

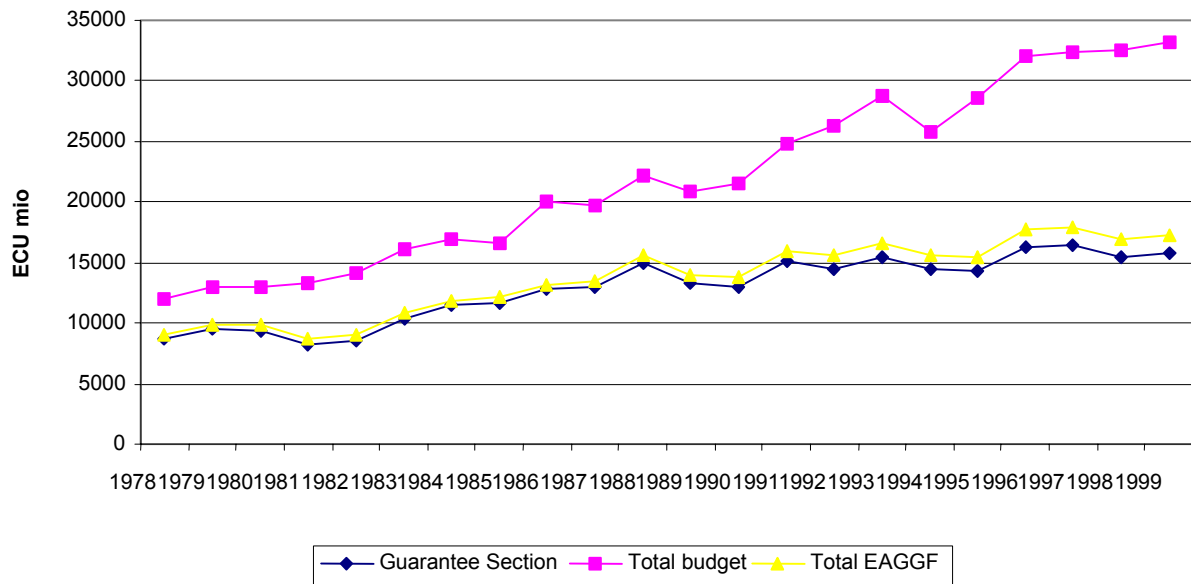
Due to the limited time available to the consultant, this report cannot pretend to be anywhere near comprehensive. Out of a long set of important topics, only a few were selected for a detailed treatment. The rest of them were mentioned in passing only, just to document their significance, so that they may be picked up for a comprehensive study in future.

INTRODUCTION

Agriculture still plays a major role in the European Union. Economic and social interest is justified by the inherent characteristic of farming and reflected by the wide public debate involving all parties: farmers, consumers, countryside lovers, taxpayers, administrators and politicians. Budget, trade, environment, animal welfare, public health, consumer interest and, more and more often, also Regions have increasingly been considered in agricultural policy making. Actually, one of the main challenges is to construct an integrated common agricultural and rural policy, which suits the natural and historical diversity in Europe. This diversity is primarily related to problems of structural adjustment to the changes taking place in the other sectors. Within the EU, the framework is very variegated between regions and also within regional boundaries. As two fundamental prototypes, we have areas in which farming is fully integrated in the agribusiness structure, whereas others are heavily dependent on a lagging behind primary sector.

The significance of agricultural policy is also ensured by the fact that half the substantial EC budget continues to be allocated to the sector, representing an issue of major importance to EU citizens and taxpayers. Even if we observe a gradual reduction in agricultural expenditure as a proportion of the general EU budget, in 1998 this amounted to 42136,1 millions of ECU, or around 0.6% of Community GDP.

Graph 1: Evolution of expenditure for agriculture in the budget of the EU
 [real values at 1978 constant prices; 1978/1999]



Source: our elaborations - DG AGRI data

The Guarantee Chapter of the European Agricultural Guarantee and Guidance Fund (EAGGF), which represents around 90% of the agricultural budget, absorbed 48,9% of EU budget in 1998. Spending under the EAGGF Guarantee covers direct subsidies to farmers, market intervention measures, export refunds, as well as co-financing for agri-environment, afforestation and early retirement schemes.

The Guidance Chapter represented 4% of agricultural budget in 1978 but its share is increased up to 9,2% in 1999. It is one of the EU's four Structural Funds and co-finances measures to promote rural development and assist structural changes in the agricultural sector. These include investment aid, schemes to help young farmers set up for the first time, training activities, compensatory allowances for areas with natural handicaps and rural infrastructure projects.

In dealing with the effects of old and new CAP instruments on cohesion among EU Member States and regions, main consideration will be given to the set of Guarantee Chapter measures, because of its significant dimension in budgetary and economic terms.

The evolving nature of the CAP

New objectives for the CAP

When it was created in 1958, the CAP could count on public support in countries where the population was hit by food shortages during and after the war and who therefore tended to share the production-based aims set out in the Treaty of Rome. In addition, farmers and the rural world represented a considerably greater demographic factor, since agriculture was a much more important economic activity than it is today, either through the percentage of the population employed in this sector or in terms of its contribution to GDP.

Since that date, the importance of agriculture as an economic activity has declined steadily and issues of concern to the public have changed: concern about food security, initially expressed purely in quantitative terms, now concentrates on qualitative aspects, such as safety and taste. At the same time, concern to research for higher levels of productivity has been replaced by major attention in the protection of the environment; besides, farmers are also seen by countryside lovers and rural tourists as potential "stewards of the countryside".

Under Agenda 2000, all these developments have been explicitly identified and a new set of objectives has been defined for the future agricultural and rural policy.

Old CAP objectives art. 39 of the Treaty of Rome (1957)	New agricultural policy objectives Agenda 2000
- Increasing agricultural productivity	- Incorporation of environmental goals into the CAP
- Ensuring a fair standard of living for farmers	- Safeguarding living standards for people working in agriculture. - Creating alternative sources of income and employment in rural areas
- Stabilising markets	- Greater competitiveness in the internal market and abroad
- Warranting food security -Ensuring reasonable prices for consumers	- A fundamental commitment to food safety and quality
	- Simplification of Community agricultural law

Slow steps towards the territorialisation of the CAP

In the coming years, it will be vital for many rural regions to adapt their agriculture in time to new market conditions and to diversify their economies. The process of structural adjustment in the rural regions will bring about positive economic developments if the decline of traditional agriculture will be more than compensated by the emergence and expansion of new economic activities, on- and off-farm (pluriactivity, development of rural tourism, on-farm processing and direct sales of food products, supply of environmental services).

Agenda 2000 is designed to accompany these structural adjustments through two main policies: market-oriented agricultural policy, as first pillar of the CAP, and rural development policy, as second pillar of the CAP. The process of moving from a sectoral to a spatial policy would reinforce the ties which link agriculture to the rest of the local community and would open the prospect for the “regionalisation” of rural policy, or, as the French say, for the “re-territorialisation” of rural policy.

A more market-oriented agriculture would be able to develop the possibilities offered by regional differentiation of its produce, increasing value added and even creating employment. For example, as for the competitiveness a food product has in a world wide economy, it will depend more and more by its historical, cultural and geographic characteristics. Rural development policy should facilitate the structural adjustment of the farm sector, favour the integration of environmental concerns and promote the diversification of on- and off-farm activities.

However, we have to remark that under Agenda 2000 the importance of rural development measures is higher in the claims of the proposal than in terms of resource endowment. As indicated by the financial perspective 2000-2006, commitments for agricultural expenditure are at least 9 times higher than commitments for rural development expenditure.

Succeeding reforms of the CAP

The aims assigned to the CAP through the article 39 of the Treaty of Rome have been generally achieved. The creation of a common market and price policy has been the instrument through which those goals have been realised.

Until 1992, the CAP market policy almost exclusively relied on price support systems, combined in a few cases (mainly sugar and milk) with strictly quantitative controls. Price support was generated through the combination of high border protection (variable levies and tariffs), export subsidisation and intervention buying at guaranteed prices on the internal market.

Price support and the guarantees linked to it set a strong incentive to increase production and stimulated capital flows into the sector to improve productivity. Production grew much rapidly than consumption, so that the Community became self-sufficient for a number of key

products during the 70s. This generated also growing surpluses, which had to be exported with subsidies or piled up in intervention stocks. As a consequence, internal market prices dropped down to intervention levels and farm incomes came into pressure.

This situation created some negative effects: growing public expenditure on storage and export subsidies, destabilisation of international markets which led to growing tensions with the EU trading partners, development of intensive agriculture to the detriment of the environment, animal welfare and, on occasion, consumer health, and decline of vulnerable rural areas.

During the 80s, the Community brought in a variety of measures which sought to curb growing costs and surpluses¹, but these adjustments turned out to be insufficient to prevent major market imbalances in the EU.

These developments led to a major reform of the CAP in 1992. For a number of sectors a partial but significant shift from price support to direct payments was introduced and these payments were limited to historical references (e.g. areas cultivated, yields, number of animals). The main sectors affected were cereals, oilseeds and protein crops, tobacco, beef and, to a lesser extent, sheep meat. In the case of cereals, oilseeds and protein crops, direct payments were in addition linked to an area reduction condition (compulsory set aside).

Three further types of measures were introduced alongside the above commodity measures, to be financed partly by the Community (50% in general, 75% in Objective 1 regions): an early retirement scheme, afforestation aid and several types of agri-environmental measures.

With Agenda 2000² a new step has been adopted in the CAP reform process. Basically, the reform represents a deepening and an extension of the 1992 reform. It includes:

- a significant reform of Common Market Organisations with a further shift from price support to direct payments ;
- a consolidation of rural development policies as the second pillar of the CAP (agri-environmental measures, LFA payments, investment aid, forestry measures, early retirement, and young farmers' aid).

Moreover, as we have seen, a new set of priorities has been identified to guide the agricultural and rural policy of the future, but political decisions have to correct the distribution of financial support, which is still too focused upon the market and price policy.

Objective and outline of work

In recent years, there have been a lot of works on the expected impact of the CAP 1992 Reform at national level as well as on the effects on international trade trends and compatibility with the GATT agreement. On the other side, a review of the existing literature shows few studies specifically devoted to the regional consequences of this reform, although such an issue seems crucial as regards the economic development policy of the European regions. While a not negligible amount of funds have been devoted to improving the economic situation of rural regions, through the means of the 5b objective, one can wonder which is the contribution of the CAP reform to attaining this objective. Thus, our purpose is to examine the distributional effects of the reform among EU regions.

¹ We refer to more restrictive setting of price support levels, imposition of co-responsibility levies on cereals, introduction of supply management instruments, in the of production quotas in 1984 on milk, ceilings for support payments on cereals, oilseeds and certain fruits, and area reduction programme.

² The agricultural policy reform decisions of Agenda 2000 were taken at two stages. First a qualified majority of Ministers of Agriculture agreed in February 1999 on a reform package which remained relatively close to the Commission's proposals. This compromise was re-opened again in the framework of the final negotiation on the overall Agenda 2000 package at the European Council of Berlin in March 1999.

The study will be structured in six parts, which are described below.

Chapter 1 will present an opening snapshot of EU agriculture, either at aggregate or regional level. Therefore, we will introduce basic indicators on agricultural GDP, agriculture share in total employment, Gross Value added at Market Prices (GVAMP), Value Added at Factor Cost (VAFC), agricultural income per labour unit.

We will deal with the localisation of the agricultural labour force, the importance of agriculture in the regional economies, the importance of each region in EU agriculture.

In *Chapter 2*, we will carry out estimates of the transfers generated by the CAP at national level for the period 1989-1998. The CAP may exert its impact on Member States (and regions) in various ways: our task is to classify the measures of public support in agriculture and assess their effect on EU Member States. We will take into account two different clusters of policy instruments:

- price support measures, which lead to "preferential trade effects" at Member State level;
- direct income support and other measures which are not aimed at sustaining the internal price.

We will emphasise how both forms of support are distributed among countries and by commodity, and will see which countries generally gain (lose) from the CAP.

Chapter 3 will be devoted to accurately identify the principal tendencies in the development of national and regional agricultural incomes, by taking into consideration both market factors and policy changes. In particular, we will look over the main results by considering sub-periods ante and post 1992 in order to highlight the impacts of the Mac Sharry Reform.

We will also introduce indicators of the incidence of total public support on incomes, that is to say the weight of total subsidies (national plus EU subsidies) in total agricultural incomes (GVAMP and VAFC). By so doing, we will be able to identify the importance of the public support at regional level.

In *Chapter 4* we will investigate the concentration of agricultural production at regional level; we will also provide insights on the factors which shape the competitiveness among regions the EU agrofood market.

In paragraph 4.2, we will briefly enlarge our perspective by considering the links between agriculture, as production industry, and the other segments of the agrofood chain.

Furthermore, we will explore those modifications undergone in the downstream sectors of the food industry, and we will evaluate which firms and, eventually, which countries get the major advantages from the EU liberalised market within the food industry.

Chapter 5 will be centred on the examination of the effects of CAP measures in quantitative terms at regional level. Our analysis will include an assessment of the CAP impacts both within the agricultural sector and for the economy as a whole.

By referring to the former, we have to consider that disparities in the distribution of CAP support between regions stem mainly from two sets of measures: market price support and direct income support. We will examine the distribution of both forms of support across the EU regions. In particular, we will check whether the 1992 introduction of direct payments has caused significant shifts in the distribution of support at regional level.

Turning to the overall impact of the CAP on regional economies, we will see whether a given region benefits (or loses) from the implementation of the CAP. Besides we will evaluate the agricultural policy effects on three categories of economic agents: producers, taxpayers and consumers.

In *Chapter 6* we will ultimately identify and explain the channels through which the 1992 changes in policy instruments led to the overall impacts previously assessed. We will examine in order: which are the implications of a shift from price support measures to targeted lump-sum transfers as direct payments, which are the characteristics of the specific type of direct payments carried out by the CAP. By so doing, we will be able to explain why the 1992 Reform has produced the distribution of support, identified in chapters 2 and 5.

Above and beyond, general remarks will be devoted to those aspects of the Berlin CAP reform containing elements of interest for cohesion issues.