linking intervention prices to the international price⁵². It should also be accompanied by a reduction of the set-aside percentage to zero, and a reduction of import tariffs.⁵³

Given current expectations for grain markets, it is possible that these actions could be taken without too much pain. The real test of the will to follow the strategy of continuing the '92 reform, and moving to a more integrated rural policy is whether the same approach will be used for the milk, beef and sugar sectors. Approximately the same orders of magnitude of institutional price change will be required for milk as was implemented for cereals in '92, viz. a thirty percent price cut, a somewhat smaller institutional price cut would be required for beef and a larger one for sugar. Furthermore, to ensure a balanced overall policy, it is assumed that the reform of the fruit and vegetable regime, formally adopted by the Council in October 1996, and which is indeed broadly in line with the philosophy of these proposals, is implemented. This leaves several other sectors, wine, olive oil, tobacco and cotton which should receive comparable treatment.

The agreement and implementation of the MacSharry reform should give confidence that the magnitude of changes described here can be contemplated. That experience demonstrated that big changes could be implemented over this sort of period. The next round of reforms affecting mostly the grazing livestock sector should be no more difficult than the grain price cut, not least because there is no additional requirement of taking resources out of production. Indeed, if the internal prices are brought close enough to the

⁵² One of the problems is that the international price is not an invariant number which can be looked up in a reference book. For most products the EU is a significant enough actor on international markets that it influences the world price, for some sectors (e.g. most dairy products) the EU is the most important actor determining prices. Thus reducing internal prices to the world market level is a process of discovery and continual adjustment.

⁵³ The tariff reductions could leave a small margin of Community preference and would of course be done in a context of the next round of multi-lateral trade negotiations under the WTO.

international level, production quotas and export subsidy constraints for milk and sugar could be expanded and removed, giving those farmers with low enough costs, the freedom to expand their production if they can find markets for their output.

Given the starting point, it is not necessary to remove altogether the instruments of support; the regulations for intervention, supply management and border measures can remain in place, but be operated at much lower levels of market support. These moves will open up EU markets, and may expose them to greater price variation than in the past. In fact, this has already been accepted. It was an important and explicit goal of the Uruguay Round to decouple supports to farmers and rural areas from agricultural production decisions, and to re-couple isolated markets such as the EU with international markets. This is to be achieved by the tariffication and reduction of import barriers. This is a delicate matter. It does not mean that there is no EU public role in market stabilisation, but that the instruments and scope are circumscribed by the need to be more aware of the effects of domestic stabilisation on the international market.

If these reductions in market price support can be achieved, what remaining justification is there for any public market regulation or intervention?⁵⁴

7.1.1 Justification for public stabilisation

The agricultural industry is unique in having a particular combination of exposure to risk and difficulty in coping with it. Agriculture is characterised by having:

- a high degree of risk given its dependence on weather *and* exposure to pests and diseases (which strike locally)
- exposure to interest rate and exchange rate risk (which affect the whole sector - but which may diminish post EMU);
- a spatially-diffused, atomistic structure of many small businesses, which have a high proportion of immobile assets, land, which restricts freedom of manoeuvre;
- a moderately long gestation period involved in the production cycle;
- producers who have, individually, insufficient resources and information easily to manage the risk;
- the responsibility to supply products consumed by every citizen every day.

As the accompanying Figure 4 illustrates, there are many industries which have one, two or several of these features but none which shares them all. There are many things

⁵⁴ The regulations and interventions referred to here are those relating to market prices and quantities. Other forms of public intervention to regulate competition, promote hygiene and protect health, safety and welfare are not formally part of the CAP so are not discussed here.

farmers can, and should, do privately to manage these risks. There are numerous management techniques for appraising and managing both production and marketing risks. These include crop diversification, technical actions to minimise the effects of weather and disease risk, storage, co-operative actions, vertical integration in the filière and forward contracting. These are forms of private institutional regulation of the market. Another possibility is to make fuller use of futures markets. These latter are not well developed in Europe because there has been little scope for such markets when the public authorities were so active in market management.

Figure 4 Are farming structures and risk exposure different?

	Atomistic	Spatial Diffusion	Weather Risk	Pest & Disease risk	Normal production Cycle	Interest (i) & exchange rate (er) risk
Farming	Yes	Yes	Yes	Yes	6 mths to many yrs mostly yrly	Some exposure to i & er risk
Small retail shops	Yes	less so	No	No	wks	No
Small Builders	Yes	less so	Yes	No	up to 1 yr	i risk
Small hotels B&B	Yes	Regionally concentrated	Yes	No	wks	Some face er risk
Restaurants etc. in holiday resorts	Yes	Regionally concentrated	Yes	No	wks	Some face er risk

Making use of all these risk management techniques requires knowledge, some training and certainly information. Agricultural development assistance within the programme of Rural Development Incentives should foster this, particularly through training, information services and encouraging group and co-operative marketing. However, the general perception is that the scale of the problem of risk management in relation to the size of the businesses involved and their capacity to act is such that some public assistance is justified. Because of the critical nature of food and the sensitivity of rural areas, there are potentially high political costs attached to market extremes. European society would not accept a dramatic shortage of a basic food commodity and thus extremely high prices, or, if a dramatic market collapse caused wholesale farm bankruptcies.

These kinds of events seem very unlikely in Europe. The last real community-wide commodity crisis was over two decades ago when sugar prices 'spiked' in 1974.⁵⁵ But the main explanation for the absence of such crises in Europe is precisely because the CAP has prevented them. American and especially Australian farmers are exposed to a harsher regime. An important debate is now taking place about whether the post-Uruguay Round world of liberalised agricultural markets is going to be less stable, or, as most economists predicted, more stable. It is too early to judge this as yet. Nothing can be concluded about changes in market volatility based on one or two years' data: implementation of the URAA only started in July 1995. In any case, world markets have not been liberalised very much yet by the outcome of the round.⁵⁶

There has only been a tiny degree of improvement in market access, subsidised exports are beginning to come down but still remain, and there is still a significant degree of state trading in the Communist and ex-communist parts of the world. 1996 was characterised by the lowest grain stocks in the US and EU for two decades. The effect was record high grain prices. In such circumstances when stocks are low, prices are high and there is much policy-induced uncertainty, prudent governments, understandably, act on the precautionary principle.

However, the major actors in world markets should be cognisant when designing domestic stabilisation schemes, that the more open the market and the greater the number of agents participating, the better able it is to absorb the effects of instability. This suggests that, in the deregulated world ahead, it may be desirable to find new instruments for stabilisation. It is possible that, initially at least, liberalised market agents could find themselves overreacting and even causing greater instability. Elements of this could be detected in the behaviour of financial and foreign exchange markets after the deregulation in the late 1980s. For example, an important ingredient in such regulation is the collection and public dissemination of information, now facilitated by electronic communications.

There are usually three kinds of stabilisation or security objectives considered by governments, but there is not always a very clear distinction made between them in implementing schemes. They are, domestic food security, domestic market price stability and contribution to international food security. The first was clearly a major impetus for the high protectionism of the CAP as it was constructed in the late 1950s and 1960s. The target was to increase Europe's food production capacity so that it would not again face the shortages experienced in the catastrophic 1940s. There is no doubt that this aim has been achieved.

⁵⁵ More restricted crises have struck individual member states, eg. Olive oil in Spain in 1996.

⁵⁶ See Tangermann (1966) for a review of the effects of the Uruguay Round Agreement.

Given the international political situation, current production systems (with their high degree of dependence on imported energy) and consumption patterns (in which about half of grain production is consumed through meat), there is little necessity or rationality in a policy of 100% European self-sufficiency, product-by-product, in order to secure food supplies. This still leaves the question of strategic food stocks for domestic purposes to guard against a market or political crisis. Clearly, EU stocks would have a role in such circumstances, but Member States no doubt make their own provisions for such situations too. This issue is not one which receives much public discussion.

The principal objective in mind when the subject of stabilisation is raised concerns the second of the three objectives, domestic market price stability. Here the major concern is price collapse and its effects on producers, rather than sudden shortage and any harmful effect on consumers. This latter point is taken as a security rather than a stability issue. The short term effect on consumers of reducing or eliminating price slumps is to restrict consumers' ability to consume more at the time of a bumper crop. Elementary, static analysis suggests that consumers lose from such price stabilisation when the instability is on the supply side.⁵⁷ However even consumers have a longer term interest in market stability.

There are two types of longer term damage resulting from market price instability. First, farmers will be more cautious in their investment in risky markets so a sub-optimal production results. Second, it is not in society's interest for a basic industry to suffer periodic collapse causing many producers to be driven out of business. This would cause social, and environmental damage as well as impose economic losses which could extend well beyond the immediately affected producers. It hardly needs stating that such a situation is not in producers' interests. It is less clear whether the target of such stabilisation should be individual commodity prices or farmers' revenues or their incomes. This will be pursued a little more as methods of stabilisation are reviewed.

Another dimension to the case for agricultural price stabilisation concerns the macro-economic effects of surges in food prices. This case is strongest when food expenditure accounts for a high proportion of total household expenditure and when food choice (range of products and sources) is restricted. In such circumstances, sudden and significant rises in food prices can lead to demands for increases in wages and social benefits such as pensions. If these are automatically indexed (often based on specific food items with fixed weights which do not allow for consumer substitution) then inflationary effects can result from the agricultural market instability.

Such stimulus to inflation and, potentially, public deficit through higher costs of pensions and public sector wages could impose a real economic cost. In many Member States, in

⁵⁷ Of course, for basic commodities such as grain with low price elasticities of demand, the welfare losses to consumers from being denied the low price periods are likely to be small.

the EU-15, with low average food expenditure shares (the average 1992 EU-15 share was 19.7 %, it was highest in Greece 36% and Portugal 32%), with the single market, good infrastructure and wide range of choice, these arguments do not seem very substantial. However, in some of the existing and prospective new Member States, they could carry some force.

7.1.2 *Stabilisation methods*

The three main methods of publicly assisted stabilisation measures are through:

- (i) Short term market management using intervention purchasing and border measures.
- (ii) Medium term market management using supply control schemes (e.g. quotas and set-aside).
- (iii) Revenue or income insurance schemes.

From the EU perspective, there is a strong presumption in favour of the first two approaches. The Union has the instruments and a great deal of experience in using them. However, if it is decided to continue with these tried and tested instruments, it is vitally important that there are built-in safeguards to ensure that stabilisation will not slip again into systematic support and protection. It is instructive that in the 1996 US Farm Bill (USDA,1996) the instruments of set aside was abolished altogether to remove any possibility that it could slip back into use. One response is to amend regulations so that the price stabilisation objectives are clear, and also to redefine intervention prices (there is a different concept used for different commodities) clearly in relation to world prices. For example, the single grains intervention price could be a fixed proportion of the moving average of the international price for grains. The intention should be that market intervention is an exceptional event, taking place only rarely to limit the worst falls in price.

A variant of this approach would be to devolve responsibility for price stabilisation to an agency which only has this duty, and is not empowered to do anything other than manage public intervention stocks to reduce price fluctuations. Such an agency could, as far as possible, work through the private market, empowering or stimulating private storers to carry out the necessary intervention, as it is already used in various market organisations. To the extent that this could be done, it would help minimise the public costs of maintaining storage and handling capacity which, by definition, will only be used infrequently.

Border measures can play a part in domestic stabilisation. For many years, the EU used the instruments of variable import levies and variable export refunds as primary tools for market stabilisation. Undoubtedly, these were major contributors to domestic market stability. However, this was at the expense of international market instability, and it was

of course agreed in the Uruguay Round that variable levies should be converted to tariffs and the use of export subsidies reduced. In recognition of the right of countries to defend their domestic markets against sudden surges of imports or collapse in import prices, the URAA allows the use of safeguards, i.e. higher tariffs, in well defined ways. This is, therefore an internationally agreed tool of market price stabilisation.

There is concern in some quarters that longer term stabilisation instruments may be necessary for some markets. If world grain prices again become seriously depressed to the extent that a significant section of European grain production is threatened, then to avoid the building up of intervention stocks and the system switching, once again, from short term stabilisation to longer term market support, it might be justifiable to re-introduce land set-aside or other supply management tools. Clearly, set-aside has no place in short term market management; it is simply too slow to take land out of production next year to solve a price slump this year. Likewise, once the land is fallowed, there is nothing which can be done, within a period of a year, to increase supplies to deal with a shortfall.

There is also a danger that the slow-acting set-aside could exacerbate an unfavourable market development. There are no clearer examples of this than the 1995 decisions by the US to idle 7.5% of their corn area and the EU to have a 12% COP set-aside. These coincided with poor weather conditions in several markets and contributed to the 1996 shortage and price surge. The main burden of these 'wrong' decisions is of course borne by importing countries which include some of the poorest areas of the world.

These longer term considerations raise the issue of who is going to take responsibility for the third objective of stabilisation, namely, concerns with international food security and specifically, global stock management. Some would answer, "no one", "the market is the best device for balancing supply and demand". As both US and EU public stocks have all but vanished, and neither shows a great desire to take on this global role, this perhaps looks the most likely choice. However, it is not a satisfactory answer. It is plain that neither of the two largest players in international grain markets (the US and the EU) have any intention of leaving their domestic markets entirely free of intervention. At present, the US is taking, and the EU is talking about taking, a minimalist approach, designed for relatively modest domestic stabilisation. But, such is the importance of these two blocs in world grain trade, that this is not likely to be the end of the story. Each will continue to see a role for some stocks, at the very least for famine relief. Beyond this, the situation is quite unclear. Much more international consultation and discussion will be necessary on this question; it is a matter which extends far beyond the CAP and its successor.

A completely different approach to stabilisation is through income or revenue insurance schemes. This recognises that price stability *per se* is not the problem. The most important social cost of instability is that, in a bad slump, many producers are driven out of business. This is bad for them, it is costly because it creates economic and social

disruption for other businesses which traded with the failed firms, and the threat of such failures encourages a more conservative approach to investment than is socially desirable. In short, the problem occurs when the revenues of farms fall below their survival threshold.

Superficially, it could be argued that the MacSharry reforms, *de facto*, introduced a major element of revenue or income assurance through the arable and livestock compensatory payments. These payments certainly provide a strong degree of income stability. In the case of the Spanish grain sector in 1994 and 1995, many farmers were saved by these payments given the severe drought in those years. However the origins, recipients and basis of the compensation payments contain none of the desirable elements of risk insurance. There are no premiums paid for the insurance, no definition of the risk insured, and no mechanism to ensure that only victims are compensated. With the arable compensation payments, all grain and oilseed farmers get the payments irrespective of whether their revenues have fallen or risen, and there is no mechanism to ensure that farmers of other crops affected by drought receive assistance. The arable payments were not set up to deal with risk management so it is only accidental if they can help.

There are potentially strong advantages in turning from price stabilisation to revenue stabilisation. It allows for the fact that most farms are multi-product businesses and it is unusual that all markets fail simultaneously, and it also allows for the inverse relation between prices and quantities (when prices are low it is usually because quantities are high and vice versa). It is focused on the real problem caused by instability, and it pays out only to those in need of assistance.

A move to revenue insurance would also have the advantage of enabling a complete withdrawal of the 'state' from all market management. Despite these attractions of the insurance approach, it is not used as a central part of agricultural policy in any country.⁵⁸ Even where it is used, it is confined to the producers of the major field crops and is not a general facility available to all farmers. The principal problems are those of moral hazard. This has several dimensions. First, there is an asymmetry of information, the insured usually know more about their precise conditions, their actions and the risks, than the insurer. Second, there is a tendency for adverse selection; insurance schemes will naturally attract more of the high risk farmers. Third, if farmers are insured, there is a danger that they will be more careless about risks than otherwise, thereby raising the overall costs of providing the insurance.

⁵⁸ Canada is the country which has developed this approach furthest, particularly for the crop farmers of the Prairie Provinces through a variety of revenue stabilisation schemes, the most recent being the Grain Revenue Insurance Programme, GRIP, see Agriculture and Food Canada (1996). The US has experimented with similar schemes for grain farmers.

For these reasons, the private insurance sector will generally not get involved in this business. This means that such schemes must be state supported. That in itself is not an objection; after all, the present support arrangements done in the name of stabilisation are very heavily state supported. However, governments themselves seem reluctant to move into the insurance business, and especially on behalf of just one part of one economic sector (grain farmers). Other farmers and some other small businessmen face just as risky circumstances without such state revenue insurance.

It would be a major departure for the EU to move in this direction, but it is certainly worth close examination to see whether it could play a role under a market stabilisation programme. At the same time, to assure farmers that a significant reduction in market price support does not mean that the authorities are abandoning farmers completely to the market, it would be sensible to follow the suggestions of the 1995 Spanish Presidency suggestions to review the desirability of harmonising member state national insurance and disaster relief schemes and to consider if there is a role for EU action in either of these. These matters are presently handled mostly by Member States, although from time to time the EU is called to assist with natural disasters, e.g. floods or drought and, most recently, BSE.

7.2 Environmental and Cultural Landscape Payments (ELCP)

The principle of this element of the CARPE is that farmers provide goods and services for which they are not rewarded by the market, and this programme is designed to provide the appropriate inducements and rewards for these services. In its purest form, these payments are offered to avoid the possibility that there is an under-provision of environmental and cultural landscape services. They are not entitlements to receive money if the provision of the services do not impose additional costs on farmers. The proposal is to take a multi-tier approach to achieving these environmental and cultural landscape goals.⁵⁹

At the base level, Tier zero, are conditions which farmers and all land managers must respect without payment.⁶⁰ These are legally defined environmental standards. Society insists on certain basic property rights in clean air and water, well husbanded soil and healthy food and humanely cared for animals. Beyond this, there is a recognition that property rights are with the landowner or farmer, and if society wishes land managers to produce environmental and cultural landscape benefits, then it is reasonable that the suppliers of these services should be paid.

⁵⁹ These ideas build on schemes in circulation by many environmental and land management groups, see for example the Scottish Landowners 1995 proposals.

⁶⁰ This can be thought of as zero payments, or Tier O for Obligatory.

Within this, two further tiers of support are proposed to exemplify the principles. This could be elaborated into a multi-tier system or even a continuum. Under this programme, for all ecosystems and landscapes requiring greater care than those defined under the Tier zero obligatory legislation, and for other 'public' environmental services (including access) rendered by farmers and other rural land managers, there should be pluri-annual, purchaser-provider schemes in which purchasers contract and pay for the preservation or enhancement of defined habitats, landscapes, and provision of other rural features and services. The first, Tier 1 is directed to farming systems which provide high nature value. These systems and thus payments may well cover large parts of the European territory. The second, Tier 2 is concerned with specific environmental management practices; these will generally involve more restricted areas and more intensive action on the part of the land managers in order to preserve or create environmental effects of greater significance.

In order to reflect the diversity of environmental conditions and problems in Europe and also the spectrum of concern about these problems, the ECLP programme has to be regionally based. All regions will be required to create the institutional arrangements to bring together the main rural land owning, land management and environmental interest groups together with competent regional authorities to create regional land use programmes. This will, of course be integral with rural development programming discussed in section 7.3 below. Part of this procedure will involve selecting from a menu of EU ECLP schemes, those pertinent to the region.

The EU framework will define the principles and requirements for obtaining EU financial support; within these rules, the definition of precise targets, indicators and payments will be determined locally. The operation of Tiers 1 & 2 ECLPs will then be based on multi-annual contracts between the regional authority (the purchaser) and individual or groups of land managers (the providers) to supply certain benefits and receive agreed payments. To satisfy the principles enunciated in section 6.1, the farmers or other land managers will be paid in proportion to the goods and services they contract to supply.⁶¹ Such payments should, as far as possible, be decoupled from production decisions. There should be explicit targets for these environmental schemes and in-built indicators and provisions for monitoring. Non-compliance with the terms of the contract or non-delivery of the environmental services should result in sanctions.

The operational procedures for the schemes and the principles for determining the payment levels should be laid down by the EU, ie. they will all be operated on a common EU policy basis. This is for two reasons. First, to ensure that there are no abuses to competition policy, and second, because it is envisaged that for reasons of cohesion, there may have to be a high degree of EU financing of these measures in some Member

⁶¹ In principle if a member state wishes to introduce a degree of modulation in the way that funds available for such schemes are distributed this could also be done.

States or regions. EU funding implies some degree of EU control. An element of member state financing and preferably regional financing too, will be required from all Member States to ensure a strong degree of national interest in devising sound schemes. Provided that there are secure mechanisms to ensure competition is not distorted, there could also be nationally funded top-ups to the schemes for Member States who have stronger preferences and the ability to pay for more environmental goods.⁶² These points are further developed in section 8.4.

These ideas are not new for the EU. Much experience has been accumulated since the 1992 CAP reforms introduced the Accompanying Measures for agri-environment (2078/92), early retirement (2079/92) and forestry (2080/92). The agri-environmental scheme is a zonal programme to encourage farmers to use environmentally sound production methods. It is a voluntary contractual scheme where farmers have to commit themselves for at least five years (20 years for the environmental set-aside). Payments are based on the concept of added costs and income lost. The schemes are co-financed from the Community budget (at 75% in Objective 1 areas and 50% elsewhere) and are intended to supplement, not replace Member State expenditure.

The range of activities developed so far under the agri-environment regulation is wide: from general schemes to promote lower use of polluting inputs such as fertilisers and pesticides, or to reduce livestock densities where overstocking has caused problems; to schemes to promote organic farming; encouragement of specific practices like not treating river banks, maintaining hedgerows, leaving field margins, preserving threatened animal breeds and plant varieties, creating biotopes and even natural parks.

The extent and modes of application vary greatly between Member States, reflecting their different objectives, and also differences in natural conditions and environmental problems. Some try to involve as many farmers and as much land as possible with schemes with rather light environmental rules (eg. the “prime à l’herbe” scheme in France), others have been much more focused on specific problems in restricted areas with much more rigorous rules (e.g. environmentally sensitive areas in the UK). Some offer an à la carte selection of measures while others offer full package solutions.

As the schemes have been in operation only since 1993, it is too early fully to evaluate their success. They have generated a large amount of interest and debate raising the level and tone of discussions about the agri-environment. This is an important achievement in itself. However, participation has been lower than foreseen by the Member States, which might indicate that premia are set too low (in relation to current prices). Whether the schemes have delivered environmental benefits is very difficult to assess. As well as the lack of time, and the fact that a 'baseline' against which progress could be measured was

⁶² This will not be well received in the poorer countries, but the principle that any Member State can choose and pay for higher environmental standards is an important one.

not established, this is also because too little monitoring is built into some of the schemes. Much more attention should be given to this in future. As far as possible, the setting of specific objectives and criteria for evaluating achievement should be done in a transparent way, based on a system of agri-environmental indicators. These, in turn, must try to strike a balance between sufficiently incorporating local conditions and yet still allowing interregional comparisons.

Before proposing how these broad principles could be applied to an operational Environmental and Cultural Landscape Payments scheme, it is important to clarify a distinction which is often made in discussions on the agri-environment. This is the notion that agriculture can have either positive or negative effects on the environmental quality of soils, water (surface and ground water), atmosphere, biodiversity and landscape. However, there is no, clear-cut, science-based distinction between providing positive environmental effects and avoiding negative ones. Both these perspectives are formulated with respect to environmental objectives. These are based on social perceptions and can vary according to the cultural context and can vary over time.

Although there is a concept of the critical load an environment can bear, above which cumulative damage can occur, these definitions are not rigorously established and therefore inevitably have a social and political element. The distinction between benefits for which farmers are rewarded by society and those which they must provide at their own cost, therefore, reflects society's perception of equity or fairness or the prevailing institutional setting of property rights. In terms of practical policy, two complementary approaches must be embraced:

- Farmers can be obliged to avoid environmental damage (negative effects) and comply with environmental standards without receiving any payment or compensation for income losses; this is the case of a legally defined polluter, who, according to the *Polluter Pays Principle* (PPP), has to bear the costs.
- Farmers are invited to contribute to the achievement of environmental objectives and are rewarded for their services, whenever such objectives conflict with their rights in land use and therefore go beyond what can be imposed on farmers at their own cost; this is a *payment for the Provision of Public Goods*.

7.2.1 Tier 0 - legally defined and mandatory environmental standards

There can be no escaping that agriculture has to respect the same laws as all other sectors of society, and this includes the polluter pays principle as far as very basic environmental protection is concerned. To a certain extent, this is already the case and causes no difficulty of principle or practice. European farmers and agri-business already accept extensive EU and national procedures and laws relating to registration and use of

crop protection chemicals, animal health products, farm safety at work, farm waste disposal, animal welfare, and health and hygiene standards affecting farms (such as dairy farms, fruit and vegetable packing operations). Many of these have an element of compulsory environmental protection, and they are accepted and implemented and farmers are not paid for them. So there is nothing new or strange about the PPP applying to agriculture.

Tier 0 environmental standards effectively define property rights in soil, water or atmosphere as belonging to the public (and not the land owner or manager) and shift costs of compliance onto these land managers. Starting from the situation of the end of the twentieth century, where such standards are not onerous, it might be expected that over a long period of time, the target should be to raise the Tier 0 obligatory standards.⁶³ Within the range of these mandatory rules, it is necessary to create a legal definition of what constitutes pollution and who, being identified as a polluter, has to bear the costs.

There is undoubtedly an important task to be undertaken to create the social and political climate where these principles can be accepted. This will not be easy, but there are many cases in public life where it has been done, for example, in attitudes to public litter or smoking in public places. Society *can* raise expectations and exert social pressures for improved standards of social behaviour. Thus, whilst there will be problems of monitoring, enforcement and imposing sanctions on abuses of these base environmental standards, this should not discourage the attempt. A critical aspect in gaining support for such an approach is that the standards should be set in such a way that they have some credibility and thus acceptance. This, in turn, creates a problem because there is often no scientific way of defining thresholds, which can have wide applicability and are thus straightforward to legislate and administer.

A current difficult example of Tier 0 standards is provided by the Nitrate Directive. This requires the assignment of nitrate sensitive areas where a standard of 50 mg nitrate per litre of ground water may not be exceeded. Compliance with the standard is to be achieved by restricting the maximum application of nitrate from organic manure to 170 kg per hectare. Furthermore, codes of good agricultural practice have to be defined. If these measures do not prove to be sufficient, the Nitrate Directive provides for the establishment of action programmes. It is clear that the challenge of abiding by these standards poses considerable problems particularly in the intensive livestock farming areas of the Netherlands, Belgium, Germany, Brittany, N Italy and parts of the eastern Counties of England. Two other sets of constraints on farming, based on legislation in the field of nature conservation, are the Bird Directive and the Habitat directive which are in the course of being implemented.

⁶³ The device, every now and then, of raising the base level standards could create the justification for further rounds of adjustment assistance (see 7.4).

Whatever the difficulties of gaining acceptance for and implementation of this Tier 0 concept, it must be achieved⁶⁴. Ultimately, there can be no justification for farmers being allowed to destroy natural resources or pollute water or atmosphere, or for farmers to be paid to abide by these universal legal standards which apply to all other citizens and businesses. However, this is an area where transitional adjustment assistance (TAA) could play a role - see section 7.4.

The imposition of new standards may require farmers to make difficult adjustments to their long-established farming systems, the technology employed, the product mix and the resources used. It may be necessary to conduct research to discover how to surmount the problems posed by higher environmental standards. These adjustments take time, effort and maybe investment. Transitional adjustment assistance could facilitate the necessary changes so that the Tier 0 standards can ultimately apply as intended - unpaid. An alternative interpretation is that respecting environmental conditions is a requirement of receiving TAA.

7.2.2 Tier 1 ECLPs - for high nature value farming systems

Because of the special position of agriculture and forestry, which occupies 76% (EU-15, 1993) of the European land area, the public demands, and is prepared to pay to achieve, a great deal more than the elementary environmental protection defined by law. Recall that the context of these proposed ECLPs is that farmers are no longer receiving support through product prices, and the logic of CARPE is that neither are they receiving 'direct payments' (see section 7.4 where the successor of the compensation payments, the transitional adjustment assistance, is explained). These policy changes in themselves will induce changes in farming practices, some environmentally positive like the use of less variable inputs and lower stocking densities, others environmentally damaging like the loss (by dilapidation and removal) of hedgerows and ditches as farms and fields are enlarged to cope with the lower returns per hectare.

The concept of tier 1 ECLPs is to discover what system and amount of payments for environmental and cultural landscape services are necessary to induce farmers (or other land managers) to maintain locally adapted farming systems which the public can support. It is anticipated that such high nature value farming systems could be devised to cover perhaps a large part of the EU farming area, maybe in principle the whole agricultural area⁶⁵.

⁶⁴ It should be noted that the benchmarks up to which farmers are requested to comply with environmental rules at their own expense may be determined differently in the member states. This reflects their different legal traditions and attitudes with respect to property rights and equity.

⁶⁵ In practice there will certainly not be a full coverage of the whole territory.

Many farming systems provide, or have the capacity to provide, high nature value. This is easiest to describe for grazing farming systems, but the concept is by no means confined to grassland farming. Depending on the grass seed mix, the fertilisation, grazing intensity and grass conservation management (ie the timing and number of cuts of hay and silage) grass fields can be environmentally interesting, providing a rich variety of flora and fauna including bird life, or it can be extremely sparse of biodiversity and nature value. Similarly, surrounding the fields can be a network of hedgerows, wildlife corridors, woodland, wetland, coppices, footpaths and lanes or it can be stark, lines of barbed wire fencing, concrete roads or bare dikes. The environmental and amenity value of these alternatives is obvious. The challenge offered by the concept of Tier 1 ECLPs is to devise measurable indicators and criteria for these farming systems and associated physical landscape features. This exercise can be repeated to identify the corresponding characteristics and indicators for non-grazing farming systems, e.g. for arable and Mediterranean farming systems.

Other ways of characterising Tier 1- high nature value farming systems include such concepts as integrated crop management in which farmers agree to certain preventative measures, or systems of pest and disease control, or the appropriate technologies to use, or lower intensity production methods, or perhaps different rotations and other agromomic aspects. These should all have in common *the potential* to produce environmental improvements in certain specified ways. As far as possible, all Tier 1 production systems should be certified, ie. they should have clearly identifiable features from which there is reasonable prospect that the expected environmental protection or enhancement will emerge. Another variant of the Tier 1 approach is to seek out the obstacles (lack of information and education or inappropriate incentives) which discourage intensive farmers from taking up specific environmentally advantageous technologies and providing the necessary incentives for removing these obstacles.

The principles of tier 1 ECLPs are that farmers and other interested parties in local areas or regions will define and agree the characteristics of high nature value farming systems in their area. The essence of this tier is that the definitions and targets are in terms of the farming systems themselves rather than the detailed environmental and cultural landscape features. This is suggested mostly for practical reasons; it would be excessively complicated to have to define and measure the precise environmental targets for each participant and each hectare of land. The point is that to prevent many types of environmental losses and achieve some gains; it is sufficient to stop or reduce harmful actions which can adequately be defined in terms of farming practices. A considerable environmental gain can result from low-effort action over a wide area of application. Examples are: fertilisation practice, use of certain CPCs, grazing management, drainage, field boundary type and maintenance, crop rotations and mixes, cropping and livestock intensities and systems, and timing of certain operations.

The conditions or defining criteria of the farming systems will no doubt, initially at least, be seen by farmers as unwelcome restrictions on their activities. It is strongly preferable that the acceptance of these 'restrictions' in return for receiving Tier 1 payments should be voluntary. Compulsion or stronger powers of coercion may be necessary to achieve some environmental or cultural landscape features which require solidarity of all land managers in a locality or region, but these should be exceptional. It should not be overlooked that there will be a strong economic incentive for farmers to accept these new payments. There is ample evidence that, on a significant proportion of farms in many regions of the EU, the supports provided in the form of higher prices and various direct area and headage based payments make up a significant part of income from farming. If, in the shift to a market oriented agriculture, these are removed, or substantially curtailed, then acceptance of the ECLPs and the conditions attached become rather more attractive.

But this is a rather negative way to view the ECLPs. Farmers know they are the custodians of the countryside and are not explicitly paid for it. In time, the proposed ECLPs for public services in combination with 'correct' market prices for marketable goods will seem a perfectly natural state of affairs. With more education, attitudes can change to see the logic of such payments on the part of both the farmers and the taxpaying public who foot the bill for the ECLPs. Farmers can surely be persuaded that society wishes to purchase from them not just milk, meat, corn and eggs but all these foodstuffs together with an environmentally balanced countryside.

The latter features are becoming just as important to today's consumer as the food itself. Just as today's consumers (ie the dairies on behalf of final consumers) reject milk if the bacterial count is too high and the milk sours too quickly and thus the farmer will not be paid; so society is trying to move to the point where consumers will collectively 'reject' the milk which is produced in a way which sours the rivers and atmosphere and destroys the rich and varied landscape they are paying for. Of course, offering cash is the clearest economic signal that society is willing to pay for these environmental services and this will do most to change attitudes. Farmers, as businessmen, will naturally react to opportunities to provide goods or services if people individually or collectively offer to pay.

Two critical practical questions concerning Tier 1 ECLPs are, how does society determine how much environment and cultural landscape in total it wishes to buy, and how much it must offer farmers to deliver it? As with the provision of all public goods, it would be nice if these questions could be answered by objective, *ex ante* Cost Benefit Analysis (CBA) of environmental goods and services. However, this is a simplistic answer. CBA is too data-demanding to be a practicable approach. Even conceptually, the CBA approach faces some immense problems.

The environmental and cultural landscape goods under discussion are the ones which *would be* lost, if price supports and compensation payments were curtailed with no measures such as the ECLPs put in their place. This clearly is a political judgment. Some argue that there is a degree of scare-mongering by both farmers and environmentalists about the environmental degradation which would be caused by an unsupported agriculture. They say that it is 'only to be expected' that the potential financial beneficiaries of environmental payments will exaggerate the case for such schemes. This provides an argument for a 'wait and see' approach, to observe how much benefit arises from the removal of incentives to over-intensify and to see how much environmental improvements farmers will effect without being paid. In this approach, a widening of ECLP schemes should only be undertaken, when environmental damage is clearly happening or clearly about to happen.

The counter arguments are that this is a dangerous approach. By the time the damage is done, it is too late. Also, starting from a base of generally acknowledged under-provision of these environmental and cultural landscape services, combined with a lack of conviction by farmers that this is a serious problem, it is wiser to follow the precautionary principle and take the more positive approach.

The judgement behind these proposals is that society is not prepared to risk losing these, goods. Therefore, defining and valuing them is a matter of conjecture. Even if the support cuts were made and implemented quickly (which is not a serious option), the environmental damage would not show up overnight, although the social pain would appear much more quickly. Whilst society waited to see the extent of the degradation, argued about its seriousness and performed the CBA to assess what action is justified, the landscapes, biodiversity, other valued aspects of nature and some farmers, would disappear or change, some, irreplaceably.

In any case, the tools for valuing non-market goods are simply not up to the task. There are three main techniques available. The first uses contingent valuation - in which people are asked what they would be prepared to pay for public goods. The second is based on the travel cost method - where sites are valued by the implicit costs people are prepared to spend visiting them. The third works by constructing hedonic indices - determining implicit values of intangibles, e.g. a panoramic view, by comparing prices of goods with and without them. These all have their usefulness, but each has its severe short-comings, too. It is inconceivable that these methods could be used to provide a systematic basis for widespread ECLPs on the scale envisaged. That is not to say that all research, which has been done and can be done to consider these questions, should not be compiled as part of the information available to policy makers. It should be. But formal CBA does

not provide the answers to the questions posed at the beginning of the paragraph. The practical solution is that they will be discovered iteratively, by learning by doing.⁶⁶

The two questions (how much ECLP in total and at what rate to pay) are inextricably linked. The elements of the process to discover the answers could be as follows. A decision has to be taken about how widely applicable the tier 1 ECLP scheme should be (ie how many hectares the scheme will cover). At the same time, for each of the major farming systems eg. various common types of livestock/grassland farming systems, arable systems and Mediterranean farming systems, calculations will have to be made on the amount of payment necessary to induce people to maintain those systems, given world market prices for the agricultural produce (ie how much per hectare). After a year or two of close monitoring and evaluation, it will become apparent if the scheme is delivering the environmental services expected or not, if it is grossly under or over-funded, if there are too few or too many participants, and if some regions implement it well and others not at all. These results will indicate the corrective actions necessary.

It is hard to see a practical alternative to this iterative, learning-by-doing approach. The important elements are to have clear objectives, good monitoring and transparency. This procedural solution will not appeal to the purist, who would prefer not to set-off until there is complete agreement on objectives, and careful assessment of public benefits and costs in order to determine the total expenditure and its distribution amongst the Member States. The EU can only work on the basis of political bargaining and compromise between the Member States. Thus, there is a high risk that the total expenditure on ECLP schemes and their distribution between Member States will be heavily conditioned by the expenditure and distribution of the payments they replace.

There are dangers and penalties associated both with being over-generous and under-generous with ECLPs (the individual payments and the aggregate amounts). Because the scheme is paying for the marginal cost of providing the environmental services in addition to the sheep, milk or olives, there are reasons to suspect society will find itself overpaying for these services. First, the farmers have more information than the regional authorities (and certainly Brussels); second, they have an incentive to overstate the actions they have to take to supply the environmental goods and to overestimate their additional costs; third, the calculations initially will be based on the situation of supported markets where prices and costs have been inflated by CAP supports; and fourth, the farmers themselves will derive utility from the more environmentally friendly farming so should not be 'paid twice'. If this results in gross overpayment, it will discredit the scheme both with the taxpayers who are footing the bill, and with international competi-

⁶⁶ These are not new questions. Experience with and evaluation of the operation of the agri-environmental measures is now in train. This will provide many lessons on how to design, implement, monitor and evaluate these schemes.

tors who will have grounds for complaining that these are not payments for environmental services, but subsidies to sheep, milk and olive farmers.

However, given a fairly widespread scepticism about the value of environmental and cultural landscape services, and whether they are as important as some environmental enthusiasts claim, the combined foot-dragging of both farmers and the finance Ministers could result in too low payments, and thus poor uptake of the schemes and too narrow a focus for the schemes in the first place. The penalty in this case is that agricultural and rural policy would fail, once again, to deliver the environmental protection society desires. The key to finding the right balance is built-in indicators, adequate resources devoted to monitoring and open public involvement and discussion of the outcome.

There are some built-in safeguards against the danger of overpayment of ECLPs. First, such schemes are starting from a low base. A considerable amount of political persuasion and local activism will have to take place to work up the regional programmes for widespread schemes. This will take time, thus there is less danger of swinging into action immediately with grossly over-sized and badly conceived schemes (such as the 1992 arable compensation scheme⁶⁷) which cannot then easily be scaled back. Instead, there will inevitably be an incremental process starting from experience with the agri-environmental (2078) schemes already in operation. Second there will be two kinds of brake on the system applied by taxpayers and by environmentalists.

The budget (ie taxpayer) pressure will be to avoid paying for things which society doesn't value. In addition to official monitoring, the vigilance of the citizens and environmentalists which should be embraced and encouraged, can be relied upon to 'blow the whistle' either if farmers are not delivering services for which they have been paid or if the schemes are not ambitious enough. Environmental NGOs are not a single voice, but each group knows what it wants and what it does not want. Each scheme will be watched closely for the reduction in damage and the appearance of the environmental benefits society is paying for. Once again, information and transparency are the vital ingredients to ensure that these pressures can be effective.

7.2.3 *Tier 2 - specific environmental management practices*

The concept of Tier 1 Environmental and Cultural Landscape Payments was based on farming systems which, when appropriately operated, have the potential or capability of delivering nature services over wide tracts of land. The Tier 2 concept focuses directly on the environmental and cultural landscape services. It requires more explicit, usually, but not always, zonal-specific, matching of environmental targets with the necessary actions on the part of the farmer or land manager. In specific zones, Tier 2 is thus more

⁶⁷ A critique of these payments is found in section 3.1 above.

selective than Tier 1. It will generally demand greater action on the part of the land manager to deliver the environmental services and will pay in proportion to this effort.

The operation of such schemes should again be based on a menu, determined for the whole EU, of types of schemes available under the programme. Regional authorities will decide, within their integrated plan for the region, which schemes are suitable and the targets within these schemes. They, in turn, will negotiate multi-annual contracts with individual farmers, or groups of farmers, who agree to take certain actions to provide the desired environmental services. The contracts will specify the environmental targets, the indicators and procedures which will be used to monitor their delivery and the payment the land managers will receive. Where the schemes are zonally defined, there may have to be powers of compulsion, if farmers and land owners in the zone cannot be induced to co-operate, and their lack of co-operation threatens to undermine the efforts of their neighbours in the scheme. The Tier 2 payments may well apply to farmers, who are also in Tier 1 schemes. The payments are additive. The more a land manager offers to supply, the more he may be paid.

One application of Tier 2 ECLPs will embrace the protection of particular high interest eco-systems, wetlands, habitats for specific birds or other fauna and the preservation of valued physical features in the rural landscape. Some of these might relate to geographically quite small and concentrated areas. Other may extend over large tracts of land. The UK-style Environmentally Sensitive Areas (ESA) scheme provides one set of examples of this approach. Another application of Tier 2 ECLP schemes could be to stimulate organic farming. This is not zonal, and can be entirely voluntary. It demands stringent action on the part of the participants, and there are already codes of practice for the definition of this type of farming.

Of course, there is a danger that, without proper monitoring, economically motivated organic farmers might be tempted to slide a little on the strict requirements that the label 'organic' demands. Such action would threaten the integrity of the labels painstakingly established by others. This should be dealt with by encouraging mutual community 'policing', by spot-checking farms and their produce, and by withdrawal of offenders from the scheme and its payments.

It might be possible to deal with issues of countryside access using a Tier 2 ECLP scheme. This requires negotiation and contracts planned on a regional basis, but struck with all relevant land owners or managers.⁶⁸ A related but special example, for which some payments are already implemented, is the practice of transhumance of shepherds

⁶⁸ The access issue illustrates the necessity of a differentiated approach, it can only be conceived and executed at regional and local level, and also because of the different, long-established, laws and customs concerning rights of access to the countryside in the member states it is impossible to deal with this in a uniform way across the EU.

with their sheep flocks in Spain. This ancient tradition has created an environmentally rich network of pastures and trails. Appropriate contracts ensures the continuation of these customs in a way which preserves the desirable environmental benefits.

The same two problems concerning the determination of the socially optimal quantum of environmental benefits to be purchased, and the rates to be paid to the suppliers of these services arise for Tier 2 ECLPs as for Tier 1. Broadly, the answers will be found in a similar way, through a political process of trial and error. With time and experience, some help may be given by establishing eco-points systems to aggregate the various components of environmental services a farmer is contracting to supply. This still does not indicate what costs are involved in their supply, and how much society should offer, but it can help simplify the determination of the 'exchange rate' or monetary value of the services. Such a system is already operational in Baden Württemberg in Germany.

An additional consideration arises, in the case of ECL payments for services which require an initial investment, as well as purchase of current services. A prime example of this is organic farming which requires a conversion period, perhaps lasting several years, when produce cannot be sold as organic but when additional costs and thus lower returns result. Once organic status is acquired, the produce may then be sold at a premium price. These features should be reflected in the payments offered. Some of the same features may also apply more generally for ECLPs. To the extent that farmers are able to create higher-value, regionally-denominated produce within their ECL schemes, this enables part of the social benefit to be captured in the higher quality product prices. This too should be reflected in lower payments for the public service, after a certain establishment period.

In order to determine the 'correct' payment to offer for farmers to supply environmental services, it could be useful to employ *tendering or bidding procedures*. This seems to have greatest relevance to Tier 2 ECL services. The regional authorities would invite land managers to bid to supply defined services, and would presumably accept the bids of those, which it felt best combined quality and reliability of delivery of the services at lowest cost. This has the obvious attractions of helping to minimise the cost of obtaining public services.

Whilst this might be a useful approach for some general environmental services, it is unlikely to have universal applicability. This is primarily because there is not a competitive market in supplying environmental services. Many such services are strongly linked to specific territory, and thus to strongly monopolised supply conditions giving suppliers the capacity to drive up the price. There would also be a danger, in these circumstances, of collusion between bidders and even with local administrators. The services themselves are complex and thus the bargaining process would be costly and difficult, limiting the efficiency savings of such an approach.

Recognising that the environmental benefits sought under the ECLP schemes are long term, and yet the policy process is inevitably short term, another idea worth further consideration is that of creating *environmental covenants*. In this context, these would be agreements between land owners and a public authority to forego certain rights over land in return for payments. The value of the approach is that the agreements once made would be very long term, possibly in perpetuity. Whether these could work in all Member States depends very much on land law and attitudes. An added feature of this approach could be that the payments, an annuity, could be capitalised and transacted, which offers some flexibility to the land owner.

This 'chapter' of the CARPE provides the vehicle for the positive achievement of all the environmental objectives for rural areas. For each of the measures defined in the chapter, environment is the prime objective. A critical feature of the Environmental and Cultural Landscape programme is that farmers are paid for *compliance*, that is, they are directly paid for delivering environmental services. However, agri-environmental policy does not rest here, because there may be other schemes (under the titles of market stabilisation, rural development and transitional adjustment assistance) with other prime objectives which have the potential, unless precautions are taken, to undo or diminish the environmental achievements of the ECLP programme. Therefore, as a general principle, environmental conditions may be attached to all other CARPE policy instruments involving payments to farmers. This is one of the ways in which a better integrated policy is achieved. Such conditions can be termed *eco-conditionality or cross-compliance*.

7.3 Rural Development Incentives (RDI)

Neither of the words in the term 'rural development' is clear cut. Both are subject to extensive debate. The consensus on the definition of rurality is to back simplicity and define it in relation to population density. The OECD does this in a two stage approach. At the detailed level of rural communities (communes), rural areas are those having a population density of less than 150 people per Km². Then, at the broader regional level, regions are classified according to the proportion of their communes which are rural; a three part classification is suggested:

Predominantly rural	if more than 50% of communes are rural
Significantly rural	if 15% to 50% are rural
Predominantly urbanised	if less than 15% are rural

This two-way definition and focus on rural regions is doubly useful. First, it provides a reminder that rurality is a continuum, which fits well with the proposal that RDI should cover the whole territory allowing a continuum of actions depending on the scale of problems. Second, the focus on rural *regions*, which include the small towns of rural areas, allows certain problems to be considered, e.g. unemployment, which might not be

considered as closely, if attention was restricted to rural areas. In this way, integrated rural policy is more capable of dealing with these regional problems.

The concept of development should also be rather general. According to Commins and Keane, it should embrace both 'people-development' and 'place-development', bringing about not only "improvement in physical and social conditions but also durable gains in the capacity of people to control and sustain these conditions. In other words, the process of development must be sustainable and, moreover, should be so, as far as possible, through the autonomous, self-reliant decision making of the people concerned".⁶⁹ The object of rural development policy is to stimulate and enable these developments to take place.

Just as rural is not synonymous with agricultural, rural development is much wider than agricultural development. Thus a common rural policy is not just concerned with farmers and agriculture. Agriculture was at one time the dominant industry and employer, but this is no longer true. A CARPE, of course, will include farmers, agriculture and food related activity. These will always be very important parts of rural areas and policy, but it must go considerably beyond them.

By the same token, CARPE cannot deal with all or even a majority of the issues relevant to rural areas. A common agricultural and rural policy for Europe must be thought as a policy sitting alongside and co-ordinating with the overall context of rural or regional policies. The latter refers to the rural dimension of other governmental policies for health, education, housing, transport and social security and infrastructure. All types of rural policy are based on the premise that the very nature of rural areas, with their low population density, remoteness, and yet guardianship of most of the national territory, creates special problems deserving special public interventions.

The special role for a CARPE is to contribute to those aspects of rural development which relate directly or indirectly to land use questions. In short, and following the OECD, rural development is primarily a spatial or territorial concept, it is multi-dimensional, and requires an integrating strategy (because it is multidimensional and not mono-sectoral).⁷⁰

A very important part of what CARPE must set out to do is to stimulate institutional development in the poorest regions. It is no accident that the most developed regions and Member States manage to gain a large share of the EU's structural policy funds. They have the best regional and local organisation; as a result, they are better informed about the procedures and requirements for taking advantage of national and EU development

⁶⁹ Commins P. and Keane M.J. (1994) 'Developing the Rural Economy' in National Economic and Social Council, *New Approaches to Rural Development*, Report 97, Part II, NESC, Dublin.

⁷⁰ OECD (1988) *New Trends in Rural Policy making*, Paris.

assistance. A purposeful action programme is required to stimulate the bringing together, training and encouragement of local authorities, regional authorities, interest groups such as farmers and land owners, and relevant NGOs. The aim is to learn from the models of the best organised regions where possible by bringing-in information and expertise from these regions to train the locals. Some of the lessons learned from the EU LEADER programmes and their associated Observatory have much to contribute.

Much of this activity can focus around concrete actions. The most important initial task is to elaborate a regional development plan. This should be a comprehensive exercise embracing all aspects of regional development. From it will flow the choice of programmes from CARPE which can be implemented. This will include all aspects of the Environmental and Cultural Landscape programme, elements of the Rural Development Incentives and any relevant nationally funded schemes. Thus, the programming is done at the regional level with the appropriate involvement of national authorities. The implementation of most elements of the programmes is then done at local level.⁷¹

The very process of drawing up regional development plans has the capacity to be integrative as far as economic and environmental development in the region and between the various levels of government (local, regional, national and EU) is concerned. It also gives concrete expression to the ideas of partnership between those agencies and groups involved and shared responsibility. The task of creating the institutional framework and devising the initial regional plan represents a large political and administrative investment, although, in many regions in the EU, such institutions, capability and plans already exist. Once it is in place, there will be a process of continual monitoring and evaluation of the effectiveness of the elements of the CARPE programmes.

Every four or five years, there should be a regular review of the measures at EU, national and regional level. Under-performing or redundant measures should be improved, or discarded, new ones introduced. Many of the elements of the CARPE will involve multi-annual contracts, so the review gives the opportunity to amend terms prior to the renewal of these contracts.

In terms of existing EU structural policy instruments, the programme of Rural Development Incentives will build on and integrate actions currently available under Objectives 1, 5a, 5b and the LEADER programme. This will enable a more comprehensive, integrated - and simplified - approach. RDI should in principle cover the whole European territory. The actions available to each region are determined within an overall EU framework. This element of top-down administration is necessary to ensure that

⁷¹ The disparity of the size and sub-national administrative structures of Member States requires some flexibility in defining regions and localities. However there are limits on the number of regional programmes that the Commission could be expected to scrutinise, which will restrict the extent of member state fine tuning.

competition is not distorted between regions. Thereafter, the policy becomes mostly bottom-up. The proposed changes from CAP to CARPE involve a big shift in the centre of gravity of policy moving it out from the centre.

At present, much of the negotiation takes place between Member States and the Commission and the results are pushed down to the regional and local level. Under CARPE, much more action should take place at regional level with, of course necessary contact and negotiation at national level and with the EU institutions. Rural development policy must be more decentralised. National governments who are responsible for paying for the policy will continue to negotiate with each other and the Commission about the size and shape of the overall policy and their share; they will also hold the ring in the competition for resources between their regions.

Within the RDI programme, actions will be available both for agricultural development and for wider rural development. In principle, there is no distinction between these two elements except the beneficiaries of the former are farmers. It should be an instructive signal in itself for farmers to see that they draw on exactly the same programme as non-farming interests in rural regions.

It is expected that the Rural Development Incentives will be an enduring part of the CARPE, as the kind of problems they are designed to tackle are deep-seated and recurring. However, once the institutional apparatus is in place and the initial rural development plans elaborated, local groups, individual farmers and others assisted by the programme will generally only be assisted once or sporadically, but certainly not continuously. The assistance offered is designed to get these groups or individual businesses over a threshold, or beyond a critical point, from which it is intended and hoped they can be independent, thriving enterprises.

7.3.1 *Agricultural Development Assistance*

Under a CARPE, developments in agriculture will take place under the condition that it has to compete freely in the international market place, but where farmers can also be rewarded for the public environmental services they supply. Those engaged in agriculture will continue to choose whether their skills and resources suit them to be full-time farmers, whether they diversify their activities to become pluri-active, part time farmers or whether they cease agricultural activity altogether.

The key requirement for successful development is, and will continue to be, entrepreneurial skill. Farmers have to find their own solution to the economic survival of their farm or other businesses. Handing them fixed 'direct payments' is exactly the way *not* to stimulate creative responses. Rural development incentives may have a part to play for all of these groups. The purpose of the programme is to help foster the acquisition of skills

and stimulate improvements in productivity and quality, in a way that is consistent with the regional plan for rural development.

Actions under Agricultural Development Assistance are concerned with the adaption of agricultural structures, improving the productivity of farm labour, encouraging farmers to improve produce quality and marketing, and, the new element, assisting agriculture to move to more environmentally sensitive methods. They may apply at farm level, to farmer groups concerned with the better marketing of their produce and to the processing industries beyond. Examples of the kinds of measures are to:

- help consolidate farm structures and land holdings;
- provide for early retirement for those who cannot adapt;
- help risk management by farmers by education and training, and also by encouraging private storage;
- improve market information;
- develop agricultural infrastructure where this is necessary;
- promotion of non-food crops;
- raise revenues by re-orienting agriculture to the concepts of quality, local denominations and value-added produce;
- encourage the development of market institutions, and the formation of farm marketing groups and co-operatives;
- help equip and train the staff in these marketing organisations;
- assist the modernisation of food processing and distribution activities in rural areas.
- help change attitudes towards the provision of environmental services, by,
- providing information; training; institutions to share experience and to foster contact between land managers and local communities;
- assist with necessary investments for environmental improvement.

Thus, as the objective of CARPE states, agricultural development refers to an economically efficient and sustainable agriculture. These two elements must proceed hand in hand and not as separate activities. Economically motivated developments (e.g. new techniques, or new crops) must take full account of their environmental effects. Likewise, environmental developments must pay attention to their economic effects. A principle of Agricultural Development Assistance is that it is finite for the individual farmers and enterprises concerned; it aims to create viable businesses which can then survive the market conditions without perpetual support. Apart from giving-up the approach of predetermined target areas and the increased emphasis on the environmental impact of agricultural developments, there is little new in these kinds of actions. Most have been

available nationally or through European Community structural programmes for many years. Despite this, there are, of course, still EU regions where more remains to be done.

The domination of structural policy by the commodity support programmes led to the situation where the more enterprising farmers, who had the necessary quantum of resources and were thus favoured by the provisions of the CMOs, capitalised on these opportunities. This led to a polarised socio-economic farming structure. While many farmers obtained the benefits and consolidated their economic status, many more remained excluded or were marginalised. The more comprehensive approach proposed offers another chance to address the problems of the latter group.

These challenges - to help marginal agricultural producers develop their farming activities, their environmental management and non-farming activities - will expand massively as the EU enlarges to embrace the countries of Central and Eastern Europe. A great effort will be needed to help mainstream CEEC agriculture meet the twin challenges of international competitiveness and environmental awareness.

Before leaving agricultural development, it is important to mention the necessity for a continual programme of research to back up the application of CARPE. There is a great deal more work to be done to discover the mix of new technology, new products and processes, and the integration of productive agriculture and environmental sustainability. There should be a close connection between the EU research programme and the development of new policy initiatives.

7.3.2 *Rural Development Initiatives*

As agriculture already accounts for a low and falling share of employment and output even in the most rural regions, one of the best ways of helping those currently in agriculture who cannot achieve satisfactory living standards in farming, is to stimulate non-farming activity in the rural economy. There is a spectrum of such activities:

- from - processing of farm produce
- use of 'farm' resources for non-farm activity - e.g. agri-tourism, or renting out buildings, equipment or land for non-farm activity
- off-farm activity for 'farm' resources, e.g. labour and machinery
- to - non-farm activity

It is reasonable to ask how far from the farm is it possible to extend a rural policy which grows out of the CAP and its foundation in Article 39 of the Rome Treaty? Two responses can be given. First, another reminder that even a CARPE cannot deal with all the initiatives required for integrated development; thus it should not attempt to. Instru-

ments of overall regional policy are potentially much more powerful in this regard, for instance national policy for decentralising the provision of public services. A second response is that the policy must fit the circumstances. Thus, if it is necessary in order to implement a meaningful CARPE, to amend the Treaty to enable RDI programmes under CARPE to be more active beyond the food and agricultural sectors, then it must be done.

This is particularly relevant for new Member States from Central and Eastern Europe. The option of sheltering their farmers for three decades behind a wall of price support whilst the out-migration from agriculture occurs is not available. They must be assisted purposefully to develop a broad range of economic activity in rural areas including, but not confined to, food and agriculturally related enterprises.

The kinds of support envisaged under this heading are:

- stimulation of institutional development to ensure agencies bring together and catalyse local/regional interests to propagate rural development;
- technical assistance for rural development projects - feasibility studies, advisory services and professional management.
- human capital development, retraining ie. provision of non-farming skills and knowledge;
- infra-structural development, roads, telecommunications, housing, social and business services;
- investment assistance for new small-scale and micro enterprises in rural areas;
- stimulation of new information technologies in rural areas (tele-centres);
- development of local marketing systems - networking producers, local regional branding of 'territorial' products;
- village renewal in association with cultural landscape projects;

7.4 Transitional Adjustment Assistance (TAA)

Changing circumstances require both physical adjustment and a mentality which is willing to accept the need for change and to prepare for it. Change creates uncertainty and anxiety and these impose costs. The special case of agriculture is the scope and scale of these adjustments. In all countries, historically, agriculture has always been the major employer in rural areas and still was until comparatively recently (ie until a few decades ago in Italy, Portugal and Greece). Moving labour out of the sector is therefore a massive and deeply cultural matter, and it is now recognised that because it alters the nature of farming, it has big environmental implications too.

So, even if most, if not all, of the old reasons used to justify support to agriculture have diminished, vanished, or, with experience, have been found to have been empty, it takes time for this to be realised and accepted. These are the justifications, in a humane society, for adjustment assistance. This is not a new or fanciful concept, Article 39 2 (b) of the Treaty of Rome recognised that "account should be taken of the need to effect the appropriate adjustments by degrees". Such assistance is not confined to rural adjustment. Society recognises the need to assist people and areas affected by declining industries, such as coal mining, ship building and steel manufacturing.

It is therefore proposed that the compensation payments introduced in the 1992 CAP Reform are transformed into Transitional Adjustment Assistance. Two extremely important consequences flow from making the switch from 'compensation' to 'transitional adjustment assistance'. First, TAA is forward, and not backward, looking. A major criticism of the present arable and beef headage payments is that they are based on the past. This is very explicit in the regulation, they are *compensation* for revenue expected to be lost following the large cut in institutional prices. On the other hand *transition or adjustment* refers to the future, it is an attempt to reorganise resources (land, labour, management and capital) so that farms (and rural businesses) are capable of surviving unaided in the future.

Making this switch away from compensation instantly offers legitimacy to these supports. Transitional Adjustment Assistance is forward looking, offering at least the hope of change and adaptation to future conditions and future prosperity. On the other hand, compensation payments are retrospective and rather negative; they are to do with making amends for, or counterbalancing, harm in the past. They are not very constructive, they have the danger of encouraging a dependency on the payments and they explicitly offer no grounds for hope that the future can be better.

Second, and following on from the forward looking nature of transition assistance, it should not be necessary 'for ever'. If people and businesses are helped to adapt, then after such help, they should be able to manage on their own. They will be self-reliant and self-supporting. This is the purpose of the adjustment, it is positive, it is trying to achieve something. Thus, transitional adjustment assistance will both help the transition from one policy environment to another and it should be transitional itself. This means that TAA, unlike the present compensation payments must be degressive and/or time-limited. Whether it takes the form of a fixed payments, for a defined period, and then stops or whether it tapers off gradually, i.e. is degressive, is debated below. Whether it is paid as a capital sum, income flow or bond can be discussed and negotiated.

There should be no illusions that such TAA, especially if it is widely applicable to farmers across the EU, can be specifically and explicitly channelled into concrete, definable and defensible adjustment activities such as specific investments in infrastructure, better marketing, help to provide public environmental services, provision of

information, diversification or training. To the extent that these can be created, they can and should be done explicitly under the other support programmes, ECLP and RDI.

Much of the transition assistance is to help farmers to adapt to the reality, to provide a cushion whilst farmers receive and digest the message that society will pay market prices for marketable products and reasonable prices for the non-market services they provide but not more than this. This message has to be repeatedly explained, and emphasised by making it clear that adjustment assistance is indeed transitional whilst farmers prepare to change their businesses and, if necessary their lives. For many, especially those over 50, the truth is that their chances of finding new careers outside farming are limited and thus the adjustment assistance is *de facto*, early retirement.

In short, the message to the recipients of TAA is that society recognises that they have been encouraged, maybe even trapped, in certain forms of agriculture which are fundamentally non-viable, therefore they are offered some cash to help them rearrange their resources and life, but are warned that it is finite and time limited, so they should make the best use of it as they see fit.

Three important principles of TAA are that it should be *decoupled* from production, it should be *non-distorting* to competition, and recipients should respect *environmental conditions*. The basis for calculating the initial amount of TAA will inevitably relate to past prices, income and production (but see the discussion below on trying to relate payments to adjustment costs). This does not contradict the principles of TAA being forward looking or decoupled.

To ensure the latter, once determined, the payment per hectare, per farmer or per annual work unit - however it is calibrated - should in no way relate to current decisions about production, resource use or current prices.⁷² It should not even depend on whether the recipient is still farming. As mentioned, in some cases the recipient will decide to adjust by retiring from farming during the period of receiving the assistance.

⁷² A vexed question is whether payments under TAA should be adjusted in response to developments in market prices. The question is prompted by the EU experience since 1992 and the US experience in the first year of operation of its own 'transition to market payments' in the 1996 Farm Bill. In both cases the payments were calculated in relation to cuts in support prices, but market prices turned out to be unexpectedly high resulting in overcompensation. Should the adjustment payments be adjusted, down if market prices are high and up if they fall? If this is done there is a danger of recoupling supports and production decisions, and reintroducing market distortions. Also, making the payments flexible should be objectively justified in terms of the difficulties caused for adjustment if the payments are fixed. Experience of agri-monetary compensation in the EU suggests that it is dangerous to get into this territory. The political process is likely to produce the result of rewarding farmers when market prices go down but failing to reduce payments when the market prices recover. This is another instance where it is probably better to advance the argument that the payments should be degressive than to insist on making them responsive to current conditions. That way, any anomalies are at least short-lived.

The second principle of TAA, which should follow on from its decoupled nature, is that it does not distort competition. This will be much easier to achieve if TAA is paid across a wide spectrum of farms and not confined mostly to one particular 'type' of farm. To explain: suppose the only real change in the near future in the CAP market regimes is to reduce milk and beef prices, and to pay TAA to cattle farmers. In this situation, it will be more difficult to argue that these payments are decoupled and non-distorting, than if many regimes are simultaneously reformed resulting in TAA for most farmers. In the former case, even though the cattle farmers get no more than the international price for their products, it will be clear that they are getting payments which, while they last, keep some of them in the production of beef and milk.

If TAA is still being paid as the EU enlarges, cattle producers in new Member States, who do not get the payments, could reasonably feel they are at a competitive disadvantage. It would be some consolation if they were not the only farmers suffering from such a disadvantage, and of course if the TAA is degressive and time-limited, it further reduces the distortive effect.

The third principle concerns what recipients do with their TAA. Society is not indifferent to what happens to the land, and the landscape as a result of these payments. A well integrated policy cannot provide one sum of money to improve the rural environment and another sum which leads to environmentally destructive outcomes. Therefore, there must be some environmental conditions attached to TAA.

Many farmers receiving TAA will also be in receipt of environmental payments (ECLPs). For them, the conditions are straightforward, they must continue to respect the terms and purpose of the environmental payments - following the prescriptions of their chosen farming system, or delivering the particular environmental features. Also, they must agree not to take other actions which negate or undermine the environmental scheme. It is more difficult to state the conditions for those who are not participants in ECLP schemes. The principle is that such farmers should not engage in activities which are environmentally destructive, defined in terms of local environmentally friendly farming systems. This passes the responsibility for defining the environmental conditions to the regional level where it can best be tuned to reasonable local circumstances.

Initially, the volume and distribution of TAA will necessarily follow closely its predecessor, the arable and livestock compensation payments introduced in the 1992 reform. The scope will then widen and change in significant ways as the 1992 process of reducing support prices to international market levels is pursued for other sectors. It should be the aim to make this process as wide as possible covering, in principle all commodity sectors. There are no obvious reasons why *any* particular sector should be shielded from the process. Indeed the logic of a territorial or regional approach in which ECLP and RDI programmes extend over the whole territory is that there is no need for any one product

sector to have its own policy. This is the best way to avoid the charge that the policy or its reforms have a 'northern' (or any other) bias which has traditionally been argued.⁷³

As with all the elements of CARPE, two vital questions are what will be the total volume of expenditure on TAA, and what determines the rate of payment to each beneficiary? These will depend essentially on three factors. (i) How fast can the MacSharry compensation payments be converted to TAA and start to decline. (ii) How fast institutional prices in other supported sectors can be cut, this requires decisions on which sectors, in what order and how fast. (iii) How rapidly and to what extent the targetted programmes for environmental and cultural landscape payments (ECLPs) and for the rural development incentives (RDI) can be expanded.

In considering the first factor some regard has to be given to the over-compensation already paid out. It is so substantial that it cannot simply be overlooked. In considering the second factor, there should be explicit discussion of the necessity to accompany every change in policy with compensatory payments. There has been a tendency amongst farmers' groups and even policy administrators to slip into the assumption that *all* policy change must be fully compensated for.

In the past, small changes in institutional prices or small adjustments in quotas could be made without recourse to explicit compensation payments. Indeed, the reforms of the fruit and vegetable regimes and the considerations on olive oil do not foresee compensation. If the switch is made to adjustment assistance, then it is reasonable to ask how difficult an adjustment is to be made. In some cases, such as a substantial reduction in support prices in a relatively short period, there is clearly a great deal of psychic and physical adjustment to be made. It is desirable, in principle, to have some regard of the size of the adjustment demanded by policy change, in arriving at the amount of TAA offered.

Logically, the third factor should be considered farm by farm. To the extent that farmers are able to make good use of the ECLP and RDI programmes, then they presumably have less of an adjustment problem and therefore require smaller TAA. It may be helpful to illustrate these ideas with an hypothetical example. Suppose dairy and beef prices were cut to world market levels over a period of years, and particular farmers were to devise an excellent system of more extensive grazing livestock production in which they receive ECLPs for their herb-rich meadows and other environmental and cultural landscape features. Suppose, in addition, they were part of an RDI assisted scheme for marketing their traditional-breed milk products and beef at premium prices. Then, how much TAA would be justified in for these farmers? The case was, of course, constructed to elicit the reply, 'perhaps not very much, and certainly only for a few years (maybe six to ten?)

⁷³ This charge has long been around, and persists as some countries eg. Italy claims a disproportionately low share of compensation payments in relation to the size of its crop sector..

while the old investments were written off and the new systems were put in place'. However, other examples could be constructed to illustrate situations where there is genuine hardship caused by the proposed policy changes to reduce market price support. These would be in localities where there is much less potential for supplying environmental and cultural landscape services or local, quality, high value products. Not everyone in all regions can take advantage of such programmes. In these difficult examplesm Rural Development Incentives are the main alternative for the long term, but greater and longer lasting TAA may be necessary whilst farmers and others discover ways to create viable alternative activity in the most difficult regions.

It is hoped that this sort of considerations of local problems could indeed be applied in devising fair and sensitive systems of TAA. However, it is likely, given the national bargaining process in the EU and the need for simplicity, that a somewhat coarser approach will have to be employed, at least to start with. There will be a strong temptation to devise per hectare payments which measure the amount of adjustment assistance necessary as proportional to the size of the reduction in supports. This has the strong advantages of simplicity, transparency and universality. However, it is urged that consideration be given to *some* degree of differentiation of TAA to take account of the difficulty of adjustment, even if it is only a somewhat lower general rate of payment in order to create a fund for farmers who can demonstrate they have special difficulties in adjusting. This approach worked well in the case of the Swedish reforms introduced briefly in the early 1990s before they entered the EU.

This is essentially a discussion about the politically charged concept of modulation. In the 1992 reforms, the initial Commission proposals for compensation payments included several elements of modulation. The most important of these was rejected on the logical grounds that compensation must reward most those who are hurt most by reforms, and on the political grounds, that it would have resulted in far lower budgetary flows to certain Member States.

The switch from compensation to adjustment assistance should remove the former objection, and in any case, if the policy is being changed because the past distribution of benefits was considered unfair, there is little point in freezing this inequitable distribution in the compensation or adjustment payments. The political argument remains to be dealt with. On the face of it, there seems an unassailable case for differentiating the large sums of public money given to people who have to adjust to policy change according to the real difficulties they face in making this adjustment. At the very least, this might imply a

ceiling per farm or per annual work unit (ie. in relation to the total labour input on the farm).⁷⁴

Adjustment does seem more likely to be a personal problem, not very closely related to the number of hectares farmed; larger businesses may even find it easier to adjust. However, progress on reform must secure agreement in the Council of Agriculture Ministers where the predominant political calculus is the balance of budgetary flows of any proposal versus the status quo. Therefore, it is difficult to escape from the logic that within the total sum that is agreed for CARPE expenditure, initially at least the member state shares have to be balanced out. Thus the total expenditure on TAA and its distribution will be determined jointly with the corresponding decisions for MS, ECLP and RDI. If this is the political reality, then it is perhaps more constructive not to debate too hard the principle of modulation *per se*, but to clarify the trade-offs and relative importance of *modulating* the payments versus making them *time-limited* versus making them *degressive*. The present arable compensation payments have none of these three features.

Which is most important? It is tempting to answer, time-limited. But a policy which offers money today, but not at some date in the future, has a credibility problem. The famous 1988 stabilisers and maximum guaranteed quantities (MGQs) are an example of how jam-today and pain-tomorrow is always preferred to the opposite. In that scheme, automatic grain price cuts in the future were supposed to occur if production exceeded an agreed volume. Production duly grew beyond the MGQ, but the price cuts were quietly forgotten. For this reason, to demonstrate to farmers, taxpayers, prospective new Member States and international competitors alike that the proposed changes must occur, it is better that the TAA is specified in the regulation as being degressive. If this can be agreed, then it takes the sting out of the debate on modulation. If the payments are to decline and will not be in place for ever, then there is less to be gained from quarrelling about the fairness of their distribution.

There are other important aspects of these payments to be debated. Can they be paid in the form of bonds which allow recipients the option of capitalising them in order to make adjustments which require new investments. Are the payments tied to the present generation of farmers? Can a successor take them over? Are new entrants to farming eligible for TAA? However, these are secondary matters, which should be dealt with after the principal issues of the switch from indefinite compensation to transitional adjustment assistance is clarified.

⁷⁴ These are important, but secondary details. American experience with payment limits per farmer is that it encourages a new branch in rural legal practices in discovering ways of dividing the farm business to maximize the total payments an extended 'family' can extract from the system.

In summary, transitional adjustment assistance is the necessary psychic and political lubrication to ease the friction of moving policy forward. Such payments should be decoupled, should not distort competition and may have environmental conditions attached. For political reasons, their initial level will have to relate to reduction in supports, but it is urged that there should be some modification with respect to the difficulty of adjustment which confronts the recipients, at the very least to enable especially disadvantaged groups (e.g. younger farmers with high debts) to cope with the changes in policy. Beyond that they should be degressive and time limited. Within these general principles, there could be some latitude for Member States to determine precisely how they pay TAA to farmers. The proposed schemes should be approved by the Commission in order that there can be no question of distortions of competition, but whether it is paid uniformly or non-uniformly, monthly, quarterly, semi-annually or annually, can be nationally determined.

8 FURTHER ELABORATION OF CARPE AND HOW TO ACHIEVE IT

8.1 Changing attitudes, political and administrative institutions

For the ideas outlined in this report to be fully implemented, a significant change in attitudes and in political and administrative institutions will be necessary. The proposals here are not pointing in revolutionary new directions. Agricultural policy already took a big step forward in 1992, becoming more market oriented, making direct payments from taxpayers to farmers rather than affecting consumer transfers, and building up experience in identifying and paying for desired public environmental services. However, the full significance of these new policy directions has yet to be realised by everyone engaged in agriculture. This will be achieved only by the widest public debate involving all parties - farmers, consumers, countryside lovers, taxpayers, administrators and politicians.

As this happens, it will become evident that the programme described here is an integrated package of measures. To explain: first, until price distortions are completely removed, producers and exporters will be hampered by supply controls and (shrinking) limits on subsidised exports. Second, until Europe has a programme for achieving socially accepted environmental goals over all its territory, then improvements in one area are likely to be offset by damage elsewhere. Third, until it is realised that rural development depends less and less on what happens to farmers, it will not be possible to channel sufficient assistance into activities which stimulate a balanced rural economy to the benefit of all rural dwellers (including farmers). Having started to shift from essentially a market policy to a policy for rural regions, this process must be taken several stages further.

This process involves some inevitable political and administrative changes. First and foremost, farmers' unions have to get used to sharing power and influence with other interest groups in the countryside. It would be unfair not to acknowledge that they have always interacted with all local interests in land and farming. However, for many decades, there had developed a powerful corporatism in which the real decisions involving farm policy were sewn-up between farmers and their civil servants in Ministries of Agriculture and the Agricultural Directorate General of the Commission. This power has already changed; budget, trade, environmental, animal welfare, public health and consumer interests have increasingly been involved in agricultural policy making.

In a few cases, this wider involvement is becoming institutionalised. It is significant that the Commissioner with responsibility for DGVI is the Agriculture and Rural Development Commissioner. Some national Ministries for Agriculture have seen their remit

broadened to embrace responsibility for natural resources and environment.⁷⁵ But this process must go further. Whereas a sectoral policy can essentially be decided by sectoral interests, a territorial policy must embrace the much wider interests of rural regions. The consequent loss of influence of farmers will not happen without a struggle, but the decline in political influence and political benefit must sooner or later catch up the reduction in economic weight of agriculture. Far-sighted farmers' leaders have already seen that it is far more constructive to seek coalitions with environmental and consumer interests to achieve what all groups want.

It is not just farmers and their organisations who have to adapt, but the political and administrative systems too. The CAP has itself stimulated Member State Ministries and other organisations to create commodity divisions which have primary responsibility for negotiating and implementing the policy. Over time, with the introduction of a CARPE, these administrative units will have to shrink with their responsibilities. There will doubtless be discussions between government departments about competence for rural environmental matters and rural development. These will be mirrored in the Commission by debates between DGVI (Agriculture and Rural Development), DGXI (Environment) and DGXVI (Regional policy). It must be the case that administrative structures are determined by policy requirements and not the reverse.

Equally important are the administrative changes on the ground. Sections 7.2 and 7.3, describing the Environmental and Cultural Landscape and Rural Development features of CARPE, explained how these schemes are based on regional environmental and development programmes. These, in turn, necessitate appropriate political and administrative structures, and machinery to create the programmes and ensure their implementation. In some Member States, this can be achieved within existing structures; in others, it will require some regrouping and reorganisation, while in some, it may have to be constructed *ab initio*. A good deal of assistance and stimulation may be necessary in some regions to ensure they can benefit from the proposed arrangements. Without such concerted action; there will be a repetition of the experience that the least developed regions are least able to benefit from programmes designed to assist development.

⁷⁵ Two shining examples are Luxembourg with its Ministry of Agriculture, Viticulture and Rural Development, and the Netherlands' Ministry of Agriculture, Nature Management and Fisheries. It is also notable that seven of the German Länder have changed their titles to reflect this broader remit than just the traditional mix of agriculture, forestry, food and fisheries.

8.2 Simplification and integration of payments

There is no doubting the complexity of the CAP. It has been remarked that part of this complexity is its sophistication. As there is so much diversity between the Member States this invariably results in complex packages of general rules with particular exceptions and derogations. EU regulations are therefore bound to be a perpetual struggle between simplicity and complexity, or integration and differentiation. At first sight, moving from a sectoral policy to a territorial policy sounds alarm bells that this could be far from a move towards simplification. What could be simpler than arranging policy for millions of farmers by deciding two or three policy prices for each product in an annual meeting of farm Ministers and getting a group of experts together for regular management committee meetings to decide on the precise operation of intervention and export refunds?

The alternative of planning the development of the whole rural economy, region by region, including the environment and cultural landscape, and contemplating contracts with millions of farmers can be made to sound an administrative nightmare. Neither characterisation is accurate. Market policy turned out to be anything but simple. Agricultural product markets were far too differentiated and dynamic for simple regulations to work. Each intervention provoked reactions which necessitated more and more details and restrictions to be defined and built-in, resulting in the morass of regulation which few, but the most involved, traders and administrators understand.

The challenge is to construct an integrated Common Agricultural and Rural Policy which is an improvement in terms of delivery of objectives without excessive complexity. There are several grounds for arguing that this can be done. The three most important are that the core parts of the proposed policy will be *decentralised*, the decision process will be based on *multi-year programming*, and there should be a *single contract* with each participating farmer or group of farmers. These should apply to the environmental, rural development and adjustment assistance measures.

The decentralisation, which is necessary in order to differentiate measures to suit the natural diversity in Europe, also avoids the need for a top-down policy which specifies all the detail for the whole EU. All EU funded programmes will specify their objectives and principles, but the application criteria will be decided locally (though subject to EU prior checking and monitoring to guard against unfair competition). This may itself sound too top-down and dictatorial. Regions may have their own views on what are suitable objectives. But within the single market, and the international set of trade rules, distortive measures arising from a diverse interpretation of the common framework must be avoided. Furthermore, over successive rounds of definition and implementation of CARPE, the right balance between fairness and uniform application from the top-down and suitability for local conditions from the bottom-up will be found.

The move from annual price fixing to multi-year contracts (which is already underway for some elements of the CAP) reduces the scope for creating more and more complexity because it reduces the number of regulations and amendments to regulations. Thus legal changes will be made only infrequently allowing problems and pressures to be relieved periodically, and in one balanced package.

The single contract should apply to all payments for environment (ECLPs) and adjustment assistance (TAA). Negotiations about the terms of these contracts will be conducted by regional representatives of farmers, land managers and other relevant groups. Contracts will then be struck between individual farmers or organisations representing groups of farmers and the local authorities. Each contract will define the tier 1 and 2 environmental services the farmers are willing to supply and the appropriate payments. Whatever their initial basis, these should be convertible to a per hectare basis so they may be aggregated and pooled with the schedule of TAA payments defined for the farmers involved. The contracts for rural development (RDI) will sometimes relate to individual farmers, in which case they too should be aggregated into the single contract with the other payments. Otherwise, they will involve separate contracts with other agents in rural areas.

8.3 Financing and co-financing of CARPE

It is assumed that the new policy and any policy stages necessary to bridge the gap between the CAP and the CARPE must respect the financial guidelines already in place for the CAP. In the longer run, it is assumed that as the transitional adjustment assistance declines, the total budgetary cost will fall. In other words, the presumption is that the total expenditure on market stabilisation (MS), environmental and cultural landscape payments (ECLP) and rural development incentives (RDI) will eventually be less than the 'guideline' expenditure as currently defined. If this did not happen, there would be grounds for suspecting that the reforms were only an exercise in maintaining existing transfers under a different name. In addition, CARPE has to meet the challenge of ensuring compatibility with eastern enlargement and further international commitments. Of course if society deems that it wishes to spend even more securing legitimate environmental or rural development objectives, the total could rise.

The logic of the CARPE is that MS, ECLP and RDI are objectively defined programmes on which expenditure is the outcome of satisfying the societal needs for these public services. The transitional adjustment assistance, in this logic, is the minimum amount required to lubricate acceptance of the change in policy. This logic enables CARPE to be introduced through a succession of reforms of the major regimes (beef, dairy, specialist crops, sugar, cereals).

Each step would involve a '92-like process of price cuts, introduced over three-or-so years, bringing prices close to international levels. In parallel, the apparatus for determining regional plans for the environmental and cultural landscape and rural development programmes would be underway. The rate of growth in expenditure, under these programmes, is likely to be determined by administrative considerations, how long it takes the regions to draw up and get their plans and programmes approved locally, nationally and by the EU. The amount of transitional adjustment assistance would then, be the residual between the available budget and the expenditure estimated or allocated for MS+ECLP+RDI.

This process would start by converting the existing compensation payments for COPs into Transitional Adjustment Assistance and agreeing a schedule of cuts. This would create some room to start TAA for, say, beef and then dairy producers. As soon as the new payments under TAA started to decline, the process could move onto the next sector for reform and so on.

It is open to question whether this process must be completed by the time of full Member Stateship of the CEECs.⁷⁶ The 1995 Agricultural Strategy paper suggested that for a period after accession, CEECs would not get compensation payments but a special package of restructuring and modernisation aids. However under CARPE, such measures, in addition to the environmental and cultural landscape payments, are already part of the policy they would adopt. A special package of measures would therefore not be necessary, just a realistic allocation of ECLP and RDI budgets.

The logic of denying compensation payments to the new Member States is that they are not expected to have to suffer price cuts, and therefore would not qualify for compensation. Two factors might modify this conclusion. First, if major CMOs are reformed starting in, say, 1998, it is not inconceivable that some CEEC prices could then be above the EU levels at the time of accession. They would no doubt try to argue that this entitled them to some compensation. Second, if compensation payments or TAA were still being paid to EU-15 farmers at the time when CEECs were fully adjusted to the CAP/CARPE, it would be politically difficult to exclude CEEC farmers from the payments. It would be easier to persuade the CEECs to accept this situation if there was a clear schedule for the payments in the EU-15 to fall and disappear quite quickly.

Even so, it might be argued that, as CEEC farmers are faced with a difficult process of adjusting to the higher standards and intense competition in the EU, there is a case for them to receive transitional adjustment assistance. This would be the wrong way to deal

⁷⁶ New member states of course become full members politically on day-one of accession, and it is assumed that the full single market provisions apply immediately also. This reference to full membership refers to the idea that eligibility for some kinds of assistance or certain rates of assistance may be phased in over a transition period.

with such problems. Real adjustment in the CEECs should be assisted by the RDI programme. If TAA is to retain any respectability it must be reserved for genuine hardship caused to businesses when long-established policy is changed. This underlines the necessity for the EU to give clear signals to the CEECs about the policy they must adjust to. The conclusion of this discussion is that the aim should be that TAA is more or less phased out by the time of full Member Stateship of the new Member States from Central and Eastern Europe. If TAA was to last eight years starting in 2002, then the Union has twelve years to adopt and adjust to the mature CARPE if the new policy is in place in 1998.

At present, the agricultural budget, FEOGA, is divided into two funds, 91% for guarantee expenditure and 9% for guidance measures. These divisions have become rather artificial. The guarantee fund includes what are clearly structural measures (like aids to producer groups in the fruit and vegetable regime) and the agri-environmental measures which are hard to characterise as agricultural market policy. The guidance section contains LFA payments which are market support measures to cattle and sheep farmers. Compensation payments which come from FEOGA guarantee are somewhere in between. They are not a market price support measure, although that was their origin, but neither are they a true structural measure.

Under CARPE, it would seem clear that market stabilisation, the remnant of the CMOs, would continue to come from the guarantee section. As transitional adjustment assistance succeeds compensation payments, these would also come from FEOGA guarantee. Traditionally, expenditure financed from this part of the budget was 100% EU financed. The Commission has already proposed that there should be an element of member state financing for the fruit and vegetable regime. In any case, it is important that the various parts of the CARPE should be judged by Member States on their intrinsic merits and not on the extent to which they are co-financed. For this reason, it may be wise to consider harmonising the co-financing rates for both sections of the budget - especially as the distinctions between the two sections has become very blurred.

It makes sense that the other programmes under CARPE, environment and rural development, are co-financed. They are by definition regionally differentiated. The problems and the concerns they create vary tremendously around the Union. In these circumstances, it is essential that there is a strong national and regional interest in the success of such programmes, and this is helped (but not guaranteed) if there is a component of national and where appropriate, regional financing.

If much more of the funding of the Common Agricultural and Rural Policy is co-financed, there should be a rethink of the principles behind the rates of co-financing. At present rates are fixed at 100%, 75%, 50%, or 25%, and are often related to simple criteria which define the regions under objectives 1, 5a, 5b and LFAs. To cope with the complete territorialisation of CARPE (ie. its ECLP and RDI programmes cover the

whole Union), and thus the wider range of income levels, intensity of problems and ability to deal with them, there should be a more graduated set of co-financing rates. Without this approach, it may prove very difficult to gain the enthusiasm of some of the poorest potential Member States. They would no doubt prefer to get 100% EU financed direct payments than to have to co-finance much more challenging rural development programmes. Apart from this pragmatic argument, such differentiated co-financing can be justified on grounds of cohesion and partly because some of the environmental benefits sought are truly of European value.

8.4 How the CARPE suits the CEECs

The accession negotiations for the Countries of Central and Eastern Europe are not due to commence until after the Intergovernmental Conference, which itself started in March 1996. This means the earliest start to negotiations would be towards the end of 1997. If the negotiations proceed smoothly lasting no more than four years, the date for the next accession would be 1st January 2002. It would greatly simplify the enlargement negotiations if the shape of the new CAP was to be known before they start. This means that 1997 should be period for debating and then negotiating the further reform of the CAP.

It is important for the CEECs to know the target towards which they are aiming. More importantly, the policy should offer them the chance to develop their agriculture and rural economies to best advantage. It is suggested that CARPE can offer this.

The idea of switching from CAP to CARPE would signal to the CEECs that they can move directly to a 'post-productivist' policy. They can 'build-in' their rural and regional development programmes side-by-side with their developing agricultural economy. This should enable them to avoid the mistake of creating exclusively agricultural institutions to try and solve problems in rural areas but to integrate these with rural development agencies. The requirements for a regionally based programming approach can also assist them to think about the appropriate development of agriculture within the rural economy.

It is argued that the four elements of CARPE would suit the circumstances and needs of the CEECs. The first element, stabilisation, is important to them. The agricultural development component of the RDI should offer assistance to provide management training, to develop producer marketing groups and other private actions which can be taken to help manage risk. Of course the security offered by the Market Stabilisation system can also be an important factor encouraging investment in the sector and the development of the much needed rural credit system. Creating the conditions for stability was an important part of the development of agriculture in many parts of the EU; it is equally important for the Eastern countries too.

However, this message may not be understood in some of the CEECs. For them, food security is still thought to be a much more serious problem than instability. This is understandable given the sharp reduction in agricultural output post-reform, especially as it has often been accompanied by greater production variability. This has occurred where the disruptions of reform have led to reductions in mechanisation, irrigation and availability of high quality seed and other means of controlling yields. The difficulty is that food security is all too often thought to require 100% self-supply, product by product. It will take much public debate and explanation to get acceptance of the idea that, training and education, plus a more open market, together with a social safety net for disadvantaged consumers can be a better guarantee of food security than trying to interfere with the domestic market and border regime to achieve self-sufficiency.

The rural development package, which includes agricultural development, will play a vital role in the rehabilitation of the agro-food sectors of the CEECs. This is not a new concept to them. There is a strong awareness of rural development related to territorial development left over from the days of central planning. The CEEC rural development programmes were closely linked to the population engaged in agriculture. These programmes generally had two aims, to provide work for farm labour during the quiet periods of the farming calendar, and to provide employment in rural areas for family Member States who did not work in agriculture. This was achieved through the development of small and medium sized enterprises in the villages, and often as part of the collective farm.

Much, but by no means all, of this rural industry was agriculturally related, and it was often designed to be suitable for a relatively unskilled and work force and was often labour intensive. Many of these industrial and agro-industrial enterprises have closed since reform. Plainly, they were not economically viable, and it is probable that the quality of output was often below that corresponding to products in a market economy.

This background offers reasonable prospects that the integrated rural development approach will find strong support in the CEECs. There is a clear recognition that rural development requires balanced development of the economy and not just agricultural support. It is recognised that this will require much infrastructural development and general service provision, especially for education and health services. These, of course, go far beyond the scope of what even a redefined agricultural policy can do. The role of agricultural and rural development, in this context, is to help reduce over-manning in agriculture but to combine it with the development of suitable rural industry. In the CEECs, much of this can be agriculturally related.

There is an underdevelopment of marketing services for farmers. As agriculture stabilises, it will require better provision of new technology, mechanisation, crop protection and animal health products, management and financial advice and other professional services. There is great scope for more and better processing of agricultural

products to improve the reliability, grading and standards of farm produce, to develop regional labels and quality marks. Much of the food processing sector requires modernisation, much of this can be part of rural development.

Given time and more general economic development in the CEECs, plus tourism, there is great scope for diversified, agriculturally-based activities which can also be developed, from recreational equestrian activities to farm tourism and crafts. However, if CEEC agriculture is to become competitive, it is inescapable that there must be development of rural business which goes beyond these food and agriculturally related activities. RDI as defined under the CARPE should be available to assist this spectrum of developmental activity. To take advantage of these opportunities, it will be necessary to undertake much effort in institution building and training of staff in local government, farming and other organisations. There is an important role here for pre-accession assistance from the EU.

The environmental and cultural landscape elements of the CARPE will also have important application in the CEECs. There are similarities and differences in these considerations between Western and Eastern Europe. The similarities are the conflicts between agriculture and the environment and the challenge to find ways to encourage farmers to supply the quantity and quality of environmental services society wishes to find in rural areas. The differences are, first, the attitudes towards these problems and, second, because CEEC agriculture suffered two kinds of damage not found to the same extent in the EU. These problems are the industrial pollution of agricultural resources - water, soil and atmosphere, and the particular environmental problems of the very large collective farms created in CEECs. The latter include soil compaction resulting from very heavy machinery, erosion problems from the over-sized fields, the lack of biodiversity, and pollution caused by inappropriate pesticide usage. CEECs therefore have an extra task for the ECL programme, which is to clean-up the past damage which will be important in some regions. The question of attitude may be harder to deal with.

Public concern about the degradation of the countryside is inevitably muted when food prices and food availability are vital concerns in daily life. However these attitudes can change quite fast as development occurs. Private land-ownership itself is only slowly being restored. Much land in Central and eastern Europe may remain in quasi-collective hands in the private co-operatives for some time to come. Thus, awareness of even the private responsibilities and duties of the ownership of land may take time to evolve, let alone the social responsibilities for environmental care. It is for this reason that there will have to be a great deal of public education and awareness raising, and more to the point, financial incentives for farmers to take these issues seriously. The lack of alternative sources of support, and reasonably generous levels of EU co-financing will do a great deal to focus attention on their seriousness.

8.5 Distributional considerations for CARPE

One of the more difficult aspects of the CAP to justify, is the distribution of the benefits and costs it generates. This can be looked at in many different ways: the distribution between commodities, between farms of different sizes, between producers, consumers and taxpayers and between Member States. The latter distribution is of greatest political significance. The two most frequently encountered ways of expressing the distribution are to focus on budget expenditure shares by function, commodity and member state and by the economic transfers set in motion by the price support arrangements. These transfers can be captured using the concept of the budget and trade effects or through calculations of PSE flows or welfare effects by product and member state.⁷⁷

⁷⁷ The budget and trade effect is the sum of the net budget transfers for each member state, and the extra costs of intra-EU trade as a result of the high EU prices. Examples of such calculations can be found in the UK Ministry of Agriculture's 1995 review of the CAP and in Ackrill *et al* (1995).

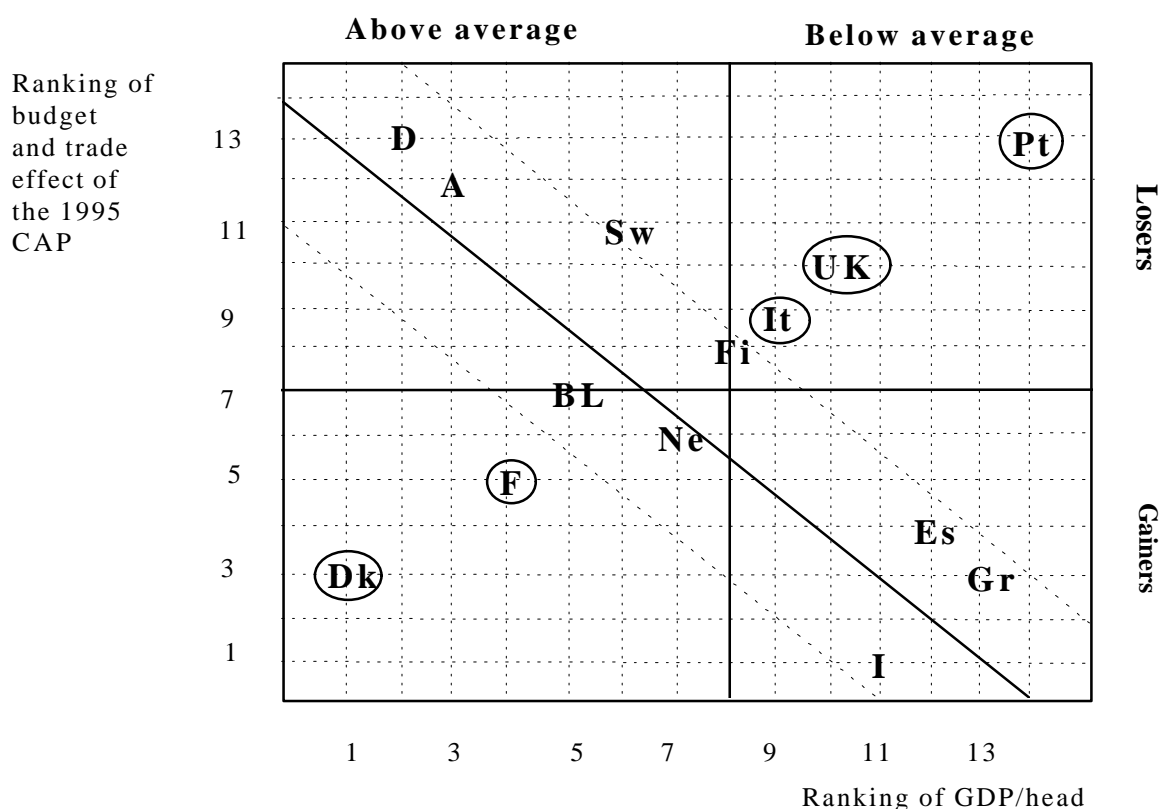
Figure 5 Distribution of benefits of the CAP 1995

Figure 5 summarises the distribution of the benefits (expressed as a percentage of GDP) of the 1995/96 CAP by Member State in relation to their average incomes (GDP per head). The Figure compares the rankings of the beneficiaries of the CAP and the rankings of income per head. In such a diagram a 'perfectly redistributive' policy would show all the countries on the diagonal, ie the poorest country would be the biggest beneficiary and vice versa. The further from the diagonal the more perverse the distributive effect. The box itself is divided into four quadrants showing the Member States above and below EU-15 average income levels and the net gainers and losers from the budget and trade effect of the CAP. It is clear from the diagram that the distributive effects of the CAP could be 'improved'.

In particular, there are three countries in the box marked 'below average income - losers from the CAP' (especially Portugal, and to a lesser extent UK and Italy), and there are two countries who stand out clearly in the box marked 'above average incomes - gainers

from the CAP' (particularly Denmark and France). The other nine⁷⁸ Member States cluster quite closely round the diagonal. The distribution was little changed by the 1992 CAP reforms. The main effects as shown by calculations of budget and trade effects pre and post-MacSharry were that Ireland, France and the Netherlands, all net beneficiaries on this measure, became smaller beneficiaries after the reform. The rankings of greatest and smallest net beneficiaries and losers were unaltered.

Full implementation of CARPE has the potential to greatly alter the distribution of support. This is both a benefit and a problem. It is a benefit because it is reasonable to expect that the EU's largest spending policy should make a strong positive contribution to its principal economic aims of progress and social cohesion. If this cannot be done, it reflects either that the political institutions of the EU are not functioning as they should or there is no real determination on the part of the Member States to achieve the objectives of the Union.

It has not been possible to make calculations of the re-distributional effect of CARPE. This requires difficult judgements of the likely size of environmental and rural development programmes. Changes brought about by reducing support through market prices and by the gradual phasing out of TAA are more predictable. However, it is unlikely that the distribution of benefits of CARPE would exactly follow the pattern created by the CAP which itself flowed from the pattern of support to agricultural commodities. There would inevitably be some losers and gainers from this process.

Whilst it is unreasonable to expect that large and sudden changes in the distribution of benefits could be achieved, it is equally unreasonable to conclude that no changes in the distribution can be made. The conclusion is that there will inevitably (implicitly or explicitly) be a process of agreeing national shares of the envelopes of support under each of the ECLP, RDI and TAA programmes but there must be some room for manoeuvre to allow these shares gradually to change to enable countries with the greatest problems being tackled by the rural policy to receive, proportionately, more of the support.

To be more specific, but still qualitative, the main effects of reducing individual transfers, due to the changes in policy discussed in this report, will be felt by the larger commercial farmers producing price-supported products and currently receiving large compensation payments. Unless such farmers engage in significant provision of environmental and cultural landscape services, they will not extract as much benefit from the CARPE as the CAP. Such farms are to be found in all Member States. They are the ones who are, and must be internationally competitive. They are the ones, generally, who want to be liberated from the constraints of supply management and limits on exports.

⁷⁸ Luxembourg and Belgium are aggregated in these figures.

The proposals here are not to end their present support immediately, but to help them adjust using TAA. Categories of farmers who might be marginalised by the switch to CARPE (or who are already marginalised by the CAP) are young farmers on small holdings, older farmers who are less able to adapt and change, and those small 'farmers or peasants' who are not seriously engaged in commercial production. The first group can be helped by employment created in rural areas by ECLPs and RDI. The second group can be helped into retirement by TAA. The third group may not be reachable by either a sectoral policy or a territorial policy. They may only be assisted by Member State or stronger EU social policy.

Another distributional issue to mention is the capitalisation of the benefits of policy into land values. It is frequently asserted that the ultimate beneficiary of policies which operate through raising market prices are the suppliers of the most inelastically supplied factor of production - land. Also, it is expected that the suppliers of some farm inputs have a sufficiently concentrated market structure to be able to capture part of the benefits of the high farm product prices (eg. the suppliers of mechanisation equipment and agro-chemicals). These groups may lose from a contraction of support through price policy. However, to the extent that market support is replaced by ECLPs, this will counteract the fall in land values. Put simply, if environmental services offered by specific forms of land use are not traded in the market, then they cannot be reflected in the value of the land. As soon as society explicitly creates the market for these services, then, quite rightly, the value of the land - which embraces the possibility to receive payments if managed in certain ways - will rise. The net effect is hard to predict; there is a fall in land values due to the cut in agricultural product prices and a rise due to environmental and cultural landscape value being marketed. These effects will vary from region to region and will of course depend a great deal on the size of the ECLPs. On balance, though, it would be surprising if the new policy did not lead to lower land values.

Finally, the concept of the cohesion effect of a Common Agricultural and Rural Policy should not be interpreted solely on the narrow calculus of budgetary transfers. Cohesion has a wider political and cultural purpose. The EU's largest policy should unashamedly aim to contribute to this goal. From its origins, when the CAP was most definitely part of the big European political and cultural compromise - assistance for agriculture to adjust, in return for an open market for industrial products - it has descended into purely commodity approach. In this process it lost its sense of purpose. A bold new start towards a more integrated rural policy could reassert a constructive role for this important aspect of the European Union.

8.6 Concluding remarks

We should not get carried away on a council of perfection. The CAP is deeply entrenched, it has developed over a long period, and is very large scale in every dimension -

budget, regulatory scope, people affected, interest groups balanced, and bureaucracies involved. Given EU decision making procedures which involve progress by majority voting by farm ministers on balanced packages of measures, it may take some time before a large reduction in support given through the CAP can be achieved.

It will be a test of the maturity of political institutions in the EU to achieve a reform of one of its major policies without the crisis atmosphere of previous reforms. This report attempts to show how large scale changes could and should be made so as to steer the CAP in the direction of a more rational use of scarce EU funds and political capital to produce more of what society wants with fewer undesirable side effects. Developing a Common Agricultural and Rural Policy for Europe will be an iterative, learning-by-doing exercise. The best guarantees of success are transparency, open monitoring and involvement of Europeans through their local democracy.

This analytical exercise has been conducted in the explicit knowledge that a redirected agricultural policy has to apply to a much enlarged community incorporating many new Member States with quite different agricultural structures, problems and interests. In this context, it would be churlish to seek to demolish each individual strand of the proposed package by pointing out their undoubted uncertainties, weaknesses and frailties.

The criterion against which the authors of this document hope it is assessed is whether it defines a preferred direction for agricultural policy. Does it offer a chance that the extent of the internal resource misuse and waste, and the inequities of distribution of current measures could be significantly reduced? If the judgement is 'yes', then the challenge is to discuss these principles widely and to engage all interested parties to help in the difficult task of building on them a more legitimate set of detailed policy measures which suit the needs of European rural society for the next two decades.

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