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### **PART III**

#### **ENDOGENOUS AND SUSTAINABLE DEVELOPMENT IN RURAL AREAS**

The shift in the dominant concepts of rural development favouring sustainability and endogenous approaches is notably linked to the diversification from primary sectors towards industry and services that is taking place in a majority of rural areas. Given the volatility of branch plant investment and the vulnerability of small firms in the rural context, sustainability of communities is increasingly a concern. Not only is the focus on local development related to the need to embed investment in the territory, it is also pertinent to the necessity to better tap rural resources, notably territorial capital and amenities. Thus far, this focus has been weak and rural policies have remained ancillary to agricultural policy; however, this is changing. For example, the EU has set up many measures in support of rural development in the second pillar of the European Common Agricultural Policy. Moreover, there is a need to rethink traditional agricultural policies due to their rural insignificance and to avoid negative side effects. As these traditional policies are dominated by commodity market interventions, they cause major market distortions but have limited leverage on rural development. In addition, these agricultural policies do not score well on equity grounds since they benefit mainly large farms, which are usually well off in terms of income and assets. They contribute little to rural poverty alleviation and to the maintenance of the rural environment.

These issues were introduced by several speakers.

Mr. David Freshwater (University of Kentucky) addressed the question of manufacturing activities in rural areas. Although declining, the manufacturing sector will continue to contribute to rural development, especially for intermediate value added products. Branch plants and clusters of small firms will nevertheless need to face continuous structural adaptation in those areas.

Mr. David Baldock (Institute for European Environmental Policy) analysed recent trends in the EU policy within the framework of cohesion policies and of the Common Agricultural Policy (CAP). He showed how environmental issues and directives are increasingly impinging on the rural agenda and changing the rural environment in Europe.

Mr. Ken Ash (OECD Deputy Director for Food, Agriculture and Fisheries) assessed the impact of agricultural policies on farms and the rural economies. He pleaded for rural reforms that could provide long-term benefits even if they will incur adjustment costs in the short term. In his view, agricultural and rural policies are distinct, but they both need to comply with national policy objectives and broader policy approaches.

Mr. Francesco Mantino (Italian Institute of Agrarian Economy) focussed on the main aspects of rural development planning within the EU Agenda 2000 (*i.e.* the concentration of interventions, the simplification of instruments and the strengthening of management instruments).

Mr. Jesús Regidor (Autonomous University of Madrid) insisted on the duality of agriculture (*i.e.* its territorial and commercial aspects). Territorial agriculture is an asset for sustainable development and should receive priority support especially in lagging regions. So far the CAP is putting too much emphasis on commercial agriculture.

Mr. Paolo de Castro's (NOMISMA Italy) argument was that the CAP has to respond to the new demands of citizens. This will affect rural development which will need to be made more flexible since the enlargement will modify the distribution of funds while support will have to be compatible with WTO regulations.

Mr. Bertrand Hervieu (INRA chairman France) gave some insight into the debate on the multi-functionality of agriculture and on the French policy about territorial farming contracts.

Finally, Mr. Jan Douwe van der Ploeg concentrated on high quality products and regional specialities; an area where a lot of value added could be generated. In certain areas saturation could be overcome through carefully designed rural policies.

## **Will Manufacturing Remain a Pillar of Rural Development?**

**David Freshwater  
University of Kentucky**

### ***Abstract***

*Manufacturing was one of the major sources of rural employment growth in OECD countries in the post World War II period. Much of the growth of manufacturing reflected the relocation of firms from urban centres to rural places in an effort to reduce operating costs. Most of these firms only moved production facilities to rural locations and kept higher order functions in cities. However a number of rural areas were able to develop an indigenous manufacturing sector that was based upon locally owned small firms. In many cases, these firms adopted a strategy of collaboration to synthesise scale economies in production and marketing. More recently many rural manufacturing firms have relocated to developing countries or closed.*

*The argument made in this paper is that while the nature of rural manufacturing is changing in important ways, it will continue to be an important source of earnings and jobs. Further while OECD countries are far less competitive in the production of low-wage, low-skill, high volume goods, there is still considerable potential for growth in higher skill manufacturing organized as clusters of locally owned firms. However there is also the possibility of investments in new branch plants of multinational firms. Rural areas of OECD countries have tended to lose employment from domestic firms, but there has been significant rural investment by multinationals outside their home country. In addition there is growing evidence of firms from developing countries making their first external manufacturing investments in rural areas of OECD countries. This suggests that rural manufacturing is changing, but that it will continue to follow a range of organisational models.*

## Introduction

For nations the process of development is widely held to involve a transformation from a predominantly rural and agricultural based socio-economic system to one that is predominantly urban and dependent on manufacturing and services. Most OECD member countries have passed the point where their population has become predominantly urban and many are thought to have entered a post-industrial era where the service economy surpasses the manufacturing economy in terms of being the main engine of national economic growth (OECD, 2001, Part II; Pezzini, 2001). Even those that believe manufacturing remains an important project, a smaller sector is driven by advanced technology and skilled labour (Cohen and Zysman, 1987).

Yet even in all but the most urbanised nations, there is still a significant rural population, and in rural regions the stage of development is typically less advanced than in larger urban centres. While most rural regions are no longer dependent only upon agriculture, many remain dependent upon manufacturing or a combination of manufacturing and some resource based industry (OECD, 1996, p. 114). Even those rural regions that rely upon the service sector as an engine of growth typically provide services that are based upon natural or cultural amenities (tourism). This is a very different set of services than the advanced producer services that are common in large cities and that are the core of the “new economy” (Coffey, 1993).

This suggests two significant questions for those interested in rural development in the OECD. The first is, what is the comparative advantage of rural areas in the OECD region? In a world where the broad development process entails countries moving from subsistence to market based agricultural systems, and then on to manufacturing, what can rural areas in the most developed nations do to remain competitive? The second question is, how do rural regions within a given nation, or trade block, relate to a predominantly urban society and post-industrial economy that is diverging from rural regions at a rapid rate? Most analysis suggests that rural areas are at a significant disadvantage in the new economy because they lack many of the central institutions that make it function (Coffey, 1993). These include: research universities, corporate research centres, sophisticated financial intermediaries, a large supply of skilled professionals, and most importantly the critical mass that allows all these components to function efficiently. In economic terms it appears that the new economy relies upon significant economies of scale and unless rural areas can find ways to mimic these scale effects it will be difficult to keep up.

A significant part of these two questions involves the fate of manufacturing as a pillar of rural economic development. Given its current importance, the fact that there are concerns that manufacturing might have a limited future in rural areas of the OECD countries is significant (Barkley, 1995; Gilmer and Pulsipher, 1992; Glasmeier and Lychenko, 1999). Rural manufacturing is threatened by two factors; the general decline in manufacturing as a share of GDP in the most developed countries, and the parallel growth of manufacturing in the developing countries. The two phenomena jointly suggest that manufacturing, like agriculture, is a stage in the development process and rural economies in the OECD should expect to see its role diminish. If manufacturing is to survive as a key part of the rural economy how will it have to change to accommodate competition from developing countries and structural change in the domestic economy? If rural manufacturing has a bleak future, then what will replace it?

The standard story of rural manufacturing is based upon the domestic product cycle (Galston and Baehler, 1995; Roth, 2000). It holds that manufacturing takes place in rural areas as a result of firms in a higher-cost urban environment determining that it is more profitable to locate their production processes in peripheral rural areas while keeping the corporate offices, product development and marketing functions in the urban centre. An integral part of the product cycle is an evolution in the production technology of the firm that allows both the separation of production from these other functions and the use of a generally lower skill labour force. Typically most rural manufacturing has relied upon low-skill workers who would have limited alternative employment opportunities if this type of job disappeared.

The second part of the product cycle is that the search for lower cost production does not end with relocation to rural areas in industrialised countries. Firms soon find ways to move to even lower cost locations in the developing world. This shift has been enhanced by trade liberalisation, lower transport costs and technological change. Until recently we could say that rural areas in the OECD seemed to face the dual challenge of being the least developed part of the developed world and simultaneously the most developed part of the developing world.

This model suggests that rural places that rely upon manufacturing have four choices: find some other source of income and employment; find a way to compete with urban areas for the remaining sophisticated manufacturing activity; find a way to compete with developing countries for routine manufacturing; or cease to exist. Although in an abstract sense these are the choices, in reality the outcome is less clear cut and a given place may choose to try a blend of approaches.

## **Sustainable rural development**

With the pressure on manufacturing, there has been an increased interest in the sustainability of rural areas. Sustainability is often thought to imply continuity, stability and a resilience to forces of change. In this sense it fits well with the natural conservatism of rural communities and the sense that rural places are the main repository of social and cultural values (Howarth, 1995; James, 1991). But the notion of sustainability as permanence and resistance to change, is in many ways in direct contradiction with the past evolution of rural places. In some cases for example, communities dependent upon extractive industries such as mines, the main economic process that sustains the community is not sustainable. Thus if the community is to survive when the mine no longer is profitable there must be a major shift in the core economic function.

Even in communities that do not face the challenge of depletion a similar process of change is at work. As time passes, communities that rely upon agriculture or manufacturing can find that they are no longer competitive suppliers of particular products even though they have the same underlying potential to produce as they had in the past. For these places it is not resource depletion that leads to pressure for change but a shift in market structure.

Agriculture, the quintessential rural industry, has experienced some of the most rapid structural changes of all sectors over the recent decades. While agriculture has shrunk in many ways, it still continues to be a significant rural industry. Rural manufacturing may well be in the same position of having to adapt to change, but through adaptation there may be a new future. However the change manifests itself, to remain viable the community has to undertake a significant shift in how it is organised. This suggests that a more appropriate concept of sustainability is one that is based upon a dynamic process of adaptation to change in a way that keeps core elements of the community intact.

The key question then is, what are the core elements of community? This is the issue that makes each place unique. Each community has to assess what it is prepared to give up from the past in order to have a future that keeps it sustainable. For some places the change is relatively minor, while for others it is high. Finally in some places, despite a desire to change, there is so little economic opportunity that it is impossible to hold the resources of the community together, and so people leave and the community declines. The current focus on strategic planning and locally based development options is driven by the recognition that every community has to make fundamental choices about how its future will evolve. Similarly a community can grow and

not be sustainable, if the growth process leads to changes that so fundamentally alter the nature of the place that it becomes something very different.

An important element of sustainability is the idea that it defines successful development as something other than simple growth. In some sense a rural place that becomes more densely settled and more urban, either through steady internal growth, or because it was absorbed by an expanding urban agglomeration, has not exhibited sustainability. In either case the essential character of rurality has changed to a point that we are now dealing with a very different community. While increasing urbanisation is one form of development, it is generally not what is meant by “rural development”.

A second element of recent development theory is the notion of endogenous growth. In a local or rural development context endogenous growth is generally seen as being more desirable than growth that is driven by external forces, because it, in some way, is more determined by local values. Once again this links back to the idea that the values of the community drive the growth process. However endogenous growth in a local development context is not really endogenous. Formally, an endogenous growth process is one where the determination of growth is within the model, rather than from some external factor (Barro and Sala-I-Martin, 1995, pp. 38-40; Basu, 1997, pp. 50-55). At a global level, growth is endogenous because we can consider the earth to be a closed system. At a national level it may still make sense to think of the economy as being relatively closed, although this is a much harder decision today than in the past. But in terms of rural economic development it is unrealistic to discuss endogenous growth processes.

All rural places are small economic units that generate only a portion of the goods and services they consume internally. Over time the share of self-supply has declined so rural places are now more reliant upon external markets than they were in the past. Given this dependency on the larger world and the impossibility of recreating a “Robinson Crusoe economy” it is important to understand that endogenous growth in a rural development context deals with a very weak concept of endogeneity. It really means that local economic agents observe external conditions and try to realign their community with new opportunities, rather than having change take place in the community without a conscious effort to shape at least some aspects of the process. In either instance external pressure for change is the dominant factor that drives the adaptation process, and this reflects the simple fact that rural communities, far more than nations or even large cities, are small truncated economies that must specialise in the production of a relatively small number of tradable goods and services to remain viable. Further, it is hard to argue that there is any real degree of reverse



causality since rural areas individually, or in aggregate, do not significantly influence national or global economies.

Because rural areas have to import a large fraction of the goods and services they consume, it is important that they export to the rest of the world a sufficient value of goods and services to pay for their imports. This makes businesses that can produce for external markets particularly valuable. Manufacturing and agriculture both fall into this category of export-oriented activities. This is one of the reasons they constitute pillars of rural development. Tourism is another potential pillar because it generates income from non-residents. However most of the service industries within rural areas, including restaurants and shops, local hospitals and schools, and local government organisations mainly serve residents and do not generate much external income.

While agriculture and related renewable resource based activity was the traditional economic base of rural areas, the set of important externally oriented economic activities in rural space is now much larger. Manufacturing, tourism, and senior level government facilities of various types are now important sources of external income in many rural areas. Indeed those areas that still depend primarily upon farming, fishing or forestry are typically less well off in terms of a broad range of economic indicators (OECD, 2001, pp. 247-254; OECD, 1994, pp. 35-54). The only sense in which agriculture remains as important in the current rural economy as it did in the past is in terms of the share of land used.

The process of modernisation of agriculture in the OECD countries was a major impetus for diversification of the rural economy. As agriculture modernised it increased output by substituting capital for labour and which also led to the average size of farms increasing. The result was a substantial excess supply of labour in rural regions. While rural to urban migration was a major means for relieving this pressure, the creation of alternative forms of employment, notably manufacturing, was an important way to absorb surplus labour while maintaining rural areas. From the 1950s through the 1970s national governments in most countries made a concerted effort to encourage rural manufacturing by providing various financial incentives to firms that would locate outside traditional manufacturing areas. Although many of these firms were successful, a number, including some of the largest in terms of size and level of subsidy, proved to be viable only with high levels of ongoing subsidy. Not only were these firms an ongoing drain on the national budget but they became a source of trade conflict as international trade agreements limited the allowable level and form of subsidy to domestic firms.

Consequently if we are to think about sustainable rural development processes we must look beyond agriculture in most places. As was argued earlier, this follows from the fact that the development process at the national level is typically couched in terms of an evolution from primary industries to secondary, including manufacturing, and then on to tertiary, or services (Basu, 1997). The process involves an urbanising of the country in terms of where people live, but it also involves a shift in how the rural population lives and earns its livelihood. Rural out migration is an important part of development, but so too is a broadening of the economic base in rural areas to encompass non-farm employment opportunity for those people who do not leave.

### **Manufacturing as a pillar of rural development**

Centuries ago a large share of manufacturing was a rural activity at the time when the main sources of energy were animal power, water and wood. Each of these motive forces is easier to manage in a low population density environment. One of the quintessential first manufacturing sectors, textiles, began through a “putting-out process” where individual rural residents were provided with raw materials and produced cloth that was collected by the merchant. Similarly the production of flour from grain took place on the banks of streams in villages using water wheels. Only with the industrial revolution did manufacturing become an urban industry; because of the shift in motive power to steam, the change in transportation technology with canals and railroads, and the creation of new ways of organising business using corporations and rudimentary assembly line procedures.

In the post World War II era rural manufacturing can be thought of as having developed in one of two ways. The first is the result of an effort by the community, or some higher level of government, to encourage firms to relocate from another place to a specific rural community. This process, commonly referred to as industrial recruitment, has a long history in the United States and other countries. Its origins can be found in the late 19<sup>th</sup> century when manufacturers were first able to escape central cities for lower cost rural areas (Roth, 2000). Prior to the development of railways, water based transportation systems greatly constrained locational choices for manufacturing. During the post civil war reconstruction period in the US south, a significant number of firms left the industrialised north-east to reduce their costs. The central advantages of the south were lower wages, cheaper land, and greater freedom from government control and union activity. These advantages overcame the higher cost of transportation, the absence of firms that could provide support services or machinery, and higher costs of co-ordination. For over 100 years

many rural places, and the rural south in particular, were able to exploit these advantages and establish a significant manufacturing system.

However this system was based upon external ownership and a limited set of internal linkages. The effect was very similar to the old “putting out system” only on a larger scale. For the most part only a single stage in the production process took place in any rural town. Consequently the benefits to the community were mainly the direct employment created by the factory. Without any significant opportunity for local inputs or for additional steps in the production process, there were few opportunities for the community to acquire either greater knowledge of the various elements that make up that specific industry or a broader set of skills that could be applied to other industries. In this sense the development potential of industrial recruitment can be limited. Without an opportunity to learn, the community remains reliant upon a stable flow of firms moving through their town in the search for lower cost production opportunities.

The second major manufacturing system is based upon the indigenous development of various firms. This approach focuses on the creation of small and medium size businesses, none of which dominates the local labour market or local economy. In particular there is great interest in the potential for these firms to capture synergies by working together in a cluster (Bekar and Lipsey 2001; Bernat, 1999; Henry, Barkley and Zhang, 1997). The benefits to the community from this system are obvious. Local firms are more likely to purchase within the community and to consider the external impacts of their decisions. Because the family of the firm owner lives in the community and that person grew up there, it is more likely that the well-being of the community will enter into the firm’s decision process. Local firms are also more able to rely upon informal arrangements because they know their counter-parties which can reduce transactions costs and enhance competitiveness. Further a large body of literature has developed over the last decade suggesting that at the national level small firms are more likely to be a source of new ideas and are a major source of employment growth. Finally small firms are more likely to be able to find an adequate supply of workers in a rural community and require levels of finance that are within the scope of local capital markets.

Given the clear local benefits from smaller manufacturing establishments it is not surprising that this type of system has found favour with those searching for more sustainable development. By contrast, industrial recruitment has been criticised as ineffective, mainly because it cannot ensure that a firm once attracted will remain in the community.

It is a mistake however to dismiss industrial recruitment as a strategy for rural development. In the first place the community does benefit in the form of an infusion of investment by the firm and the income that is generated by the workers at the firm. This source of funding can be critical to the short-term survival of the community and its residents. The recruitment process is best thought of as a symbiotic relationship between firm and community. The firm is looking for labour and a production location and provides capital, expertise and a distribution system. The community is looking for current income and employment and can provide labour and a building site. In the process the community may be forced to add financial inducements in the form of tax abatements, low interest loans and training programmes for workers, but it should be aware that these all reduce the net benefit it receives from the relationship. Arguably the community is in a position to bid no more than the firm is worth to it, but there is clear evidence of communities paying too much for a firm. This points out the importance of understanding the full costs and benefits associated with a given branch plant, but it does not mean the strategy is inherently damaging.

Second in many rural communities there is no tradition of an indigenous entrepreneurial class and little experience in small-scale manufacturing. In these places, especially those with limited natural amenities, the potential to diversify beyond agriculture is mainly a function of the ability to attract outside industry. An external firm provides the initial link to the larger world, and while it may be difficult to exploit the linkage its existence remains potentially valuable. Communities could receive greater benefits from the firms they recruit if they bargained for skill development and a larger role in marketing and distribution during the negotiation to increase the level of local knowledge. In this way the firm would leave greater residual value in the community when it moves on and there would be greater opportunity to move from lower skill activities to higher skill ones either with a recruited firm or with one that develops locally.

### ***Sustainability of rural manufacturing systems***

Sustainability has become a concern for a number of reasons. These include for those communities that have relied upon branch plants:

- the fairly rapid shift of large parts of the rural manufacturing base; for example, textiles, shoes and electronics assembly, offshore in the last decade;

- the relative decline of manufacturing in urban areas which has reduced the flow of new firms into the product cycle pipeline;
- increasingly intense competition among virtually all rural places for the remaining set of firms looking for new sites, which both raises the cost of attracting a new firm and lowers the probability of success.

At the same time changes in production technology that increased minimum efficient scale of operation, the growth of supply chain relationships, and the dominance of mass marketing have made it more difficult for smaller firms to compete in a number of manufacturing sectors. This has led to problems for many rural places that rely upon smaller local firms.

Nevertheless manufacturing will likely remain a central element in rural development. While many places are trying to expand the role of tourism this is not a real option for rural communities that are too inaccessible or lack a high enough level of amenities to attract visitors. Similarly there is little potential for producer services playing a major role in most rural places. Almost by default, the survival of many rural communities will depend upon maintaining a manufacturing base. Viability will be based upon a combination of: manufacturing being the comparative advantage of rural areas, simply because much of the service economy is restricted to urban centres; the fact that while manufacturing is relatively less important in the economy, this is primarily the effect of rapid growth in the service sector, not a collapse of manufacturing; and the ability of at least some portion of the rural manufacturing base to remain competitive in the face of foreign competition.

In terms of sustainability there is in principle little reason to argue that one form of rural manufacturing system dominates the other. While locally based systems have the obvious advantage of being more firmly embedded in the community, they too leave rural places when they are too successful. Because it is difficult to efficiently operate a large business from a small place even with modern telecommunications, the very successful local firms move to larger cities. For example Gateway Computer was founded in a small city in South Dakota but eventually moved to California because of difficulties in attracting skilled employees. Similarly Mrs. Field's Cookies was founded in the relatively small city of Palo Alto, California but relocated to Salt Lake City because it was more centrally located and had better airport connections. Even Boeing, which prospered for over 50 years in Seattle, relocated its corporate headquarters to Chicago. Production facilities may remain in the original location but management leaves and over time the level of new investment declines. While these are examples of very large firms in relatively large cities,

the same phenomenon exists for mid-size firms in smaller communities. The loss of a smaller locally based firm can have a relatively bigger impact on a community than the loss of the head offices of a large local firm, because the smaller firm is more likely to move its entire operation.

While any given branch plant firm may have a limited life span in a community, a strategy that recognises this fact and works to find replacements on a regular basis can be effective. Mount Sterling in Kentucky is a city of 6 000 people. In the late 1980s it relied upon two large branch plants that provided roughly 4 000 jobs for the region. Within two years both plants closed, leading to an unemployment rate of over 20%. Since then Mount Sterling has continued to rely upon a recruitment-based strategy but has tried to attract a larger number of smaller firms. The city now has two industrial parks with about ten firms in each with aggregate employment in excess of 5 000. While they still experience plant closures, the adverse effect on the city is much smaller and it is easier to find another medium size replacement firm.

Both these points suggest that large firms, relative to the size of the community, can present significant development problems. A large firm dominates the local labour market and as it grows it can crowd out other firms because it offers better pay or better benefits. If a large firm leaves it is less likely that another firm will require either the same number of workers, or workers with the same composition of skills, so there will be a more difficult recovery process. Another potentially adverse effect of a large firm is the creation of a “company town” where the firm plays a central role in social and cultural aspects of the community as well as dominating the local economy.

If the aim of rural development is to preserve core values of the community while generating income and employment, then large firms can be dangerous. This suggests that a critical issue for some communities is to not be captured by a too successful firm, since along with short term prosperity there is the risk of future losses in the form of the firm departing, or of the community losing its core values.

There is also little reason to believe that one system dominates the other in terms of stability over time. Declining rural industrial areas are common in many parts of the developed world, typically reflecting a failure of the local economy to remain competitive in a changing global economy. While the process of industrial decline of branch plant economies has been analysed more frequently, there are parallel examples of locally based industries that were once profitable but failed to adapt. Much of the furniture industry in North Carolina was until recently comprised mainly of relatively small locally owned firms, but they were unable to adapt to a combination of changing tastes,

shifts in retail structure from independent furniture stores to large chains, and lower cost foreign competition.

Because all rural places have to adapt to external change, the critical questions for manufacturing revolve around the characteristics that enhance viability. One measure of adaptability is the level of innovation. Research suggests that those places with the highest rate of innovation tend to dominate national economies in terms of household income, employment rates and population growth. But this analysis has concentrated on relatively large cities, and the factors that are considered to underlie innovation, including: the presence of a large research university, a diverse economic base and sophisticated financial and professional services, are rarely found in rural areas.

For rural areas a more relevant measure of adaptability may be one that is drawn from agriculture. Most of the new ideas in farming now originate either in universities or in the research arms of large corporations, not in rural areas. But successful farmers are those who are both early adopters and who can identify the most promising of the new ideas that are generated each year. Rural manufacturers in the OECD countries are in a similar situation. To maintain their competitiveness they have to adopt new technologies and processes to offset the lower labour costs that are a principal advantage of developing countries. Thus for rural manufacturing firms the critical question is more one of modernising an old economy than leading the changes in the new economy.

In this regard it is important to distinguish between firms and plants. Only in the case of small firms is the plant and the firm the same unit. But, the firm and plant relationship can be complex. In the case of European industrial districts one can think of a group of small firms acting in concert to essentially form one large plant. In the case of much of rural America the plant in a community is a part or branch of a much larger firm. The literature on innovation is mainly about firms, not plants, and it suggests that firm size is not a barrier to innovation. Sony and 3M are two examples of large multinational corporations that innovate on a continuous basis. How innovation at the firm level translates into practices and profitability at the plant level is an area where we need more research. Conversely although small firms are often seen as the main source of innovation there are large numbers of small firms that are not particularly innovative.

So for rural areas this raises the important question of whether small indigenous firms or branch plants will provide a more sustainable economic base. The simple answer is that this depends on something other than firm size and the location of the owners. The branch plant of an innovative firm can provide more stability to a community than can a cluster of relatively

unimaginative small firms. The central empirical question at the national level is whether there is a larger incidence of small innovative firms in rural areas than branch plants of large innovative firms. At the local level the question is more stark – what type of firms are present in your community?

Another important dimension reflects what we understand by the term sustainable. The simple notion of permanence is clearly inappropriate since in world where change is constant and rural firms are exposed to competition the only way to survive is to adapt. This means that sustainable manufacturing is more than a firm continuing in place for 50 or 100 years. In general what we are most concerned with is sustainability of the community, and not of the firm. This suggests that even if a particular firm only has a short life within a community, but its presence is instrumental in improving social and economic conditions so that the community is better positioned to adapt to future change, then that firm contributed to sustainability. Conversely if a firm or group of firms is kept alive through a process that weakens the community, for example subsidies or by the firm clinging too long to an obsolete production system when resources should have been shifted to a new activity, then the survival of the firm(s) actually reduced sustainability.

## **A broader typology of rural manufacturing**

To better understand the opportunities for agriculture in rural areas we need a richer structure for thinking about manufacturing than the simple branch plant, local firm dichotomy that has been used to this point. There are significant differences within these two broad groups in terms of future prospects for rural manufacturing. For rural communities it is increasingly important to understand the type of manufacturing system that best fits their community not just the type of product that is being produced.

### ***Branch plants***

The domestic product cycle has clearly played an important role in the evolution of rural manufacturing. But its future is seen as limited for the reasons described above.

However another basis for rural manufacturing has been the inflow of firms from other developed countries seeking a production location closer to significant markets. The quintessential case in this regard is foreign auto-manufacturers in North America, all of which have located their facilities in either rural or small city locations. These firms are in rural areas mainly



because of marketing and transport cost reasons, not simply because they are looking for lower labour and land costs. Over the last 20 years the inflow of plants from other developed countries has provided an important new source of manufacturing income and employment in a number of rural regions but there has been little recognition that this is a different process than the traditional domestic product cycle.

Finally in the last decade technological progress in much of the developing world has reached the point that rural areas in the OECD nations are now less advanced than some parts of developing countries. A consequence of this is that we are now beginning to see a parallel flow of foreign investment from developing countries to rural areas in developed countries. For example a Brazilian manufacturing company announced in late June that it will be opening a branch plant in rural Kentucky to serve the North American market (Lexington Herald Leader, 26 June 2002). As in the case of the US branch plants of foreign firms from OECD countries, the main reason for the rural location is a combination of market access and production cost. The likely distinguishing feature between branch plants from developing countries and those from industrialised countries may be the level of technology embedded in the product and the production process, with more sophisticated products being associated with the industrialised country subsidiaries.

***Small indigenous firms***

Much of the literature on the development role of small firms is based upon industrial districts in Europe where firms are in the same or related industries and have a significant degree of co-operative interaction. But this is only a subset of the ways that small firms can be found in rural areas. A simple four part category captures the main groups. The two dimensions are whether the firms are in the same industry or in different industries, and whether the firms co-operate or compete (Table 1).

Table 1. **Simple two dimensional taxonomy of small firm relations**

Same industry, firms compete	Same industry, firms co-operate
Different industry, firms compete	Different industry, firms co-operate

The industrial district model where firms in the same industry co-operate clearly has the best potential results for a community because it provides a mechanism for firms to pool their resources when it is advantageous

and operate independently when it is not. This flexibility is not costless however because it only works in an environment where large investments have been made in building and maintaining non-market relationships among the participants. From the community perspective this can be seen as another advantage to the model because it helps strengthen local institutions.

A second co-operative model involves firms in unrelated businesses that co-operate to reach a common goal. The simple example of this would be an effective Chamber of Commerce that is made up of business owners who work together even though their individual firms are not directly linked together. Similarly, when a group of retail business owners form an association to improve the appearance of their portion of a town by renovating storefronts and cleaning up sidewalks, this provides another example of collaboration that has clear spill over benefits to the community at large.

However the most common situation is one where a group of small firms co-exist without any significant level of co-operation. The firms in almost any industrial park are the most visible example of this situation. The only common element they share is their address. From the community perspective this situation results in no synergies but it also reduces risk. If firms are unrelated the failure of one has no bearing on the future of the others. In small towns without industrial parks there is also a high probability that firms in different aspects of manufacturing have no close relationship. Thus we cannot simply assume that the presence of small firms will result in meaningful co-operation.

Perhaps more telling is the case where there is a cluster of small firms in the same industry that are competitors. This example is easy to find in the retail sector where one finds automobile dealerships in close proximity to each other, and a large number of fast food establishments on one block and none for a considerable distance. The same phenomenon can exist in rural manufacturing. There are two significant clusters of manufacturers in rural Kentucky that fit this situation. The largest group of houseboat manufacturers in the United States is located in Somerset, Kentucky, while in Liberty, Kentucky there is a collection of metal fabrication shops that produce the vast majority of all the metal farm gates sold in the United States. In both cases these firms are in active competition with each other, and in the case of the houseboat industry a number of firms were started by people who had been in partnership but broke off in direct competition. This example further clarifies the danger in assuming that a rural location and small firms will normally lead to co-operative behaviour.

As a counterpoint to the argument we can consider the effect of “just-in-time” production practices. The auto industry in the southern part of the United States is characterised by branch plants located in rural areas. However, all of the branch component plants are firmly integrated into a production complex managed by the auto assembly company. Over time this linkage has evolved from a strict market based relationship to one that involves significant elements of co-operation. Thus one could conclude that one of the best examples of co-operative behaviour in rural manufacturing involves branch plants of multinational corporations, not small local firms.

The issue of co-ordination has not been adequately examined in rural manufacturing. We know firms rely upon both market based (price signals and non-market based (exchange of protocols, etc.) as means to co-ordinate supplier relationships. In addition large firms often manage co-ordination through vertical integration and absorb their suppliers. For smaller firms in thin markets where potential suppliers may be few in number the issue of how you manage co-ordination through either market or non-market forces is critical. A large part of the interest in clusters can be understood as a way to enhance co-ordination (Scorsone, 2002).

### ***Factors influencing the presence of manufacturing***

Different types of manufacturing are likely to be found in different types of rural area and require different environments. We know the most about domestic branch plants because they are still the most common, and so are the most studied type of rural manufacturing as well as being the target of most local and state policy. Critical factors for these firms include: an adequate supply of labour at relatively low cost; ready access to transport to move inputs into, and product out of the community; cheap land; and minimal government restrictions. Willingness to provide significant financial inducements is almost a necessary condition now, but these payments only matter at the margin. They determine which place among those that are equally acceptable to the firm gets the plant.

Much of what we know about domestic branch plants is also applicable to foreign branch plants, although those from other developed industrial nations tend to be the most demanding in terms of location criteria. Because this latter group tends to be part of a global production and distribution system, a fully developed transportation system is critical to their location choice. In addition many of the larger multinational plants bring with them a network of preferred suppliers that must locate in close proximity to the primary plant. This means that local labour markets have to be relatively large in order

to accommodate the needs of all the linked firms. In addition these plants typically require a significant number of relatively well-skilled workers who often have to receive specialised training that is specific to the firm. Only relatively large rural communities in good locations are likely to be able to meet all these requirements.

By contrast, branch plants from developing countries are more likely to be smaller, stand-alone operations that do not require a highly sophisticated work force. They do need reasonable transportation systems and are probably more sensitive to costs since they are typically engaged in more competitive markets. Since this is an element of rural manufacturing that is very recent, our knowledge of how to best accommodate it is still limited.

Locally based firms, particularly when these firms have established some sort of collaborative process have become a major focus for rural development. They are widely held to provide most of the benefits of branch plants but with few of the drawbacks. Local firms are more likely to have strong ties to the community, both economic and social, and are seen as being more likely to innovate. However, while we can point to numerous examples of rural places where these firms exist we are far less successful in knowing how to establish them in places where they do not exist. It is far easier to determine what it takes to make a rural community attractive as a branch plant location than to create a network of small scale entrepreneurs in that community.

In particular it is extremely difficult to establish the sort of industrial district that is lauded in the literature. Not only do the firms have to be economically viable, but the owners have to believe that it is in their best interest to co-operate over an extended period of time. Since this may involve short-run sacrifices for long run profits, there are considerable incentives to shirk or cheat, which creates the potential for failure.

A group of studies conducted for TVA Rural Studies establish the difficulties associated with any manufacturing-based rural development strategy. Winders (1998) finds in a study of south-eastern states that small businesses do have stronger community links and when successful lead to higher levels on indirect employment than do branch plants, but that there is no strong correlation between higher earnings and increased number of either small or large businesses. Maliza and Winders (1999) in a study of high growth firms in Georgia found that while those small businesses that have high rates of growth do result in significant employment increases, it is not easy to determine which small firms will grow rapidly. Most small businesses do not add many jobs. *“Fewer than four Georgia enterprises in 100 added 20 jobs or more in five years from 1989 to 1994. Only 1.4 in 100 businesses remain important*

local employers after ten years. This result pertains in a state that sustained very rapid economic growth during the study period.” (Maliza and Winders, 1999, pp. 10-11). Thompson and Hammond (2001) found that in the south, employment instability increases as the degree of rurality increases and as the share of a county population that lives in an urban centre decreases. They also found that instability of employment increases as the number of employers declines, confirming that higher risk is associated with specialisation. Finally, Henry, Barkley, Bai and Espey (2000) found that the type of industry appears to dictate the type of manufacturing system. Some types of manufacturer are more likely to rely upon independent branch plants, others on small local firms. However while they were able to find industries that do not cluster, their analysis found no statistical evidence of clusters as a positive factor in employment growth (Table 2).

Table 2. **Plant size and cluster effects on employment, TVA region for two digit rural establishments, 1981-1996**

Industry	Employment change 1981-1996 (%)	Employment 1996 (in thousands)	Cluster effect	Big plant better	Small plant better
Food and kindred products	49.7	239		+	
Tobacco products	-38.3	5			
Textile mill products	-14.7	338	-		+
Apparel and other products	-30.7	271			
Lumber and wood products	24.6	246	-		+
Furniture and fixtures	20.7	119			+
Paper and allied products	12.7	100	-	+	
Printing and publishing	45.4	71	-		+
Chemicals and allied products	-12.2	93	-		
Petroleum and coal products	-21.6	4			
Rubber and miscellaneous plastics	67.5	131			
Leather and leather products	-62.9	14			
Stone, clay and glass products	5.2	60			
Primary metals	16.8	62			
Fabricated metals	24.5	117			
Industrial machinery	42.6	188	-	+	
Electronic and other electric equipment	-5.7	120	-		
Transportation equipment	91.4	115			
Instruments	50.6	32			
Miscellaneous manufacturing	5.3	33			

1. Small plant: less than 50 employees.
2. Large plant: more than 250 employees.

Source: Henry, Barkley, Bai and Espey (2000).

In aggregate this collection of research confirms the obvious point that local leaders have limited ability to influence the path of development in their community. Certain industries are more likely than other to be attracted to a place and each industry has a preferred means of organising that is driven mostly but market conditions not government policy. This in turn suggests that the obvious strategy is to be open to various types of firm and to different means of organisation, and not commit the community to only recruitment or only locally owned business.

## **Conclusions**

The introduction to the paper set out two key questions; what are the comparative advantages of rural areas in the OECD countries, and how do rural regions relate to their urban counterparts? These linked issue because the competitiveness of rural places depends upon what happens in both the urban areas of the OECD countries and what happens in the developing world. As more urban centres enter a post-industrial economy this creates an opportunity for rural regions to take over their previous manufacturing role. However the ability of rural areas to do so will be tempered by steadily higher levels of development in other countries. Already some parts of what used to be the less developed countries are more technologically sophisticated than most rural regions in the developed world. This suggests that manufacturing strategies based upon higher levels of skill have no assurance that they will not soon face the same level of foreign competition as did low skill firms in recent years.

The second question of how rural areas will relate to a post-industrial urban society is answered by recognising that rural areas have always been different and have a distinct development path. For rural areas a major mistake would be to use large cities as a development model and to assume their future can be translated into a rural equivalent. Urban markets are critical for rural places, but the way in which they are served by rural firms will be based upon local conditions. It is in this sense that an endogenous rural development policy can be defined.

Local government with an interest in enhancing manufacturing should look to agriculture which continues to play an important role in rural areas despite its absence in urban places and the existence of foreign competition. An obvious parallel is the mix of bulk commodity and high value production in agriculture and standardised and specialised manufacturing. Similarly the path for success in both farming and manufacturing involves steady improvements in technology. Since agriculture is generally found in all rural regions where manufacturing is present, it presents other opportunities. Agricultural

processing at both large and small firms is an obvious form of manufacturing that offers potential stability if it is tied to regional products. Further, in those places where manufacturing provides mainly low-wage employment the combination of farm and wage income may be a useful way to increase aggregate household.

Evidence of the importance of this adaptive process comes from the loss of much of the manufacturing base of rural regions, while other portions have remained viable and new types of manufacturing activity are being added in other places. While most rural manufacturing was once a clear example of a core-periphery relationship with ideas and firms trickling out from domestic urban centres, this is less the case today. Globalisation has broken down the old urban dominance over a rural hinterland that defined core-periphery models. Firms in rural regions now may be part of a foreign multinational, or locally owned but with global markets. While the domestic product cycle has declined in importance, there are alternative ways to keep manufacturing an important part of the rural economy.

The stages of growth argument that suggests that manufacturing has declined in importance to OECD economies is appealing at an aggregate level but it has less validity when it is applied to smaller areas. General trends to a service driven economy do not imply that all places in a country will follow that path. For rural areas there are good reasons to believe it is an unlikely future. As manufacturing becomes less important in an aggregate sense, it can remain vitally important to some areas. Certainly some rural regions will find other export oriented industries to replace manufacturing, and some regions that continue to rely upon manufacturing will experience job losses and lower income levels. However it seems that manufacturing will still remain relatively important to rural regions. This is of course the story of agriculture in the OECD countries.

What distinguishes rural manufacturing is its intermediate position. For a number of reasons including: access to sources of innovation, limited labour supply (both in terms of skills and numbers), distance from supporting firms, weaker capital markets and distance from end users, most of the more advanced manufactured products will take place in urban areas. At the other extreme, rural areas will continue to lose industry to developing countries where rapid access to markets is not important and wages of low-skilled workers are a major element of cost. Rural areas can also expect to see developing companies take an increasing share of moderate and high skill manufacturing firms as skill levels in these countries improve.

While rural areas historically were able to attract and support semi-skilled manufacturing from urban areas in the home country when it was searching for a lower cost production location this is a much harder proposition than in the past. Not only is much of this manufacturing bypassing rural areas in the OECD countries for locations in developing countries when it relocates, but as low-skill manufacturing plays a smaller role in urban economies there is a smaller volume to relocate. However the traditional rural niche may still exist with a reverse flow from developing countries that are looking for a low cost location to serve the large markets in the industrialised countries. The Brazilian firm may be the vanguard of a new wave of rural manufacturing investment, especially if border concerns make a domestic production site more attractive.

The manufacturing niche for rural regions is likely to be increasingly determined by locational factors in a global context, and only secondarily by cost. For foreign firms that require a presence in an OECD country to adequately serve that market, a rural area can be an appropriate choice. These firms are unlikely to require the sophisticated support available in urban centres and consequently have no need to pay the higher costs associated with an urban location. What they will require is good transportation access, both road and air and possibly rail, so that inputs can be shipped in and product shipped out. To date globalisation has been seen as mainly involving investments by developed countries in developing ones, but the logic of globalisation implies reciprocal flows as developing nations “catch up” and seek access to the large OECD markets.

This suggests that for rural regions in aggregate there will continue to be a mix of branch plants and indigenous small firms making up the manufacturing sector. But, different places will continue to tend to specialise in one form or the other. In general we would expect to see local firms continue to dominate in those areas where they have an existing presence and perhaps develop in areas with relatively strong education levels, a willingness to engage in entrepreneurial activity and good social and institutional networks (Armington and Acs, 2002). Unfortunately these conditions do not describe a lot of rural regions. This suggests that recruitment will have to play the main role in many rural regions, but even in these places there will be preconditions of reasonable transportation access, openness to external investment and an adequate supply of appropriately skilled labour.

Perhaps the central feature of the new economy is the continuous adaptation process that takes place. It is clear that rural areas are not well positioned to originate the ideas that drive this process, but they have to be able to respond to the changes. Agriculture provides an example of how this adaptation can occur, albeit with significant change. At their best both branch



plants and clusters of small firms can carry out the adaptation function. Branch plants, if they are connected to innovative parent firms and are part of a co-ordinated production network, can bring new processes to rural areas. Similarly, clusters of small firms can synthesise the critical mass to do the same thing. In both cases the critical question for the rural community is whether other pieces of the puzzle are available. An adequate supply of qualified labour and the communications and transportation networks to support innovative business are critical for this to happen.

Without innovation, rural areas will have to continue to rely upon proximity to urban markets, relatively low costs of production and natural resources as attractive forces. While this may be enough for some rural places to maintain a viable manufacturing sector it will not be enough to maintain the current level of production and manufacturing will become less significant as a source of income and employment.

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## **Natural Amenities and Sustainable Rural Development: Policies for Integration?**

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### ***Abstract***

*In the endogenous model of rural development, the environment is clearly a critical element of local character as well as a resource that can be used for social and economic benefit. This leads us to give more attention to the best means of maintaining, enhancing and utilising environmental resources in rural development. It is not only an issue of protecting the environment. There is a growing literature on exploiting the provision of rural amenities and environmental competitiveness. For these reasons, policies for integrating the management and use of natural amenities are likely to be seen as an increasingly important element in making rural development more sustainable. This paper will focus particularly on Europe and recent experience with the major EU policy instrument, the Rural Development Regulation, which needs to be seen in a wider international context.*

### **Introduction**

Over the last 20 years there has been a shift in the dominant concepts of rural development to give greater emphasis both to sustainability and to endogenous approaches. These focus on the utilisation of natural, human and cultural resources of a particular rural area as the foundation for forms of development, which embody local distinctiveness as well as long-term viability.

There are various, competing concepts of what constitutes “Sustainable Rural Development”, both in an OECD and wider international context. Very often sustainability is defined in terms of outcomes on the ground, an acceptable level of resource consumption and social capital creation for example. However, other approaches are possible. Some put the emphasis

on the processes driving rural development, such as stakeholder involvement, rather than on outcomes. In both cases, there tend to be shared assumptions regarding the utilisation of specific local resources, building a future from the ground up.

### ***Agenda 21***

At a global level, a more integrated approach is evident in Chapter 14 of Agenda 21 which underscores the importance of food security, human resource development, wider participation in decision making, land and resource conservation and improved environmental planning.

The leading concept in Agenda 21 is “Sustainable Agriculture and Rural Development” (SARD). A range of different policy tools are identified for taking forward this approach, including:

- rural policy and agrarian reform;
- public participation in decision making;
- diversification of income away from pure dependence on agriculture;
- land conservation, including appropriate management of soil and vegetation;
- improved management of agricultural inputs, such as fertilisers, fuel and pesticides.

There has been a widespread response to this framework in both the developed and developing world, with many local communities and projects seeking to put a new approach into practice. It is difficult to find an authoritative appraisal of progress achieved and barriers encountered but the sense of movement forward is palpable.

### ***The Cork Conference***

At a European level, the Cork conference in November 1996, organised by the European Commission in partnership with the Irish Government, strongly endorsed this new approach. “*Sustainable rural development must be put at the top of the agenda of the European Union, and*

*become the fundamental principle which underpins all rural policy in the immediate future and after enlargement.”* A similar, if less ambitious, form of declaration can be found in government statements from several other OECD countries.

The Cork Declaration which emerged, although without complete consensus, from the event, proposed certain principles that should guide rural development policy. The fourth of these stated that policies should promote rural development that sustains the quality and amenity of Europe’s rural and cultural resources. The fifth emphasises that rural development policy must be “as decentralised as possible”, utilising a bottom-up approach.

Cork proved a vision which informed the European Commission’s proposals for the future of agricultural, rural and regional cohesion policies in the EU. These appeared as the Agenda 2000 package in July 1997 and launched rural development as a major strand of the CAP. They were followed five years later by proposals for extending the CAP to EU candidate countries which envisaged rural development funding on a similar scale to that available to agricultural support, for an initial period. (European Commission 1997 and 2002.)

### **The growing role of environmental policy in rural areas**

As rural development policy has moved forward, environmental policy has also developed over the last decade, impinging more on the rural development agenda. The significance of this is not always appreciated. Several trends have helped to propel environmental concerns nearer the core priorities of agricultural and rural policies at the same time as rural development thinking has reached out towards the management of natural amenities. In Europe at least there have been several elements in this change. For example:

- Over the last five years in particular legislation and policy development in the water sphere has focused more on protecting soil, air and water from diffuse pollution, mainly from non-industrial sources. In most countries agriculture is a major source of such pollution and the focus of increasing attention from regulators and water suppliers.
- At the same time there has been a reduced inclination at a European level to exempt farmers from environmental legislation applicable to manufacturing and other sectors. Farmers are facing

increased obligations with regard to waste management and disposal, air pollutants and pesticide use for example.

- Over a longer period there has been a shift in nature conservation policy. The tendency is to reduce reliance on small highly protected areas for meeting conservation goals and to increase the scope of measures seeking appropriate management of land subject to agricultural, forestry or other commercial uses. Sustaining biodiversity in the wider countryside is seen as a key challenge affecting many rural land users in OECD countries. The EU's "Natura 2000" network of key sites is now thought to extend to about 15% of the land area (European Commission, 2002).
- There has been a strengthened focus on positive environmental management of forests and farmland, often in return for an economic incentive. These initiatives already cover nature conservation and cultural landscapes, and are potentially expanding further to embrace carbon sinks and new forms of renewable energy.

The momentum behind these trends and the implications for rural policy should not be underestimated.

### ***Challenges for implementation***

The vigour behind these two agendas has opened the challenge of delivering a new model of rural development in practice. Numerous examples of local initiatives pursuing these objectives can be found in the OECD countries and the developing world. Many have built on a commitment to local capacity building and public participation, supported by both territorial and economic planning and often reinforced by a strong sense of local identity and exceptional leadership.

In short, some of the main challenges for implementation can be summarised as:

- establishing the sustainable development model;
- transferring authority and adequate resources from the centre to the appropriate level;



- shifting structures and resources from a sectoral model to a more integrated approach;
- enabling genuine and informed participation;
- incorporation of the environmental dimension at all stages in the development model;
- ensuring accountability and transparency;
- generating economic, social and environmental benefits;
- managing adjustment, *e.g.* winners and losers;
- administrative simplicity and affordability;
- choosing appropriate policy tools.

It is perhaps not surprising in the light of this that the established top-down model has proved more enduring than some of the political rhetoric would suggest. The process of transferring resources to the appropriate local level and empowering new actors is not always comfortable. Efforts to transfer funding from the agriculture sector to a more broadly based rural approach have met with frequent resistance and mixed success. Sectoral objectives, attitudes, budget lines and institutional machinery remain close to the centre of rural policy making in many countries. The choice of policy tools and instruments to pursue a more integrated rural agenda with a stronger environmental dimension has required a period of innovation and experimentation not always appreciated or fully recognised as such. For example, it is widely agreed that to achieve the necessary level of transparency and accountability there needs to be an enhanced commitment to monitoring, reporting and evaluation and an increasingly sophisticated deployment of appropriate indicators. Aiming at agreed indicators can itself take many years.

In short, winning acceptance of this approach and making it operational is not a change easily compressed into a short period. Some pioneering schemes, such as LEADER in the EU, have been in place for several years and have already generated evaluation studies and useful lessons for the future. However, many policy tools have yet to be deployed for a sufficiently long period to yield as much empirical evidence of their impact as policy makers would wish.

## **Rural development policy in the EU**

Many of these themes can be discerned in the EU's "second pillar" of the Common Agricultural Policy, the Rural Development Regulation (Regulation 1257/1999) and in the pre-enlargement assistance to EU candidate countries, SAPARD (Regulation 12681/1999). There are a number of different levels at which these initiatives seek to incorporate an environmental dimension into rural development planning and finance. These will be examined briefly on the basis of two recent studies undertaken by the Institute with partners from eight European countries with funding from WWF and the UK countryside agencies.<sup>1</sup>

### ***The Rural Development Regulation***

The launch of Regulation 1257/1999 on Rural Development (the "RDR") as part of the Agenda 2000 package signified a broad commitment by the EU to a new phase in rural development support. This measure – often described as the "second pillar" of the Common Agricultural Policy (CAP) – would be applied to promote a wide range of rural development measures through integrated, area-based programmes in all the Member States. A progressive expansion of funding for this pillar was clearly envisaged from the outset and has subsequently been proposed by the European Commission as part of the recent mid-term review of the CAP.

The RDR provides a single EU structure for a package of measures partly funded by the CAP budget, the EAGGF, standing separately from the EU structural funds which also address rural development. Member States can choose which measures to adopt within rural development plans drawn up for this purpose. The only obligatory measure is the introduction of agri-environment schemes offering farmers' incentives for complying with landscape, nature conservation, pollution control and other objectives, many devised locally. Other measures cover farm investment, aid for young farmers and early retirement, support for agriculturally less favoured areas, assistance for woodland management and afforestation, training and a wider range of rural development options less closely attached to farming. These measures are part funded by the EAGGF up to a maximum of 50%, or 75% in less developed "Objective 1" areas. The rural development plans have to be approved by the European Commission but there is a substantial measure of national or regional control, subject to EU rules. There is an emphasis on the need to integrate the different measures in the Regulation and a requirement to monitor and evaluate implementation.

In a related process, a new SAPARD pre-accession EU aid measure was introduced to contribute to the implementation of the *acquis communautaire* concerning CAP policies in central and eastern European Candidate Countries. SAPARD is intended to address priority issues for the adaptation of the agriculture sector and rural areas. It has a much stronger emphasis on institutional capacity building and technical measures, such as adapting to EU veterinary and food safety standards, than the RDR. There is a modest budget and direct payments to farmers are excluded outside pilot agri-environment zones. Nonetheless, many of the measures in the RDR assembly are also to be found in SAPARD.

Both SAPARD and RDR plans combine land-based aids, some of which promote sustainable farming and public benefit from the management of rural areas (*e.g.* agri-environment programmes and forest expansion), with assistance intended to stimulate and support more diverse and competitive rural economies.

The RDR offers some new scope to governments to tailor measures more effectively to meet the varied local needs of rural areas, by simplifying the detailed specifications of certain measures, offering some entirely new ones, and allowing for combined instruments and payments between measures. However, since it is based on CAP funding rather than the regional policy approach and budget of the Structural Funds, the RDR brought with it new controls and procedures over the suite of measures offered. These result from the requirements of certain EAGGF Regulations. The procedures have proved to be a significant influence upon programme development and implementation, and the equivalent rules for SAPARD have been even more influential in shaping the experience of EU Candidate Countries.

### *The environmental dimension of the Regulation*

Under the Treaty of Amsterdam, the EU is committed to integrating the environment into all Community policies. As key instruments to promote sustainable development of rural areas, the RDR and SAPARD should ensure that environmental considerations and opportunities are fully integrated into all the plans. Recent work, including an ongoing project studying implementation of the RDR or SAPARD in eight countries, gives some impression of how integration is working in practice.

Ultimately it is the environmental and amenity impact of activities, which have been funded under the plans which is of central importance. This can only be judged when there is sufficient evidence from the ground. However,

early experience of the procedures adopted to draw up plans and establish national and regional measures, together with critical analysis of phases of implementation since 2000, provides some indication of potential outcomes.

There are several ways in which environmental considerations are reflected in the requirements of the RDR, both in the substance of the measures and in the procedures required. These begin with the overall orientation of the Regulation, which emphasises sustainability more than previous policy in this area. More concretely, the environmental and amenity dimension rests on certain key elements.

First all the Plans are required to include a quantified description of the environmental situation and to propose strategies with clear objectives and priorities. The descriptions should provide the starting point for integration, and for identifying environmental objectives for the Plans. In some countries, this has clearly been an important feature of the planning process. For example:

- In Sweden, environmental considerations have clearly exerted a strong influence on the Rural Development Programme. Not least, the RDP is intended as the main instrument for delivering the National Biodiversity Plan.
- In Austria and France, considerable weight is given to the environment as an integrated element of programmes that are concerned with supporting and reorienting agriculture.

In other countries, such as Spain, the environment is frequently mentioned in the Plans but they tend to contain fewer specific environmental objectives and delivery mechanisms. In both Candidate Countries examined (Poland and Hungary), while environmental protection is a specific objective of their SAPARD plans, it appears to be secondary by comparison with the strong emphasis upon agricultural modernisation measures.

In principle, RDR and SAPARD plans could play an important role in promoting effective implementation of EU Environmental Directives. Some plans do make this link, for example, to EU nature conservation legislation and the establishment of the “Natura 2000” network of important conservation sites. The sites cover substantial areas of farmland, forest and coastal zones within rural areas. Overall, however, not many countries have used the new scope within the Regulations to support the implementation of “Natura 2000”.

Second, there is a requirement to involve national or regional environmental authorities in planning and monitoring programmes. In most

countries the preparation of the Plans has involved environmental authorities and stakeholders. For several, this has been an important new development in the delivery of EU rural and agricultural policy. Involvement by environmental authorities in implementation and monitoring appears less substantive in some countries such as Austria, Spain and Hungary, while in the United Kingdom, Sweden and France it appears to be strong at both national and local levels, involving new consultative and steering arrangements. This has been a valuable means of widening focus and generating innovation in structures which have often been dominated by agrarian institutions.

Third, an environmental element has been inserted or strengthened in a range of individual measures within the RDR, relative to previous legislation. One of the new requirements is that farmers participating in two major schemes should meet “Usual Good Farming Practice” standards. National authorities are asked to specify verifiable standards, in a move designed to make the general stipulations of the Regulation more concrete. In another example, support for Less Favoured Areas has been modified both to add an emphasis on sustainability and to alter the form of payment. Farmers now receive compensation payments per hectare, rather than per head of livestock; this is expected to reduce overstocking.

The precise impact of such measures is difficult to judge but the re-orientation of the LFA system has been sufficiently pronounced to generate considerable debate in several Member States. The change to headage payments can create significant winners and losers and considerable energy has been devoted to minimising impacts on the latter. The greening of rural development measures has mainly affected agriculture but the forestry component of the Regulation now has a greater focus on sustainable woodland management.

Fourth, agri-environment policies are the only compulsory measure required of every Member State in their plans. On the other hand, national authorities have considerable latitude in designing their own measures and determining how much of their rural development plan budgets are devoted to agri-environment schemes. This compromise seems to be widely accepted. Implementation levels have been increasing over time and our understanding of the impacts of these schemes is growing, although a comprehensive European overview of achievements, failings and lessons learned is still lacking.

Some national plans allocate a substantial proportion of their budgets to primarily environmental measures, largely in the form of agri-environment payments. In contrast, others clearly see these measures as a relatively low priority by comparison with agricultural development, most notably assistance for farm investment and infrastructure. In general, the pattern of resources

allocated to the environment is weighted more to northern European countries and does not fully reflect the likely distribution of amenity provision or wider environmental requirements on the ground. For example:

- It is clear that many Candidate Countries face major environmental threats, such as the widespread abandonment of marginal farming areas of high ecological value. Although pilot agri-environment measures were originally a feature of SAPARD plans in several countries, it now appears that these will not be implemented in the near future because of problems associated with the authorisation of paying agencies and procedures. Candidate Countries introducing national agri-environment schemes outside SAPARD, such as Slovenia, have been able to move ahead faster;
- In the United Kingdom, although agri-environment measures represent the largest proportion of RDR expenditure, the total national RDR budget is particularly small by comparison with most other Member States. (It represents only 3.5% of the total EU budget for the RDR, whereas the United Kingdom contains over 12% of the total agricultural land area in the EU.) Most farm land therefore remains untouched by environmental schemes.

Whilst there are many examples of well-designed and implemented agri-environment schemes, further information and analysis regarding their impacts are needed. Not all schemes appear of great value. The environmental case for providing a significant share of agri-environment aid for certain crops such as sunflowers, for example, has been questioned by NGOs.

In principle, the safeguards in the RDR are intended to screen out funding for projects that damage the environment. However, this form of integration is not always successful. There remain elements within national rural development plans and programmes that are of potential environmental concern. These include investments in new irrigation schemes, forest roads and certain aspects of farm investment and modernisation aid.

Nevertheless, it is clear from most programmes that the RDR has the potential to make an important contribution to environmental protection and enhancement, and has increased the relative importance given to environmental considerations in agricultural and rural development policies. Likewise, the SAPARD planning process has certainly raised the profile of agri-environment issues in most Candidate Countries, although it is yet to result in much implementation.

Fifth, a more “top down” approach to integration should be recognised, although it is not formally referred to in the RDR. Before expenditure of EAGGF funds by Member States was authorised, the European Commission insisted on a form of cross-compliance. Member States were to have achieved a certain level of implementation of both the “habitats” and “Nitrates” Directives before funding could be released. In several Member States, this undoubtedly helped to accelerate the implementation of these two measures, which was lagging seriously behind the prescribed timetable. Thus intervention at the European level complemented the predominant emphasis of subsidiarity in the RDR.

Finally, there is the option, available to national governments, to “modulate” CAP payments so that a proportion of the CAP support payable to farmers in relation to production is transferred to national implementation of the RDR. Governments choosing this route have to supplement EAGGF receipts with their own funds, thus allowing more ambitious rural development plans. Only France and the United Kingdom have chosen to do so thus far, although other Member States are considering this approach. A form of modulation may become compulsory following the mid-term review of the CAP.

### **The implementation experience**

The formal mid term evaluation of the RDR has yet to occur and it is too early to judge the performance of the monitoring and evaluation procedures. Nonetheless, the first three years provide some pointers to broader issues arising in rural development programmes. Tensions between financial accountability under EAGGF rules, vigorous public participation and local autonomy and full implementation of environmental legislation need to be recognised and explored further in an evolving debate.

There is clear evidence of greater ambition on environmental integration and more institutional involvement at local level. However, there remains uncertainty about the outcomes in many areas and it is notable that the deployment of RDR funding outside the agricultural sector has been limited in most countries.

Budgetary questions remain central. In most countries, there is a perception that the budget for the second pillar of CAP remains insufficient to tackle the range of objectives included within the RDR. In the short term, only modulation under EU Regulation 1259/1999 offers some means to increase these resources at national level, subject to various requirements imposed at EU level. Nevertheless, many stakeholders believe that the overall second pillar

budget will be too small to adequately deliver against programme objectives in the period 2000-2006 and that a substantial increase will be required beyond 2006. This perspective is shared by the European Commission, judging by their recent proposals for the mid-term review.



## Notes

- <sup>1</sup> See Baldock *et al* (2001). Further work is in process under the title “Europe’s Rural Futures”.

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## **Perspectives on Agricultural Policy Reform and the Rural Economy**

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### ***Abstract***

*This presentation highlights the impact of agricultural policies, and related reforms, on farm family households and the rural economy. While agriculture plays an important role in the economy of some rural areas, its overall economic importance is low and declining. Agricultural policy has not prevented, and cannot prevent, the long-term downward trend in agricultural employment and de-population in many rural areas. Agricultural policy reform can imply significant adjustment costs for some individuals and areas in the short term, but the long-term benefits to both farm and non-farm households, and to rural areas generally, can be considerable. Agricultural policy and rural development policy both pursue a diversity of objectives. In both cases, a clear understanding of the underlying economic relationships that preclude the desired economic developments from occurring is pre-requisite for effective policy design. Any sectoral, multi-sectoral or territorial policy should be consistent with national policy objectives and broader policy approaches.*

### **Introduction**

The socio-economic development of rural areas and the management of the rural environment are important policy issues in many countries. Rural areas differ, of course, in their physical endowments, economic structure, cultural and historical influences, social conditions, and so on. They are affected in different ways, and to different extents, by on-going social, economic and policy developments that occur nationally and internationally. Some rural areas have adapted very well to such changes, while others continue to experience economic and social difficulties. Understanding these processes of change and adjustment is essential for policy formulation.

This presentation draws primarily upon work undertaken within the Food, Agriculture and Fisheries Directorate of the Organisation for Economic Co-operation and Development (OECD/AGR).<sup>1</sup> The aim is to highlight the impact of agricultural policies, and related reforms, on farm family households, the rural economy, and society overall. Broad policy implications are noted.

Unlike other perspectives presented at this conference, perhaps, my point of departure is agricultural policy and not rural policy *per se*. This reflects, of course, the particular competence of OECD/AGR (as well as my own competency). A brief discussion of the links between agriculture and rural areas follows. Agricultural policy in OECD countries, and related impacts, are then examined. This is followed by a brief review of the opportunities and expected effects of policy reform, in particular for the rural economy. Finally, some general perspectives on policy implications are summarised.

### **Agriculture and rural areas**

The nature and degree of linkages between agriculture and rural areas depends on many factors, and the relationship is both two-way and dynamic. The rural non-agricultural economy provides alternative uses for labour, land and capital, and shifts in demand for these factors will affect farm structures. For example, a large non-agriculture economy can provide more off-farm income opportunities for farm households, improve their wealth (as well as income) position, reduce overall income risk and influence the farm production mix. A rural economy with lower alternative demand for labour, land and capital can become more dependent on agriculture as farm households seek to expand operations in pursuit of fuller employment and higher incomes.

The fact that most rural land (and water) is used by agriculture highlights the essential relationship between farm production and the rural environment. For example, there can be positive contributions, such as in maintaining a particular form of landscape, or negative effects, as in the case of groundwater pollution. There is a widespread and growing awareness of the importance of the various linkages between farm practices, rural amenities and environmental sustainability.

Changes in farm structure, output, labour and incomes vary across and within countries, of course, but some trends are clear and consistent. Total farm numbers continue to decline and average farm size continues to increase, but such data mask an important structural shift. While there are more larger farms, the number of small farms continues to be very high, and the greatest declines are in the numbers of “middle-size” farms. This bi-modal distribution reflects

the strong reliance of smaller farms on off-farm income sources, on the one hand, and the continued growth of very efficient, larger-scale farm operations on the other. Overall, farm household incomes are now generally equivalent to average household incomes in OECD countries.

While farm output continues to increase, farm employment continues to decline, and real commodity prices continue to decrease. These trends are more than 100 years old, and will continue. The share of agriculture in total output and employment is low in most OECD countries (currently averaging approximately 3% and 8%, respectively), and continues to decline. The economic contribution of sectors upstream and downstream from primary agriculture in many cases is larger than that of farming itself, and is growing in absolute terms. Technological developments that enable supply to respond more effectively to a wider range of consumer demands are expected to maintain this trend for more “value-added” product attributes.

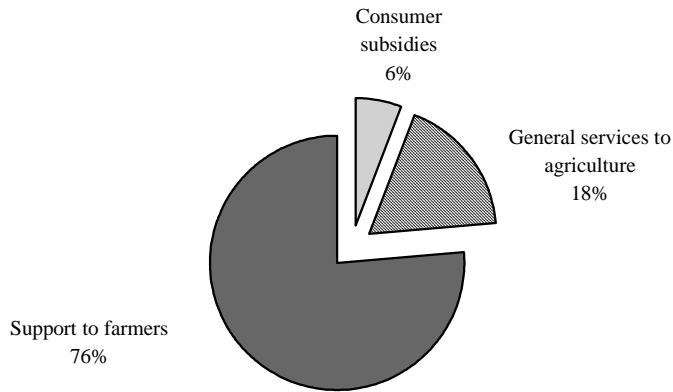
In short, while agriculture continues to play an important role in the economy of some rural areas, in many cases, and certainly in overall terms, its economic importance is relatively low and can be expected to decline further. Agriculture cannot, in most cases, comprise the long-term foundation of rural economies. Nevertheless, the link between agriculture and the rural environment remains strong, as farms, particularly small farms, remain the custodians of much of rural land and water resources.

### **Agricultural policy in OECD countries**

OECD/AGR has been monitoring and evaluating agricultural policies in OECD countries for more than 15 years. A substantial database covering both the level and the nature of agricultural support has been developed within the framework of the Producer Support Estimate (PSE) methodology.<sup>2</sup> In this context, the associated level of support to agriculture is measured and the nature of the policy instrument is described, with a view to assessing the potential impacts of various categories of support on production, consumption, trade, incomes and the environment. The PSE is the only comprehensive and internationally recognised benchmark of support across countries and over time.

In 2001, total support to OECD agriculture was USD 311 billion, representing 1.3% of GDP across the OECD area. While this total includes both support to consumers and to general services (such as agricultural-related research, extension, and inspection), much of this support is directed at producers (Figure 1).

Figure 1. **Total support estimate (agriculture)**

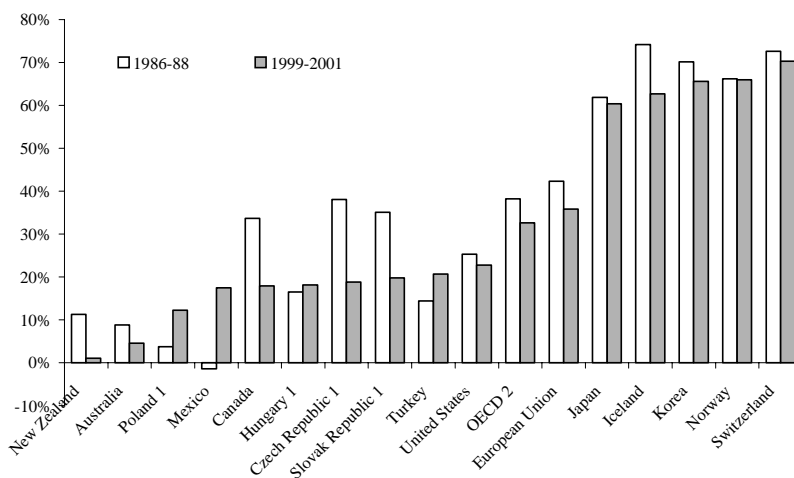


Source: OECD/PSE/CSE database (2002).

To enable meaningful cross-country comparisons, the (absolute) PSE is expressed as a percentage of the value of gross farm receipts (% PSE). There has been some fluctuation since the mid-1980s, though the % PSE remains high at 33%, down slightly from 38% a decade and a half ago (Figure 2). In other words, producers across the OECD area continue to receive, on average, one-third of their farm receipts as a consequence of agricultural policy. There are, of course, wide variations in the level of support across countries and across commodities.

Figure 2. **Producer support estimate by country**

Per cent of value of gross farm receipts

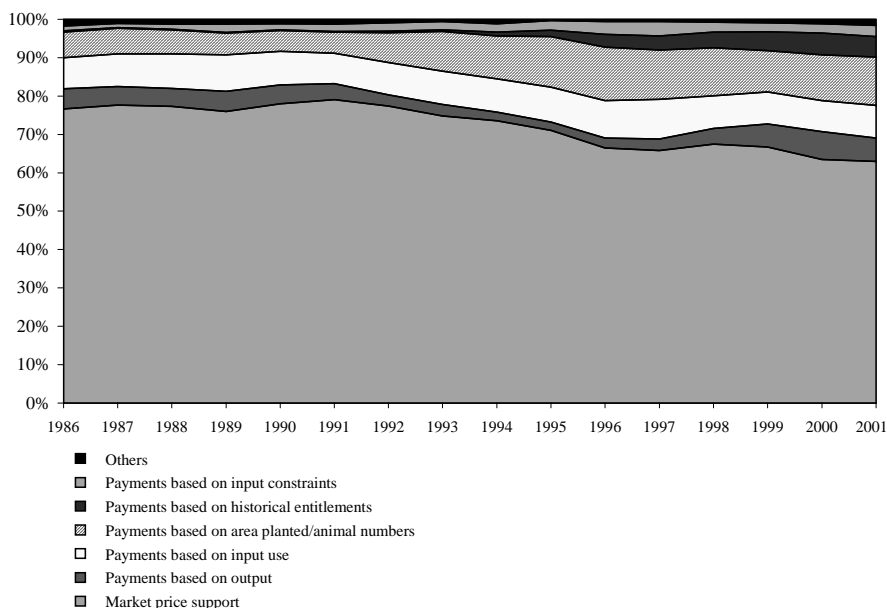


1. Countries are ranked according to 1999-2001 levels.
2. For the Czech Republic, Hungary, Poland and Slovakia 1986-1988 is replaced by 1991-1993.
3. For 1986-1988, the Czech Republic, Hungary, Poland and Slovakia are excluded.

Source: OECD/PSE/CSE database (2002).

But for the purposes of this presentation, the more important story relates to the nature of this support. Again, since the mid-1980s there has been only a modest shift in the type of support provided (Figure 3).

Figure 3. **Composition of Producer Support Estimate (PSE), 1986-2001**



Source: OECD, PSE/CSE database (2002).

Market price support (MPS) measures the gap between higher domestic prices received by producers and paid by consumers, prices paid on world markets. These higher prices are regulated (or administered) by governments, and maintained via border protection. This type of support distorts production, consumption and trade, and can have a negative effect on the environment. By raising domestic prices, it effectively acts as a regressive tax on consumers. Payments based on output are budget (taxpayer) financed, and affect prices received by producers. As such, they distort production and trade and can harm the environment, but do not affect consumption. Payments based on input use are also budget financed, and serve to reduce certain input costs. They can be more or less distorting than the above two categories, depending on the input concerned, and can have a negative effect on the environment. Taken together, these three categories of support represent more than three-quarters of support to producers. The remaining categories of support (payments based on area planted/animal numbers, historical entitlements, and



other payments, such as those based on farm income) tend to be more decoupled from production decisions and less trade distorting.

How does this high level of support, largely coupled to production, affect farm households? At present, only about USD 0.25 of every USD 1 spent on producer support actually finds its way into the producer's pocket. The balance of the support is either capitalised into asset values, particularly land, or is transferred up or down the food chain to input suppliers, processors and distributors. Because so much of the support is reflected in higher land values, the result over time is a higher cost structure and reduced farm competitiveness. While there may be a wealth gain for farmers that own land at the time such policies are introduced, farmers who must rent or purchase land at these higher prices will face reduced profitability and lower incomes. The same applies, of course, to land costs for alternative, non-farm uses.

There is another consequence of such a high reliance on price and output based support. The largest farmers, who are generally also the most profitable (and the most wealthy), receive most of the benefits. In very general terms, 20% of farmers produce 80% of the output, and would be expected to receive a corresponding share of support. Across the OECD the largest 25% of farms produce 72% of the output and receive 68% of support, though again this varies considerable across countries and commodities.

Taken together, then, these analyses suggest that much of existing policy serves to widen the income gap between large and small farmers, rather than narrow it. And this seems to be confirmed by structural trends which broadly confirm an increasing number of large farms, a more stable number of small farms (with a high reliance on off-farm income), and continuing decreases in the number of medium size farms.

At the same time, there have been a number of positive developments. The share of producer support that is provided through more decoupled and better targeted policy instruments is increasing somewhat. Agri-environmental measures and rural development policies, for example, are beginning to play a more prominent role at the same time as reliance on many traditional farm production programmes is declining. The farm policy debate seems to be shifting as the unintended consequences of many traditional policy approaches and the benefits of focussing policy efforts more precisely on the desired output are becoming more widely understood. The benefits sought will only be realised, of course, if movement away from agricultural support policy towards rural development policy is substantive, and not simply traditional farm policy under a different name.

Finally, what about the indirect contribution of agricultural policy to the rural economy? The magnitude of output, employment and income multipliers differs significantly across regions, and the strength of these linkages depends on many factors. While results should not be generalised, one study of agricultural and other households in Turkey found very weak links between increased expenditures of rural farm households and rural non-agricultural household income increases, and much stronger links to urban household income increases (Brooks and Tanyeri, 1999). In this case, at least, support to farm households had little spin-off effect on other rural residents. This serves to emphasise the importance of establishing actual linkages between agriculture and the rural economy, rather than simply assuming that they exist.

### **Agricultural policy reform in OECD countries**

Given the very high levels of production and trade distorting support to agriculture in OECD countries, policy reform implies both lower levels of support and different types of support. The expected effects of such reforms on agriculture and the rural economy are substantial.

Reform would reduce costs to consumers and taxpayers, and free up resources that could be better spent by consumers and taxpayers themselves, or by governments providing required public services (in rural areas, or elsewhere). It would help ensure that market signals, and not government rules, guide producer decisions and stimulate income and employment growth in other parts of the economy. Reform would reduce stress on the environment, as moving away from production-based payments would reduce incentives to intensive use of inputs on fragile land. It would improve trade opportunities for competitive suppliers, and expand choices for discerning consumers, as artificial barriers to more open markets are removed. And most importantly, perhaps, agricultural policy reform would enable support to be targeted to where it is needed, and where it can be most effective in achieving clearly stated public policy goals.

Policy reform would reinforce structural adjustments that can lead to a more sustainable use of resources in agriculture and in the overall economy. Analyses of the aggregate effects of reform suggest an increase in average real incomes in the economy overall, less hired farm labour, lower land prices and rents, less capital intensive use of land, and a rise in world prices for many agricultural commodities. Some farms would cease production, and others would expand, with similar developments in both upstream and downstream sectors. In general, production agriculture would shift towards rural areas with favourable natural factor conditions and necessary infrastructure, and the

relative incentives to diversify and add value to output would increase. Rural employment and other economic benefits would be expected to shift from regions producing traditional bulk commodities to those producing more highly value-added products.

Agricultural policies in OECD countries have not prevented the long-term downward trend in agricultural employment and de-population in many rural areas. However, the introduction of such policies may well have had a positive, one-time effect on employment, for example. As such, reform of these policies may have a corresponding one-time negative impact on some areas, though the aggregate effects would be small.

The adjustment process would be a dynamic one. In the short term, marginal farms and displaced labour would face considerable difficulties in responding to a new business environment. Such effects will not be evenly distributed. Some individuals and rural areas will fare worse than others, and transitional policies will need to recognise the social and economic costs of adjustment and provide appropriate temporary assistance. As land prices adjust downwards, both agricultural and non-agricultural demand would be expected to offset some of this decline, and land use might shift to better reflect its physical suitability (whether for agriculture, forestry, natural habitat, etc.). In the longer term, a more efficient allocation of resources would improve rural economic opportunities and contribute to more sustainable development opportunities. Farm and non-farm households in rural areas would benefit from clearer market signals, and removal of existing disincentives to diversification into new enterprise and new product development would open up new business opportunities.

OECD countries share many interests in agricultural policy reform. These include: achieving further trade liberalisation; allowing for a greater influence of market signals and improved producer responsiveness to them; strengthening world food security; improving the structure of the agro-food sector and enhancing its contribution to the viability of the rural economy; protecting the environment and ensuring sustainable management of natural resources; recognising consumer concerns; encouraging innovation, economic efficiency and sustainability of agro-food systems; and, taking account of the multifunctional role of agriculture. To achieve these various goals OECD countries also recognise that policy approaches will need to be more transparent, better targeted, appropriately tailored, sufficiently flexible, and equitable across and within sectors and regions.

## **Conclusions and policy implications**

There is no single, fixed relationship between agriculture and the rural economy. Neither is there a single, simple relationship between agricultural policy and rural development policy. Clearly, agricultural policy and rural development policies cannot be considered as synonymous. Agricultural policy is sector-specific, while rural development policy is multi-sectoral, territorial policy. In both cases, there are a multitude of objectives, some of which may be conflicting, and a multitude of sectoral and regional circumstances in which they would be applied. Agricultural policy cannot be relied upon to achieve rural objectives, and vice versa.

For OECD countries, the following general conclusions continue to be relevant (OECD, 1998):

- A clear understanding of the underlying economic processes which generate disparities in the development of rural areas is necessary for identifying coherent rural development objectives and policies.
- Rural policy goals should be consistent with the overall national policy objectives.
- Economic efficiency and social aspects of agricultural policy must be clearly distinguished.
- Agricultural policies should aim to enable the sector to respond promptly and flexibly to new opportunities, while at the same time dealing with any problems of market failure directly.
- Sufficient factor mobility will be of primary importance in the adjustment process.
- Appropriate cross-sectoral policies, tailored to complement agricultural policy reform, could be desirable to accelerate adjustment in rural areas.
- If environmental benefits for rural areas are intrinsically linked to farming, farmers should be encouraged to alter their farming practices to (maintain) enhance those benefits.

- An indispensable precondition for the effectiveness of these measures is that policies should yield environmental benefits above those which would result from "good" farming practice.
- Rural development requires a cross-sectoral approach.

Countries outside the OECD, in general, are characterised by an agricultural sector that is much more important in economic terms, and perhaps also in social terms, to rural areas and to the economy and society overall. Non-member countries can both benefit from, and can inform, policy formulation within the OECD area. Even though the reliance on agriculture for economic growth and employment opportunities is much greater in many less developed economies, policy conclusions are similar.

The proper policy mix between broad based rural policies and sectorally defined agricultural policies must be found in each country depending on the specific situation. However, when formulating policy, short-term considerations should not dominate over long-term perspectives. In the long run, over-dependence on agriculture and a shortage of alternative off-farm employment opportunities may cause the economic decline of rural areas with all its negative social, cultural and economic consequences.

Rural development policies, even if much more comprehensive and wide ranging than purely agricultural policies, are not a panacea for all the problems of rural areas. The most important task of national governments is to pursue macroeconomic policies conducive to sustained economic growth. The second major responsibility is to implement programmes aimed at reducing the isolation of rural areas, such as ensuring access to educational institutions at all levels, good public transport and accessible modern communication systems. Other non-sector or area policies, such as social policies or tax policies, are in many cases a more efficient way to create transfers between regions than policies specifically oriented to rural development. The more specific role of rural development policies should be to exploit the comparative advantage of rural economies...and correct market failures. Among the prerequisites for making rural development policies successful are: strong participation of local communities, a transparent institutional framework with clearly identified institutions specifically responsible for rural development policies, decentralisation of the decision-making process, retraining of local administration, and a proper legislative framework.

As in every other area where governments choose to intervene, rural development policies should be transparent, minimise economic distortions and be cost-effective in comparison with alternative policy options. Any assistance should be well targeted and limited in time. (OECD, 1997)

## Notes

1. Documents described in the references contributed substantively to this presentation, in particular *Agricultural Policy Reform and the Rural Economy in OECD Countries*, OECD (1998). Any inaccuracies or misinterpretations are the sole responsibility of the presenter.
2. This section draws in particular on the 2002 edition of *Agricultural Policies in OECD Countries: Monitoring and Evaluation*.

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## **Rural Development Policies in the European Union after Agenda 2000: Assessment and Future Prospects**

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### ***Abstract***

*Community policies to fund development interventions are of considerable importance in the national context. Nowadays, in many areas, the existence of such policies is a potentially important factor in development. In light of these considerations, this paper focuses on the assessment of some fundamental aspects of rural development planning, to which Agenda 2000 has also drawn attention. Three key points on which to base the reform process are the concentration of interventions, the process of simplifying instruments and the strengthening of management instruments.*

*As defined by Agenda 2000, rural development policies only partially meet the need for effective instruments for promoting development in rural areas. There are two reasons for this: firstly, the reform to which Agenda 2000 gave rise has failed in crucial respects (i.e. tackling some of the fundamental problems associated with the planning and management of interventions); secondly, only very limited use has been made of the opportunities offered by the reform to improve the quality of rural development policies. For example, rural development policy reform has not progressed towards greater concentration. On the contrary, it has moved in the opposite direction to that taken by regional policy. This has to some extent influenced the strategies adopted by the regions, which, despite a few exceptions (the Objective 1 regions in particular), have not laid down a rural development policy with a clearer and more definite territorial dimension. In light of the imminent EU enlargement and mid-term review of the CAP, the debate surrounding agricultural policy will be opened once again.*

## **The added value of community policies**

Community policies to fund development interventions are of considerable importance in the national context. Nowadays, in many areas, the existence of such policies is a potentially important factor in development. There are various reasons for this.

First of all, considerable resources are being deployed.

Secondly, these policies are very ambitious in their strategies and objectives. They are not individual, *ad hoc* public interventions, but a complex system of instruments which function as a complete development strategy for a given region or area.

Thirdly, they involve many actors in the process of general planning, programme management and, in some cases, local planning of interventions. This involvement, in the context of a broad-based partnership, is one of the distinguishing characteristics of community intervention.

For these reasons, community intervention differs sharply from more traditional practice. Above all, it differs from many national policies, which simply provide support and incentives in different sectors of the economy.

It needs to be recognised, in this respect, that many of the more innovative forms of public intervention in the economic and social fields are the result of community policies and the impetus they have imparted to national and regional policy. Think for a moment of community-initiated programmes such as INTERREG, LEADER, URBAN, EQUAL. They introduced totally new instruments, objectives, intervention methods and procedures, previously unknown in the context of national or regional development policies. These forms of community intervention, generated by specific initiatives on the part of the Commission, have had considerable impact on traditional thinking in the area of national and regional policy, and in many cases they have revealed the deficiencies, difficulties and outright inability of domestic technical and administrative structures to keep abreast of modern conceptions of public intervention. Where the ground was more fertile and prepared to receive these innovations, they have taken root and spread to national and regional interventions, which now fund and include them in policies.

In the field of rural development policy, we find some key aspects of community added value. We certainly find a generous provision of financial resources, which seems to have grown over the years, especially when

compared with the financial resources deployed at the national and regional levels over the same period.

We also find ambitious strategies and objectives, formalised in the Operational Programmes (OPs) of Objective 1 regions and in the Rural Development Plans (RDPs) of other regions. Finally, we also find many different actors involved in defining programme strategies and objectives.

The area in which results have not come up to expectations is in the real degree of innovation that rural development policies have introduced into the traditional system of Italian rural policy. There are some significant exceptions; in particular the LEADER programme and some forms of integrated planning now becoming apparent in regional programmes.

It is possible to make an assessment of some fundamental aspects of rural development planning, to which Agenda 2000 had also drawn attention, identifying them as key points on which to base the reform process. In particular:

- the concentration of interventions;
- the process of simplifying instruments;
- the strengthening of management instruments.

### **What strategy: concentration or diffusion of policies?**

The principle of concentration is certainly one of the key principles behind the workings of the Structural Funds. The European Union tends to ensure compliance with this principle in various ways. Over time, in the different planning cycles that have come and gone since the late 1980s, the EU has gradually increased the degree of concentration in order to make the Funds more effective.

The concentration principle is implemented in the following basic ways:

- a limited number of priority objectives are defined, which are then further reduced to just three;
- the largest shares of the Funds are devoted to regions which are behind in their development;

- the population benefiting in relation to each objective is reduced over time;
- a series of thematic intervention priorities is selected.

These concentration procedures have resulted in a growing mass of resources being channelled to:

- particular territories (territorial concentration);
- particular horizontal problems (thematic concentration);
- particular population groups (concentration by type of beneficiary).

The concentration resulting from the latest reform of the Funds is undoubtedly a combination of these three types of approach and with a tendency to put more emphasis on the territorial aspect. Indeed, Objective 1 regions receive the lion's share: Italy absorbs 78% of Community resources. Moreover, even within Objective 1 regions, the new programme provides for further concentration on ITP (Integrated Territorial Project) areas, *i.e.* areas of limited size where projects are conceived and implemented with the aim of encouraging/accelerating territorial development as a matter of urgency. The financial concentration has effectively resulted in the allocation of a financial "reserve" in favour of ITPs in Objective 1 regional programmes. This further concentration within Objective 1 regions, which has also been taken as a model by Objective 2 SPDs (Single Programming Documents), albeit in a less general way, is part of a national planning strategy intended to enhance the effectiveness of the Structural Funds.

Any strategy involving the concentration of development policies has enormous consequences, in terms of both planning and management. The main implications are as follows:

- Concentration means deliberately deciding to channel resources towards particular priorities and therefore making the objectives quite plain, assuming definite political responsibilities.
- It also mean organising the development strategy, defining its content, quantifying its objectives, in short fully exercising the planning function.

- Concentration has major implications for management procedures because it involves greater integration of the Structural Funds and of the activities permitted between the different Funds. In the operational planning and projects management phases, it also involves local partnerships, which must be appropriately structured and organised.

For all the above reasons, it is easy to understand that concentration, as compared with traditional public intervention methods based on generalised financial support for individual enterprises, also involves greater technical and administrative complexity. Moreover, it means that the public administration has to exercise a different function, more geared to strategic planning than merely acting as a post-box for funding applications. It is therefore not surprising that concentration can encounter friction and difficulties in implementation, to a greater extent than traditional public funding procedures.

Rural development policies are clearly out of step with this general trend towards greater concentration introduced by the Structural Funds. The fact is that these policies apply to the entire national territory, without significant distinction between areas that fall into one or another priority-objective categories. This has come about because, under the new Agenda 2000 arrangements, rural development policies have ceased to be regarded as policies for backward areas or rural areas in decline and have come to be viewed as policies promoting the structural adaptation of the different areas of the Union.

Although the new rural development policy that emerges from Agenda 2000 is characterised by its extension to all territories, the regulations on rural development open the way, in the context of decentralisation and subsidiarity, for targeted interventions on the part of the authorities responsible for RDPs. In light of the Italian experience, it is evident that the concentration principle has permeated rural development planning in the period 2000-2006 only to a limited extent.

In Objective 1 regions, the way forward is essentially linked to the implementation of Integrated Territorial Projects (ITPs), within which there is an emphasis on the needs of agriculture and rural areas, and more specific sectorial planning instruments (integrated projects for rural areas – IPRA – and integrated projects for “filières” – IPFs), borrowed from the ITPs themselves. It should be stressed that the resources for these instruments are by no means inconsiderable. Consequently, the challenge to be met over the next few years will be decisive for testing the possibility of greater concentration and integration in rural development policy. More generally, it will be decisive for introducing innovative elements into a policy which, in many ways, still retains

many of the characteristics of a “generalised” territorial policy and, at the same time, of mere productive modernisation.

These characteristics are even more apparent in non-Objective 1 areas and are clearly evidenced by an analysis of RDPs. These are not only deficient in territorial priorities, which are at most restricted to a few measures; they also contain no sectoral priorities, because the application of the measures embraces a broad spectrum of productive sectors.

The lack of a territorial dimension is perhaps one of the main deficiencies of the RDPs. Such a dimension might have provided an organic approach and rectified the extreme fragmentation of the financial plans into many measures. This deficiency is not only generally apparent in the way the RDPs are drawn up, but also in the definition of individual measures, for which precise identification of the territories in question is vitally important if the measures themselves are to be effective. The deficiency is particularly evident in the case of agro-environmental measures, for which territorial concentration and the proximity of the farms benefiting from support is vitally important in ensuring that the measures have a positive impact on environmental resources.

The territorial dimension is, however, one of the distinguishing characteristics of the LEADER programme. Indeed, we can say that it is, without a shadow of doubt, innate to LEADER, because the initiative is based on a series of local development projects in areas of given size and characteristics. And the new LEADER+ initiative undoubtedly has a more focused and solid territorial dimension than LEADER II, which was applied to many regions on an “extensive” basis, to the point of covering the whole regional territory. The territorial concentration of LEADER+ has been reinforced by two factors: on the one hand, a reduction in the number of LAGs (Local Action Groups); on the other, a prior decision as to which areas are admissible. This second factor makes for more rational use of scarce resources (scarcer in fact than in the previous 1994-1999 planning cycle).

In conclusion, as originally drawn up, the rural development policy reform has not moved things in the direction of greater concentration; on the contrary, it has tended in the opposite direction to that taken by regional policy.

This has to some extent influenced the strategies adopted by the regions, which, despite a few exceptions (the Objective 1 regions in particular), have not used their existing room for manoeuvre to lay down a rural development policy with a clearer and more definite territorial dimension.

## **The simplification process: what point have we reached?**

Where simplification is concerned, Agenda 2000 and the successive regulations deriving from it have tended to slim down the whole (rather complex) mechanism that the reforms of the Structural Funds had created in the previous planning cycles. This has resulted in a reduced number of objectives, programmes, community initiatives, etc.

Some effort has been made to simplify planning and financial management: programme preparation times are being shortened and less complex – but more rigorous – mechanisms introduced for the provision of funding. It should, however, be noted that the changes introduced in the regulations have not in fact shortened the programmes planning phase. In fact, experience of recent negotiations for the approval of (Objective 1 category) programmes has shown that the five-month period stipulated between the presentation of plans and a Community decision approving them is often exceeded: the average time for the adoption of a programme is between eight and 12 months.<sup>1</sup> Of the 123 planning documents presented to the Commission in respect of Objective 1 regions, only three were in fact approved within the five-month deadline, while 71 took between eight and 12 months to be approved and then 29 programmes required negotiations in excess of one year. In many cases, the delays were due to requests from the Commission for further information on the programme components which did not conform to the regulation requirements: the quantification of objectives, prior assessment of the expected impact, the environmental compatibility of the proposed interventions, financial management procedures, compliance with the principle of additionality, etc.

The Programming complement (Pc) preparation also took longer than expected. The deadline of three months for transmitting the Pc to the Commission was respected in only a few cases. In fact, in mid-June 2001, of the programmes approved not even half were supported by a Pc. The introduction of the Pc was a response, on the one hand, to the need to “lighten” the preparation of Operational programmes and SPDs by dispensing with detailed description of the measures and implementation procedures and, on the other, to the need to devolve some operational aspects to the level of the programme manager. In fact, these two objectives have been only partially achieved and the planning process has been burdened by a further phase, in which the Commission services have played a major role, contrary to what was intended in Agenda 2000 and expressly provided for in the general regulations. The European Commission itself has recognised that, where simplification is concerned, no substantial progress has been made since Agenda 2000.<sup>2</sup>



All these factors have caused friction in the planning process and resulted in delays in the programmes becoming fully operational: a large part of the Objective 1 programmes were approved in or soon after the summer of 2000, and the SPDs for the regions and provinces of Italy in the period between February and December 2001.

While, in the context of the Structural Funds, attempts have been made to simplify the drafting of the planning documentation by reducing the amount of detail and concentrating on an improved specification of objectives, strategies and intervention priorities, the rural development planning process has moved in a different direction, requiring just one plan (the RDP) characterised by a very detailed definition of the intervention measures.<sup>3</sup> The different approaches have considerably disorientated national and regional administrations in the work of drafting their programmes and have led to a difference in treatment of regions included in and excluded from the Objective 1 category despite being in the same Member state. A large part of the non-Objective 1 programmes were approved by September 2000, whereas those of the Objective 1 regions were approved between January and June 2001. This time difference is explained by the fact that negotiations relating to OPs were given priority in the Objective 1 regions, because of the magnitude of the financial resources at stake and because of the need for unitary planning of the various funds concerned, including the EAGGF. As a result, the presentation and negotiation of the RDPs were given a lower priority.

The planning of LEADER+ also suffered some delay, because priority was given to negotiating the larger programmes. The Commission gave the LEADER+ regional programmes the green light in two stages: the first, which included all the central and northern regions, between September and December 2001; the second, included all the southern regions, in January and February 2002. Apart from the issue of planning times, the amount of detail required by the regulations of LEADER+ was totally inappropriate, given that this programme is intended to stimulate, facilitate and guide the planning of local bodies, not make it more rigid.

On the whole, the innovations introduced under the new rules have not prevented a margin of delay in the new programming becoming operational – a delay which, all things considered, was acceptable where the Objective 1 programmes and RDPs for the central and northern regions were concerned (one year), but over-long (two years) in other cases (Objective 1 RDPs and LEADER+ programmes). Where compliance with expenditure objectives was concerned, the LEADER+ programmes give some cause for concern, as they still have to complete the Local Action Groups selection phase

and, obviously, the whole of the following phase during which the Groups select the appropriate projects.

### **The problem of policy management: a bottleneck?**

The issue of management is regarded as one of the most critical where use of the Structural Funds is concerned. Already in the previous planning cycle, the assessments concerning the extent to which Italy had implemented the programmes showed that considerable improvements in efficiency of expenditure could be achieved by rationalising the management systems. This was true of all administrative departments, both national and regional. In addition, in its report on the programming of the Structural Funds in Objective 1 regions, the Commission indicated that the description of the management and control systems was often the weakest part of the planning documentation.

In light of these considerations, in March 2001, when programming had already begun, the Commission adopted two sets of regulations intended to provide fairly precise and binding standards as regards management and control systems [Reg. (CE) No. 438/2001] and financial rectifications [Reg. (CE) No. 448/2001]. It is therefore quite understandable that there were delays in organising the systems concerned.

Where the efficiency of management systems is concerned, the most critical areas pertain to the following conditions:

- technical/administrative structures which are under-staffed and/or where the staff is not adequately qualified to deal with the procedures required by Community programmes;
- delays in arranging public procedures for the selection of projects;
- the existence of a large number of funding applications – a situation typical of some areas of intervention (such as training, agriculture and rural development, small businesses, etc.) – which considerably slows down the administrative departments' preliminary enquiries, especially in situations where computerised methods of data collection, data and project assessment are still in their infancy;
- the quality of the planning, which does not meet the requirements for selection procedures in some cases.

The process of sub-regional decentralisation must be added to these factors which, although positive, will require a running-in period before the local structures are up to speed.

The new system of planning associated with the Structural Funds has led to intense efforts to establish new management systems. However, it does not yet seem that the existing problems have been decisively resolved. There have been some very interesting initiatives – single outlets for dealing with applications (one source of information and technical assistance for funds applications), a monitoring system, a manual of control guidelines, the definition of assessment methodologies, etc. – but these initiatives have not had a profound impact on the more structural deficiencies of the public administration.

In the case of rural development policies, these deficiencies are keenly felt in many regions and are aggravated by the fact, as stated earlier, that there is a very large number of funding applications to deal with. A recent survey carried out by the INEA on the state of procedural progress of interventions in Objective 1 regions came up with some rather interesting results in this respect:

- Many of the measures provided for by the OPs were being implemented.
- Concerning the measures under implementation, approximately 56 000 applications had been submitted in the Objective 1 regions as a whole.
- The number of applications that went beyond the preliminary phase and judged admissible was also very high (15 500), although this figure represents only 27% of the applications submitted. The total public money that could be granted if all the admissible applications were in fact funded was more than EUR 1.0 billion, or 22% of total public resources for the period 2000-2006.
- Finally, the applications for which it was decided to grant funding numbered 8 600, representing a total investment of roughly EUR 950 million and EUR 600 million of public spending (12.7% of planned public resources for the period 2000-2006).

These figures show that, if the implementation of approved projects and the approval of those that have passed the preliminary phase were accelerated, the Ops' measures need not result in automatic disengagement. Of

course, numbers such as these are a heavy burden on the technical/administrative capacities of the regions, as evidenced by the wide discrepancy between applications submitted and those judged admissible. And this applies not only to the evaluation and selection process but also to financial control, monitoring and accounting for payments.

In these latter areas of activity, which are important in facilitating and rationalising programme management, unjustified delays and deficiencies still occur. This holds true even though these activities have been made obligatory by regulations and significant penalties can be imposed in the event of failure to comply.

The future of rural development policies will depend on these management factors, whether we look to the immediate future or further ahead (post 2006). The existence of automatic penalty measures (automatic disengagement) will mean that no concessions are made to any public administration. This will result in fierce competition between regions, programmes, Funds and productive sectors. Managerial and organisational inefficiencies, if they persist, could produce very negative return/feedback effects, which would have implications for the financial resources available for future years. Obviously, this is true for all the regions, regardless of which section of the EAGGF funds their programmes.

### **Future prospects: enlargement and medium-term review of the CAP**

Rural development policies, as defined by Agenda 2000, only partially meet the need for effective instruments for promoting development in rural areas. There are two reasons for this: firstly, the reform to which Agenda 2000 gave rise has failed in crucial respects to tackle some of the fundamental problems associated with the planning and management of interventions; secondly, as we pointed out above, only very limited use has been made of the opportunities offered by the reform to improve the quality of rural development policies.

These problems are again exercising the main institutional and social actors as two major events are set to reopen the debate on agricultural policy: the enlargement of the EU to include the new applicant countries, and the medium-term review of the CAP. These two events are closely inter-related, given that the decisions taken during the debate on enlargement are bound to have consequences on proposals for the medium-term review, and vice versa. The review of the CAP will concern both of the so-called pillars: market policy and rural development policy.

The negotiations over enlargement have involved 13 countries in all, but only some of these countries can be expected to join the EU during the period which concerns us here. Following the decisions of the European Council meeting in Berlin, the negotiations turned out to be longer than anticipated, casting doubts over the planned entry of certain countries in 2002. More recently, the European Council, meeting in Laeken (December 2001) stated that: “*if the present rate of progress is maintained in the negotiations, Cyprus, Estonia, Lithuania, Latvia, Malta, Poland, Slovenia, the Czech Republic, the Slovak Republic and Hungary could be ready (in 2004)*”. Romania and Bulgaria, on the other hand, might be in a position to join at the end of the programming period (1 January 2007). Finally, this statement was confirmed in the Copenhagen meeting held in last November, where the European Council has taken the decision to implement the enlargement for the ten new candidate countries in January 2004.

Taken as a whole, these countries are obviously in a position of relative economic backwardness compared with the existing 15 members of the Union, but in fact they differ considerably one from another. On the basis of the main socio-economic indicators and indicators of agricultural structure, we can divide them into two main groups: the first, comprising Poland, Latvia and Lithuania among the early entrants, together with Bulgaria and Romania, is characterised by a higher level of backwardness in development (as evidenced by their distance behind the 15 existing members in terms of GNP per head), higher unemployment and the greater preponderance of agriculture in the economy as a whole. In these countries, the agricultural sector fulfils not only a productive function but also, and in some cases to a very great extent, the function of a reservoir for the active population having no alternative occupation. This gives rise to the very widespread phenomenon of hidden under-employment in rural areas, which in some countries is far higher than the overt under-employment and unemployment found in urban areas. It is therefore not fortuitous that a very rural country like Romania, where 43% of the population is employed in agriculture, has apparently an excessively low unemployment rate (6.3%) for a country whose economic structure is so underdeveloped. Romania is an extreme example of how agriculture can function as a reservoir for the active population without employment alternatives. The most obvious consequence of this function is the extremely low productivity of agricultural labour; this is true of the five countries mentioned, but dramatically obvious in Romania and Poland.

The second group of countries – Hungary, Slovenia, the Slovak Republic, the Czech Republic and Estonia, all candidates for entry in 2004 – is also characterised by a position of relative economic and social backwardness. In terms of development, their distance behind the existing 15 EU members is

still considerable, but less drastic than that of the first group. The gap in terms of GNP per head is such that we can undoubtedly expect all of these countries to be classified as Objective 1 regions (and of course this is even more certain for the first group), but their levels of unemployment appear to be more contained. Agriculture absorbs a smaller proportion of the active labour force, as evidenced by the rate of employment in agriculture, and this makes it possible to increase the agricultural sector productivity. However, as we have noted, the difference between the two groups is relative, given that they still lag behind the existing 15 EU members in terms of productivity, with none of the countries in the second group achieving adequate productivity levels (levels are 50% lower than the productivity of European labour).

From the point of view of agricultural structure, the specificities of their size and ownership structures do not enable us to draw profiles indicating obvious differences between the two groups of countries. It should be stressed that some countries are characterised by a large number of small-scale, individual enterprises, occupying between 50% (Poland and Czech Republic) and 100% (Romania) of the total agricultural area. Many of these farms, characterised by technological backwardness and lack of capital, are in fact semi-subsistence farms, producing for the family's own consumption and generating only a very limited income. It is this type of enterprise that accounts for a large proportion of the hidden unemployment or under-employment that inflates the agricultural employment rate and, at the same time, depresses productivity in the agricultural sector. The semi-subsistence classification includes not only small and very small plots producing food for the family, but also medium-sized enterprises. This phenomenon is linked to a gradual deterioration in the terms of trade in agriculture, which occurred during the transition to a market economy and has also affected enterprises larger than those producing merely for family consumption. Today, semi-subsistence enterprises account for approximately half of agricultural production in the CEEC countries (Pouliquen, 2001). In terms of total area, where this can be quantified, the proportion of the land occupied by semi-subsistence enterprises ranges from 40-50% in countries such as Poland and Hungary to 20-25% in Estonia and the Czech Republic.

As well as modernising their production structures, the candidate countries are also faced with the problem of upgrading their administrative organisation. Where use of the Structural Funds is concerned, these countries are severely deficient in instruments in the following fields (European Commission, 1997):

- regional policy in the strict sense of the term (few or no resources, poorly developed instruments, reduced administrative structures, etc.);
- absence of co-ordination procedures between the various administrative structures and ministries involved in sector policies and territorial development;
- ineffectiveness of local authorities, currently lacking in financial resources and technical experience.

Concerning the intervention requirements that the European Union have to face, the aim is therefore to provide adequate financial support for investment and, at the same time, encourage the growth of technical and administrative capacities, transferring the planning and management methods of the Structural Funds to the candidate countries. This capacity will inevitably have to be built up gradually and will have a decisive weight in the future management of the Structural Funds in these countries.

The enlargement of the ten new member countries presents a great challenge to the European Union and the policies that it has deployed over the last 15 years.

The European Commission, with Agenda 2000 and the regulations deriving from it, has met this challenge with a series of analyses and proposals intended to prepare the way for the entry of the new countries and provide them with the necessary resources and instruments, in both the pre-accession phase (ISPA, PHARE and SAPARD) and when they actually join.

More recently, the Commission drew up a series of integrative proposals intended to spell out the quantity of resources available and the nature of the instruments, both as regards market policies and structural and rural development policies.

The Commission's proposals and, more generally, the policies that will be available to support agriculture and rural areas in these countries should be evaluated in light of three crucial factors:

- 1) the adequacy of the financial resources deployed;
- 2) the adequacy of the instruments being proposed;
- 3) the implications of enlargement to the very foundations of Community policies.

Regarding the adequacy of the financial resources devoted to rural development policies, an evaluation presupposes quantification of the resources involved, but the resources are not fully detailed in the Community documents. Estimates made elsewhere (see the quantification carried out by the INEA, 2002) enable us to affirm that the funding deployed is by no means negligible in relation to the productive dimension of the agricultural sector and the agricultural land area. During 2004-2006, the ten countries will be provided with sufficient resources to enable them to meet the demands of structural adjustment.

The real problem lies not with the resources available but with the adequacy of the instruments. In the case of rural development policy, the intervention instruments consist of a series of measures outlined in Council Regulation No. 1267/99. For candidate countries, Regulation No. 1268/99 defines the applicable measures and is concerned with funding the SAPARD programmes. In fact, this second Regulation consists partly of a sub-set of the package of measures contained in the general Regulation and partly of a new set of measures introduced specifically for these countries. The Commission's recent proposals amplify the measures applicable in 2004-2006 and adapt some of the measures already in force in the SAPARD programmes. The question that arises in this context concerns the appropriateness of these measures to the specific situations of the candidate countries and, more generally, the very foundations of rural development policy as currently adopted. The structure of agriculture in the candidate countries and, more generally, the state of development of their economies are very different from those of the 15 existing member countries. There is no comparison with the enlargements the European Community faced in the recent past, when the applicants were undoubtedly more backward in socio-economic terms, but already had operational market-economy systems in place and some tradition of institutional and productive structures with roots their societies. Their social and economic circumstances were not in fact dissimilar from those pertaining in the existing community member countries. The applicant countries of central and eastern Europe, on the other hand, especially the larger ones, are characterised by structural problems that have not yet been overcome in the course of the admittedly tough transition phase to a market economy. It is true that their situations differ considerably one from another, but there is a group of countries characterised by real poverty, structural weakness, high unemployment and, in the agricultural sector, hidden underemployment and low productivity. These economic and structural problems are compounded by the weakness of the institutional and technical/administrative system destined to carry out rural development as well as development policies. It is not fortuitous that in recent years, partly with Community support, intense efforts have been made with aid



and technical assistance to encourage the acquisition of the necessary techniques and administrative capacity to introduce the *aquis communautaire*.

However, the process of structural and institutional upgrading would seem to be more complex and time-consuming than anticipated by the community documents themselves, taking into account the restructuring and development needs exhibited by these countries and the outcome of the pre-accession programmes, which have proved difficult to implement.

In other words, we are impelled to ask whether the rural development policies, as set out in the Regulations and the Commission's recent corrective proposals, are able to meet the needs being expressed by these countries. Probably, they are able to do so in part; and in the countries characterised by greater structural and institutional backwardness, only to a very limited degree. The EU rural development policies that emerged from the recent reform of Agenda 2000 are perhaps better suited to the more developed circumstances of the existing 15 members.

What is really needed in these new situations is an approach to rural development characterised by the following key elements:

- close integration with structural and regional development policy (in actual fact, an approach characterised by the separateness of the various policies is being re-proposed, to the point of separate programmes being envisaged);
- close co-operation with social and human resources training programmes;
- the formulation of a strategy which, as well as making (justified) demands for the modernisation of production, considers priorities and appropriate instruments for diversification of production in rural areas (quite contrary to this approach, the SAPARD programmes tend to list measures without any clear definition of territorial and thematic priorities);
- a real simplification of some measures, which are mere income supplements masked and weighed down, from an administrative point of view, with pointless and inappropriate requirements (I am referring to aid intended for semi-subsistence enterprises);
- more incisive and substantial actions to strengthen administrative structures and managerial and planning capacity.

But enlargement also has major implications for the Community policy system itself. The problems posed by the present system in the context of the applicant countries have to do with both implementation and the real effectiveness of the instruments deployed. The developmental backwardness of some rural areas is so great that rural development policies are not alone sufficient to tackle the problems associated with the modernisation of the agricultural sector or with the economic and productive diversification of rural areas.

In the existing countries of the European Union, on the other hand, the present rural development policies are certainly better suited to meeting the demands of structural upgrading, but not the need for economic and productive diversification in rural areas. This is the result, on the one hand, of a sort of strategic deficit in national and especially regional programmes, which almost everywhere in Europe favour traditional-style intervention for organisational structures and the transformation and marketing of products. On the other hand, it is because the promotion of development in rural areas – where it actually occurs – is the result of particularly dynamic situations, where there are autonomous entrepreneurial resources and the people concerned know how to exploit the resources available to them, not only under rural development policies but also from other public initiatives.

This strategic deficit can be made up of a combination of solutions:

- a more decisive reform of the CAP, with a larger share of resources allocated to the second pillar;
- a system or rural development policy planning based on three vital principles: mechanisms to reward the quality of a strategy, more resources earmarked for innovative interventions, a simpler system for approving aid management for enterprises;
- a rural development policy management system which included a system of penalties and rewards, not only for those who prove capable of spending rapidly, but also and more especially for those programmes which achieve quantified objectives, adopt best practice, and encourage the adoption of significant innovations in the institutional system and territory concerned;
- a more complementary relationship between rural development interventions and other programmes financed by the Structural Funds (for example, Community initiatives).

On these critical points, we need a profound review of the CAP, that is able to provide answers to the challenges that an enlarged, more complex European Union will have to meet in the coming years.

## Notes

1. See, on this subject, the Commission's Communication to the Council, the European Parliament, the Economic and Social Committee and The Committee of the Regions (2001).
2. See, on this subject, the relevant section of the Communication relating to the first update of the report on economic and social cohesion (European Commission, 2002).
3. Bear in mind that this is true for the non-Objective 1 regions, whereas in the Objective 1 regions the programming of rural development, being funded by the EAGGF-Guidance, follows the more general Structural Funds rules.

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## **Territorial Agriculture and Rural Development : From Agricultural Support to Territorial Policies**

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### ***Abstract***

*Over the years, agricultural policies in OECD countries have evolved to reduce the number of farms and farmers (“structural adjustment”). A good indicator of the impacts produced by these policies is the structure of farm transformation. Now countries are moving toward a dual structure of farms and farmers, while maintaining the agricultural support level. In many countries, two principal types of agriculture became common: “territorial” agriculture and “commercial” agriculture. Although territorial agriculture does not have to disappear, it is necessary to make policy changes. In order to avoid the underdevelopment of rural areas, different types of agriculture call for differentiated policies. Not only does “territorial” agriculture contribute to sustainable rural development, it is important in many rural areas. Nevertheless, new instruments of agricultural and rural policies will be necessary.*

### **Introduction**

There are several relationships between agriculture and rural development, but these links often do not distinguish between the two, the former being considered a synonym of the latter. In developed countries, this confusion no longer has any meaning, because in the majority of rural areas the share of agriculture in the economy is decreasing in importance.

Anyway, traditionally, we place more attention and importance on agricultural policies than on rural development policies. For example, it was only just over a decade ago that rural development was introduced as a subject

*per se* in the OECD agenda, creating a specific and permanent working group in this organisation. Nevertheless, the countryside in our developed countries still suffer from relative socio-economic backwardness, especially the high level of agricultural support, despite the agricultural policies. Why?

Partially, because during this period in many of the OECD countries agriculture became a dual sector (“territorial” and “commercial”) with different importance and characteristics, while a “structural adjustment” of the agricultural sector took place everywhere. The benefits of these policies for these two kinds of agriculture, and farmers, were very different, producing a more unequal breakdown of incomes in the countryside.

But now, the future of many rural areas in our countries is linked with maintaining this “territorial” agriculture. This kind of agriculture, because of its contribution to the maintenance of employment and rural population and its multi-functional character, is an asset for a more sustainable rural development. In fact, what we would need is less agricultural and more rural policies, particularly to lead from an agricultural support to more territorial policies and instruments.

This paper shows the strong similarity in the evolution and general trends of our agricultural sectors, pointing out the need for a radical change in the priority of policies and in the allocation of budgetary resources.

### **Agricultural policies in developed countries: evolution and effects**

The evolution of agricultural policy in the OECD countries during the last 20 years has some common elements. Generally these policies were orientated to reduce the number of farms and farmers (“structural adjustment”), questioning the use of instruments such as subsidies with different compositions. At the beginning of this period the main four policy instruments were “market support price”, “deficiency payment”, “production quota”, and “direct income support”, which were assessed usually in terms of the efficiency of the government transfers to farmers from taxpayers and consumers (OECD, 1995). But later these instruments were changing their relative weight, using less “market support price” and more “direct income support” and other instruments such as “export subsidies” or “payments on input use” (OECD, 2002).

The reform of policies varied widely between countries depending on the composition of these instruments, although it seems that effects were quite similar. If we take into account simply some major countries (Japan, USA, EU

and Australia), in all of them change in agricultural land area, in the number of farms and, namely, in the number of farmers went in the same direction. The general effect of this evolution was the concentration of this activity in a smaller geographical area with fewer professional farmers. In the countryside that produced a profound change in the economic, social and ecological situation.

The share of agriculture in the rural economy became a minority in absolute and often relative terms. In many rural areas the agriculture is just a simply extractive sector in a new agro-food sector, in which transformation and distribution activities are dominant. The possibilities of retaining these two sub-sectors in the countryside appeared to be limited, being sited mainly in urban areas. Therefore, improving rural economy called for an economic diversification in these areas looking for the localisation of new economic and residential activities.

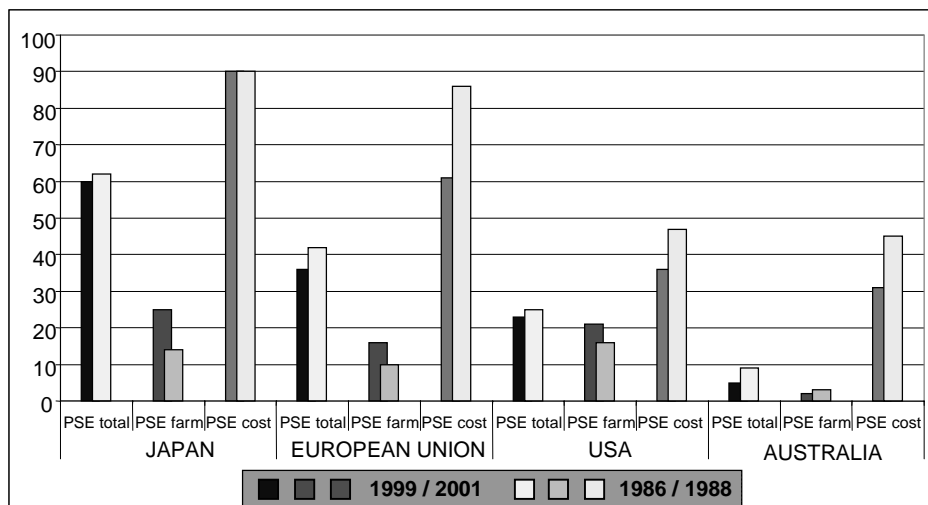
From a social perspective the falling numbers of the farmers and other social collectives linked to them contributed to the reduction of the rural population. Today, many rural areas continue to lose population, but territorial distribution of the population seems to be changing through more polycentric and less hierarchical patterns, in which little country towns are playing an important role. Consequently, some rural areas recover population although with a different social structure.

Finally, the situation of rural environment presents at least two faces. On the one hand, some areas sustain a high degradation, notably produced by the intensive technology used in the new agriculture; on the other hand many areas retain a large part of the natural resources. The amenity of these areas is often directly proportional to their socio-economic backwardness.

Nevertheless, since these policies are still in use this overall evolution and effects are far from finished. As we can see in Figure 1, the level of agricultural support has been reduced somewhat during the last period (1986-2001) in all countries, but indicators show important differences. While the level of agricultural support (PSE total) was coming down everywhere, and also was reducing the use of “market support price” (except in Japan), the relative level of support (PSE/farm) grew (except in Australia). What does it mean? Clearly, the beneficiaries of these policies in the countryside are socially more concentrated.



Figure 1. Level of agricultural support 1986-1988, 1999-2001



Source: OECD (2002).

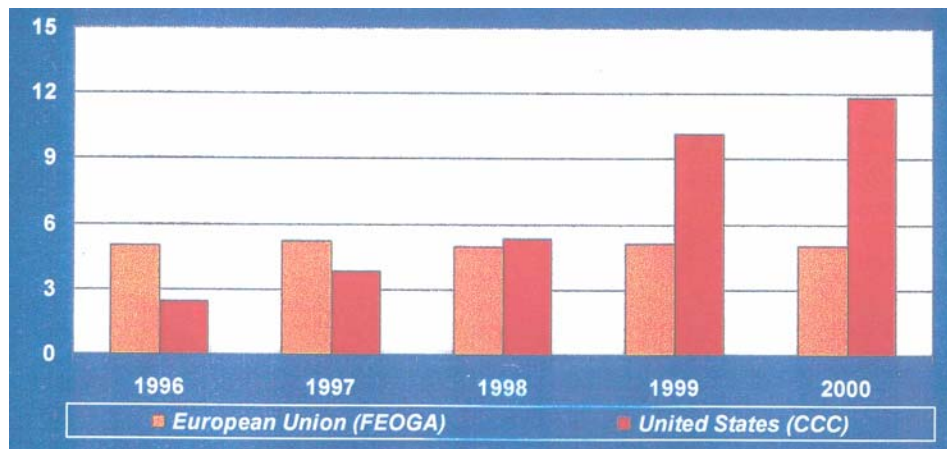
The best indicator to see the impacts produced by these policies is the transformation of farm and farmers structure. Thus, in Japan agricultural population has fallen by 50% since 1980, and the number of farms has fallen more than 20% in a decade, with a cultivated area per farm household of 1.6 hectares. Likewise, in the European Union in the major producer countries (France, Germany, Italy and Spain) the number of farmers has fallen between 45% and 60% (excepting Germany) in 20 years, while the farms have decreased between 30% and 15% during the last ten years. In the United States the number of farms has decreased by 10% in the last decade, with an average farm size of more than 175 hectares. Finally, in Australia the number of farms has fallen by 20% in the last ten years, with an average farm size of 4 000 hectares. Then, all countries were going towards a new structure of farms and farmers. But, at the same time, the agricultural support level was maintained, as we can see in the major OECD countries, reducing a few total supports while per farm support grew very much, which is especially true in the main agricultural producers.

Thus, if we compare the payments per farm made recently by the EU and the United States (Figure 2), it seems that agreements underwritten in 1994 in the World Trade Organisation (Uruguay Round) led the main agricultural producer and exporter countries to maintain or increase their subsidies. In the

case of the United States, for example, these payments have been growing during the last years, reaching the highest level of the period.

Figure 2. EU and United States payments per farm, 1996-2000

In USD thousands



Source: EC (2000).

The consequences for the rural areas have been clear. There is a more unequal breakdown of agricultural incomes between farmers; thereby more and more farmers look for new sources of income engaging in other economic activities in the countryside (multi-activity). As we will see later, in the European Union for example, which has a so-called “familiar model of agriculture”, 10% of holdings obtain two-thirds of the economic results. And there are also in many countries bigger farms versus less farming occupation, “part time employment” being a general feature of the new farmers. In the United States, for example, only 50% of operators in this sector have agriculture as a principal occupation. To sum up, the relative socio-economic backward countryside in our countries is still indeed a stylised fact of our economic development.

## General trends: “territorial” and “commercial” agriculture

In many countries two main types of agriculture became normal. There is a “territorial” agriculture and a “commercial” agriculture. These two categories, whose features are resumed in Table 1, do not allow us to classify all farms exactly. However, this classification gives to us precisely a good scheme to distinguish the two main situations that face farmers in the countryside: either preserving a holding as a marginal or complementary economic activity or maintaining it as a professional and business activity.

Table 1. **Territorial and commercial agriculture**

“Territorial”:	“Commercial”:
Small and medium-size farms: small geographical and economic dimension.	Medium-size and big farms: modern and viable farms due to their economic dimension.
Minority farmland, production and results: little land and low proportional market value of agricultural products sold.	Majority farmland, production and results: high geographical and economic importance, retaining a large part of agricultural incomes.
Maintenance of employment and rural population: high level of farming occupation in some rural areas.	Linked with international markets: their products are often commodities affected by world prices.
More multifunctional?: attention and preservation of natural resources and cultural traditions in less economic developed territories.	Less multifunctional?: intensive agricultural technologies and their impact on territorial and ecological degradation.

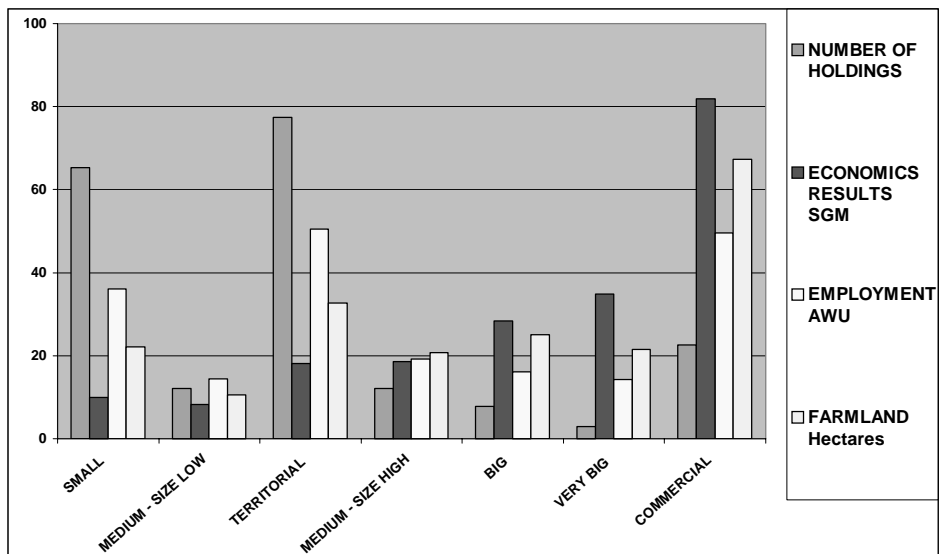
*Source:* Coulomb (1993) and Regidor (2000).

These two kinds of farms, made up of small and medium-size economic dimension farms and medium size and mainly big farms, have a different importance in the economy of the countryside, depending on the type of rural areas. Very often in the economic “lagged” areas (“predominantly rural areas”, using the traditional OECD classification) “territorial” agriculture is dominant, but in the more “intermediate” areas (“significant rural areas”) “commercial” agriculture is more present.

Thus, in spite of their reduced economic dimension these “territorial” farms play an important role in some “lagged” areas. In short, they are more important in the maintenance of employment and rural population, and natural resources, than for their contribution of agricultural production. On the contrary some others, as often happens in “intermediate” areas, “commercial” agriculture, which have the most farmland, production and economic results, and are linked with international markets, are less determinant because of their economic development.

Consequently, the high importance of this “territorial” agriculture is taken into account in many countries. In the European Union, for example, their social and environmental dimension, more than economic, is a determinant factor for the future of many rural areas in the process of depopulation and desertification. Although this same kind of categories is not used by the common agricultural policy (CAP), “less favoured areas” and “sensitive environmental areas” have been used for a long time with another definition.

Figure 3. Territorial and commercial agriculture in the European Union



1. SGM: Standard Gross Margin. AWU: Active Working Units (farm labour force). Source: EUROSTAT (2002).

As indicators show (Figure 3), while a “commercial” agriculture minority in a number of holdings has the majority of economic results measured by the participation in the total Standard Gross Margin, subsidies included, a “territorial” agriculture majority in a number of holdings remains important as a source of employment measured by the number of Active Working Units engaged and in geographical terms (farmland). Obviously this dual structure of holdings is more striking in some countries (in the Mediterranean countries, for example), while in others the lower categories of “commercial” agriculture (“medium-size high” and “big”) has become greater.

Some particular remarks on this case are that, first, the “commercial” agriculture in the EU receives the majority of the subsidies provided by the CAP (more than 80%). This means nowadays that it is few holdings that benefit mainly from a “direct income support” policy, which represents more than 50% of the CAP budget. Second, these two kinds of agriculture have a similar importance as a source of employment (50-50%) in the EU rural areas, since normally “territorial” agriculture is more intensive in the use of labour.

And third, although the geographical importance of “commercial” agriculture is bigger (two-thirds of the EU farmland), the presence of a “territorial” agriculture is still remarkable (one-third of the EU farmland). Moreover this importance is irregularly distributed in the territory, being dominant in many European regions (in the Southern countries, for example).

In conclusion, it arises as a general question if most of this kind of “territorial” agriculture has to disappear. It seems that in our developed countries we must maintain this activity in many rural areas for economic and, above all, social and ecological reasons, but the general trend is going towards a geographically concentrated agriculture with few professional farmers. A territorially more balanced economic development, a greater socio-economic cohesion, call for maintaining and improving this activity. And, what do we need to change to achieve this?

For this reason it would be necessary to change the attention paid to the diverse policies. The generic “agricultural policies” should play a less important role in the future vis-à-vis the “territorial policies”. As experience from this period reveals, with emphasis on only one sector, it will be impossible to avoid underdevelopment of the countryside. Diversification of activities requires diversification of policies, with two main orientations.

In the sector (“agricultural”) policy, different types of agriculture call for differentiated policies, because until now the target usually supported “commercial” agriculture. If we want to maintain “territorial” farmers in some rural areas, they need to be the direct beneficiaries of policies, over and above the cereals, meat and other product policies.

At the same time, other “territorial” policies would be able to introduce new instruments for a sustainable rural development. As we set out below, the “territorial” agriculture would just be an asset for a sustainable rural development in many areas.

## “Territorial” agriculture: an asset for a sustainable rural development

As is well known, a sustainable rural development needs to achieve simultaneously three main objectives: economic, social and ecological. The contribution toward this kind of development by the “territorial” agriculture can be important in many rural areas, because of allowing the maintaining of economic activity, recovering some social collectives and valuing natural-cultural goods. The contribution to all these objectives by the “territorial” agriculture will be obviously partial, but more or less relevant depending on the type of rural area (Table 2).

Table 2. Territorial agriculture and sustainable rural objectives

Main objectives	“Integrated” areas	“Intermediate” areas	“Lagged” areas
Economic:	<ul style="list-style-type: none"> <li>– improving a safe agricultural production</li> </ul>	<ul style="list-style-type: none"> <li>– maintaining agricultural activity</li> <li>– improving a safe agricultural production</li> </ul>	<ul style="list-style-type: none"> <li>– maintaining agricultural activity</li> <li>– improving a safe agricultural production</li> <li>– new products and linked activities</li> </ul>
Social:	<ul style="list-style-type: none"> <li>– maintaining some collectives of rural population</li> </ul>	<ul style="list-style-type: none"> <li>– maintaining some collectives of rural population</li> </ul>	<ul style="list-style-type: none"> <li>– recovering some collectives of rural population</li> </ul>
Ecological:	<ul style="list-style-type: none"> <li>– preserving natural resources &amp; species</li> </ul>	<ul style="list-style-type: none"> <li>– preserving natural resources &amp; species</li> <li>– valuing social-cultural goods</li> </ul>	<ul style="list-style-type: none"> <li>– preserving natural resources &amp; species</li> <li>– valuing social-cultural goods</li> <li>– improving and extending natural protected areas</li> </ul>

Source: Regidor (2000).

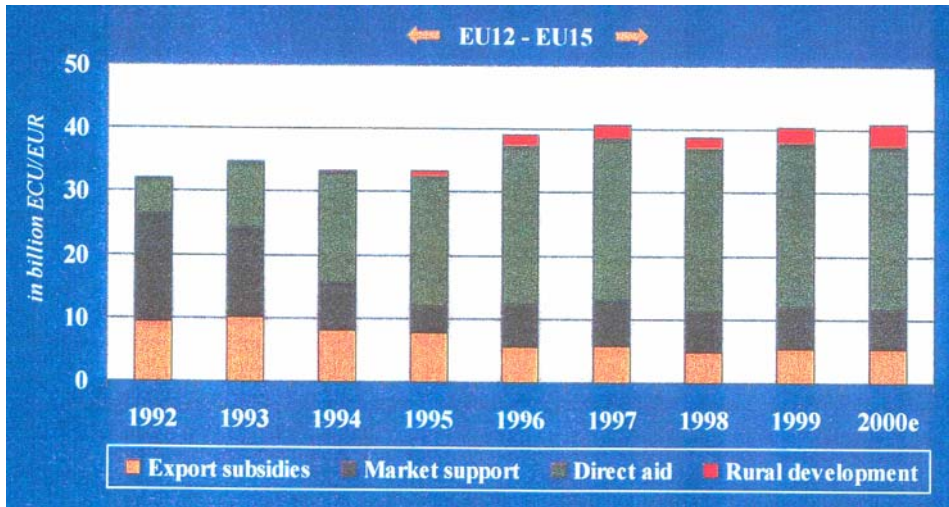
In “integrated” rural areas (those existing in the OECD “predominantly urban areas”), the “territorial” agriculture is residual, its possible economic objective being to improve a safe agricultural production versus a limited “commercial” agriculture with problems of consolidation. Maintaining some rural population will be also necessary to preserve a natural environment, which is often depredated.

In “intermediate” areas, where “commercial” agriculture is in majority, there is often a substantial part of “territorial” and “medium-size high commercial” farms with a difficult economic viability, which activity should be maintained only under some social and ecological conditions. In this case maintaining a part of these “part-time” or “professional” farmers would be justified by fulfilling these conditions (maintaining employment and preserving natural resources, for example).

In “lagged” areas, on the contrary, where “territorial” agriculture is very often in majority but their economic results are not enough, maintaining this activity is a necessity as a complementary source of income while new activities are going to emerge. In these areas a greater specialisation in safe agricultural productions and other products with market niches, would be able to maintain and recover a rural population. This limited population can play an important role as managers of an extended territory, with several activities linked to ecological targets (preserving soil and water, cultural traditions and protected spaces, for example) which must be economically compensated by the private and public sectors.

Nevertheless, to achieve these objectives new instruments of agricultural and rural policies would be necessary. As the EU case points out (Figure 4), the process to improve the territorial approach is going slowly, and until now resources in rural development programmes have been scarce compared with other budgetary resources and namely agricultural subsidies. Thus, during the 1990s “market support price “was replaced by the “direct aid”, while “export subsidies” slowed down and “rural development” measures in the PAC budget appeared with little significance.

Figure 4. **Improving the territorial approach**



Source: EC (2000).

The last proposal of the European Commission (EC, 2002) in this regard seems to go in the right direction, since it is considering the increase in the future of the attention paid to the rural development measures, reducing the resources engaged in the dominant PAC instruments. Nevertheless, as this new PAC reform is related with other important items (enlargement of the EU, Millennium World Trade Round, new American Farm Bill), it is not clear what will be the content of the final decisions adopted.

Anyway, in many OECD countries this type of “territorial” agriculture would be considered an asset for a sustainable rural development, as the case of the Siena region has shown, but to do that radical changes in current policies and instruments would be necessary. A synthesis of these new policies and instruments is displayed next.

Of the different agricultural policies, it would be more adequate to use differentiated direct aids for “territorial” agriculture. This sort of positive discrimination is justified by the unequal breakdown of incomes caused by the actual agricultural subsidies, as we commented before. Likewise, these aids have to be conditioned by economic and social characteristics of farmers’ beneficiaries and by ecological commitments accepted by them.

The main instruments linked with this new application of subsidies would be a delimitation of rural areas with “territorial” agriculture, the use of a



“pay for services” principle (*e.g.* the French “Territorial Management Contract”) and some measures to enhancing attention to any kind of more biological agriculture. All of these instruments must be substituted by other existing ones and will be able to produce a budgetary saving.

And when it comes to the new rural policies, it would be better to introduce specific rural development programmes for farmers with “territorial” agriculture, than maintain the same sorts of programmes in any kind of territory and for any kind of beneficiary. Consequently, this specific policy would imply giving more resources for rural development programmes in some areas than in others (the “lagged” one, for example).

As instruments for these new rural policies, it should give priority to farmers with “territorial” agriculture in the rural development projects subsidised, and in general involve much more this collective in the application of rural development measures. The introduction of these instruments would not need additional budgetary resources.

In conclusion, these orientations would be a new way of reintroducing the agricultural activity as an asset for a sustainable rural development.

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## **The Role of Rural Development in the Common Agricultural Policy**

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### ***Abstract***

*Throughout its long history, the CAP has witnessed a continuous series of changes. Today, many elements have emerged with force and imply the necessity of a new phase of redefinition for the CAP. Among the factors to be taken into consideration, there are the next round of WTO negotiations on international trade, EU enlargement and increased EU trade with non-Member countries. In addition to economic factors, we should highlight the profound changes in European public opinion. With the citizen/consumer very attentive to issues related to the environment, food security, biological production, treatment of animals, the EU is required to provide increasingly advanced policy responses.*

*In this context, there is a need to radically restructure the CAP. This restructuration should address both the role of agricultural enterprises (as a tool to reach CAP objectives) and the objectives of rural development. In this framework, rural development should be understood as a means to sustainable development, synthesising the cross-sectoral needs of the environment, health, landscape and territory in coherence with the new requirements of today's CAP.*

### **The role of rural development in the CAP**

Rural development is one of the most recent and innovative aspects of agricultural policy, particularly in the EU. It should be borne in mind that some of the most important measures in this area have in fact been taken during the past ten years. For example:

- specific regulations governing the registered designation of origin have been defined;
- the regulatory framework for organic products has been established;
- the foundations of an EU food safety policy have been laid, initially by the White Paper on Food Safety and as from 2001 by the “Food Law”;
- Agenda 2000 has made it possible to implement the Regulation on Rural Development, the “second pillar” of the CAP.

Until now, the last of these instruments has perhaps been ineffective and has had scant resources, but in fact it has now become the main tool for managing policies aimed at ensuring quality and preserving the environment, including at the local and regional level. The changes that have been made are not confined to instruments, but also encompass contributions and the budget. In the 1991 CAP reform, known as the “Mac Sharry” reform, 91% of the budget was devoted to market support measures such as export subsidies, while direct payments only accounted for the remaining 9%. At that time, rural development measures were only provided for in the “guidance” section of the EAGGF budget.

Under Agenda 2000, partly because of the need to adapt to WTO constraints, market measures have been reduced to 21%. Direct payments have risen to 68% of EAGGF guarantee funds, while the rural development programmes covered by the EAGGF guarantee section account for the remaining 11%, for an annual amount of some EUR 4.3 billion. This is a key step and in some respects an obvious one since rural areas constitute 80% of all European land.

Beyond the financial aspects, it should be pointed out that the new rural development policy is responding concretely to the problems and expectations of today’s society by ensuring the harmonious development of all rural areas in Europe and by creating jobs. This policy is targeting certain key objectives, such as strengthening the agricultural and forestry sector, improving the competitiveness of rural areas and, lastly, preserving the environment and rural heritage.

This rural development policy is based on four basic principles:

- The *multifunctional role of agriculture*, i.e. the fact that it plays many roles besides simply producing agri-food products.
- *An integrated, multisectoral approach* to the rural economy aimed at diversifying activities, creating new sources of income and employment and preserving the rural heritage.
- *Flexibility* of support to rural development, based on subsidiarity and the promotion of decentralisation, regional and local co-operation and partnerships.
- *Transparency* in the development and management of programmes, based on simplified and more easily accessible legislation.

### **The CAP today: new developments and objectives**

In its long history, the CAP has undergone a continual process of adaptation and change, culminating in the reforms of 1991 and 1999. However, despite the fact that the Agenda 2000 negotiations were completed only three years ago, there have been major new developments that make necessary to launch a new phase of reform. The upcoming international trade negotiations at the WTO (World Trade Organisation) will lead to further trade liberalisation, which will obviously also affect the agriculture and food sector.

At the same time, there will also be a further opening up of the EU's trade policy towards third countries, both for the least developed countries and important partners such as Mercosur, North Africa and the Balkans. Of particular importance in this regard was the openness shown by the European Commission in the initial months of 2002 to extending the EBA ("Everything but Arms") Agreement for liberalising trade with the world's 49 poorest countries to all countries of the ACP (African, Caribbean and Pacific) Agreement.

The enlargement of the EU will also raise major problems for the CAP, with the extension of direct payments to farmers in new member countries at a time when budgetary restrictions will make it more difficult to find balanced solutions.

However, it should also be pointed out that, over and above these economic factors, there has been a weakening of the public consensus over the CAP, for, in a society in which the rules of the market now apply across all sectors (and have been assimilated into a widely shared culture), the public is beginning to wonder whether the policy of protecting and supporting farms is justified. This public consensus has been further undermined by the failure to prevent serious contamination and diseases within the food system (cases of dioxin, BSE, etc.), as well as by stories of misappropriation of subsidies that periodically appear in the news. More generally, it must be borne in mind that there have been profound changes in public attitudes over the past twenty years, and today's citizen-consumers are acutely aware of the environment, food safety, organic production and animal welfare and expect the EU to be increasingly responsive to these issues.

The media are largely responsible for this awareness, which is also a new development. Ultimately, it has led to increasing public scrutiny of the CAP in recent years. The main criticism levelled against this policy is that it consumes a large share of the EU budget – nearly 50%, with an annual expenditure of over EUR 40 billion – but also that it has failed to prevent crises, such as the BSE and swine fever epidemics, and more generally that it has been unable to ensure the safety of consumers and citizens.

This has raised the issue of the quality of agricultural policy rules and instruments, but also of how acceptable they will be to public opinion in the future. In this regard, the results of the 2001 Eurobarometer Survey, which studied what European citizens thought that the CAP's objectives should be, are extremely interesting (Table 1).

Table 1. **What European citizens expect of the Common Agricultural Policy**

Objectives	Ranking by priority (in %)
Ensure that products are safe and healthy	90
Preserve the environment	89
Protect small farms	82
Adapt agriculture to consumers' needs	81
Improve living conditions in rural areas	80
Make EU agriculture more competitive	78

*Source: Eurobarometer Survey (2001).*

This table shows clearly that new needs have emerged that differ from the objectives assigned to the CAP in the past. The priorities now expected of the CAP are the need to ensure that products are safe and healthy, to respect the environment and preserve the social base of rural areas. In other words, there is a clear and unambiguous demand for rural development.

At the same time, issues relating to farms are seen as being less important. Although there is a certain concern over the fate of small and medium-sized farms, the objectives of defending farmers' incomes (77%) and protecting farmers' interests within the sector (71%) have a very low priority.

Consequently, a radical rethinking of the CAP is required. However, in addressing this problem, Europe must not lose sight of the fact that it does need an agricultural policy, just as all countries in the world, including the most free-market oriented ones such as the United States, New Zealand and Australia, etc., have their own agricultural policies. The agricultural sector is different from other sectors of the economy for a number of economic, political and social reasons that justify having a specific intervention policy in this field.

The problem does not seem to be the cost of agricultural policy *per se*. It is believed that the overall cost of the CAP is less than 0.51% of the gross domestic product of the EU. Rather, the problem is the interrelation between the cost of the CAP and the objectives targeted. If the objectives defined in the revised version of the Agenda 2000 programme being prepared for 2003 are in line with citizens' "new" demands, there is every reason to believe that it will be possible to launch a policy for the development of the agri-food sector and farm businesses that will be genuinely sustainable over time.

## **New prospects for rural development**

In this new situation, it is necessary to rethink not only the role played by farms in achieving the objectives of the Common Agricultural Policy, but also the very objectives that rural development should pursue. This reappraisal should focus on three elements:

- objectives;
- resources;
- instruments.

Regarding objectives, it is necessary:

- to provide farm businesses with new tools and means of action that will enable them to select and shift to better adapted farming models, moving away from a rationale of broad support to specific types of production and national systems;
- to grant support on the basis of the behaviour of farms and farmers;
- to consider farms and farmers as the prime actors of rural development.

At the same time, in light of what has been said above, rural development must be understood as a model of development that is sustainable over time and an approach that is aimed at meeting the cross-cutting needs of the environment, health, the local area, the landscape and other factors, in line with the overall requirements of the new CAP. As regards farms, agricultural activity must shift towards a multi-functional approach. The fact that an agricultural activity is carried out within an area can in fact have an enormous environmental, social and cultural impact, due to a series of interacting factors that affect the identity and values of residents, the organisation of space and productive activities. However, experience shows that the mere presence of agricultural activities within an area does not always have positive effects, for in some cases overly productivist models can also cause serious environmental damage.

It is only if agricultural policy is given a strong environmental orientation that the multifunctional role of agriculture will be able to have its full positive impact and contribute effectively to sustainable rural development. Consequently, quality and the multifunctional role of agriculture are the two cornerstones of rural development that must be promoted. An agri-food system based on quality and which fully plays its multifunctional role within an area will meet the expectations of citizens and consumers and can also constitute an economically valid response in the context of globalisation.

However, it must be borne in mind that the “new rural development” must be compatible with the following future constraints:

- The enlargement of the European Union. The countries that are candidates to enter the EU have 60 million hectares under cultivation and nearly 10 million agricultural workers; consequently, there will be a shift in the distribution of financial



contributions, but above all rural development will have to be made more flexible (social aspects of the environment and animal welfare).

- International trade. Rural development will have to be implemented in ways that are “compatible” with WTO agreements. Multi-functional services and activities will have to target a specific market, with a supply (that of multifunctional farm businesses) and a demand (even if it is from the public sector).

As for the resources made available to rural development, financial resources for market measures for rural development should be increased with the medium-term revision of Agenda 2000, which should bring the share of agricultural expenditures devoted to rural development from 11%, as set in Agenda 2000, to 20-25%. Nevertheless, the expected results cannot be achieved simply by assigning new resources to implementing the Regulation on Rural Development as it stands today. The quality of the results will not be determined solely by administrative and regulatory aspects, but will also require a more careful reappraisal of the measures being used to ensure rural development.

An important step has been taken in this direction in the draft medium-term revision of Agenda 2000, which seeks to strengthen regional development by laying down new accompanying measures in the field of food quality and safety (in this regard, the chapters on the promotion of farmers’ participation in quality certification and guarantee schemes – PDO, PGI, organic labelling, etc. – and on support for the promotional activities of producers’ associations are interesting), as well as that of health and animal welfare.

In conclusion, if we can succeed in promoting within the EU a rural policy that is consistent with the constraints of the general economic system and developments in the agri-food sector and with the needs of civil society, then it will be possible to make a comparison with other systems in order to define common foundations of rural policy that will be valid beyond EU borders.

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## Multifunctionality and Agriculture

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### *Abstract*

*The concept of agricultural multifunctionality is the fruit of intense debate of which the initial phases date back to the early 90s. Its main phases include the principal of sustainable development ratified at the Rio Summit (1992), that of decoupling agriculture subsidies adopted in the Marrakech Agreements (1994) along with the concept of an integrated rural policy put forward at the Cork Conference (1996). In France, the Agricultural Orientation Act (1999) designates the principal points and results of this debate. In this country with a rich farming tradition, the crisis affecting the agriculture of the developed countries has been the mostly deeply felt.*

*There are five dimensions to this crisis: the demographic and socio-political crisis of the farming community; the emergence of extraordinary territorial fragility; the increase of disregard to food among the citizenry; the growing manifestation of a split with the living; farmers' uncertainty in identifying their own profession. In confronting this crisis, multifunctionality is a concept, which can give meaning to the farming profession and to agriculture. Indeed, it shows that farming activity plays many roles that can be illustrated through five distinctions: foodstuffs and non-foodstuffs, production and transformation, material and immaterial wealth, private and State goods, market and non-market goods. To be meaningful, these different functions must be apprehended and encouraged globally. Here is where one finds the interest of an agricultural policy based on the "decoupling-recoupling" principal: "decoupling" the different functions of the act of production so as to assure their remuneration then "recoupling" them so as to preserve the links uniting agriculture to the territory, to nature and to the living.*

The debate on multifunctionality emerged from a profound crisis in the agricultural world. Although this crisis has affected all developed countries, it has been felt particularly strongly in France, a country with an old farming tradition. That is why this debate has reached such proportions in this country.

## **The concept emerges**

The crisis to which we refer has the following five dimensions:

### ***The agricultural population***

The first dimension concerns the agricultural population. One has to appreciate what it is for a social group to suddenly discover that it has become a minority in society. Exactly a century ago the agricultural working population accounted for half of the French working population. In this respect, farmers are the only social group that, in just a century, has gone from an absolute majority to a minority.

*The French farming community is not a social group like any other. It is a group with a history marked by the various missions that different governments have entrusted to it over time. When this group suddenly realised that it had become a minority among others and that its missions had changed considerably, an immense feeling of discontent emerged.*

### ***The agricultural world's relationship with the land***

The second crisis that the agricultural world had to deal with in the late 20<sup>th</sup> century concerned its relationship with the land. The reasoning had always been that, by nature, agriculture held the land – until it was realised that all agricultural production required only a small portion of our territory.

When we look at France's ten main agricultural products, we see that ten *départements* – that is 10% of the territory – produce as much as 45 departments, that is 45% of the territory. Those ten *départements* are all situated north of the Loire River, while the 45 others are situated south of it. Taken one by one, these ten *départements* all consider that, technically, they could probably double their production – and that is true. In other words, if there were no constraints, about 20 *départements* instead of 100 would be enough. There is clearly an extraordinary *territorial weakness* here.

### ***The relationship with food***

The relationship with food is another source of tension and thus of fragility, for a major historical break occurred in this respect in the late 20<sup>th</sup> century. For the first time, an entire generation is living as if it were sure to have enough to eat to the end of its life. This is something never witnessed before in the history of humankind, and it radically changes the way in which we consider those producing the first link in our food chain: the farmers.

We are thus in *an entirely new situation, characterised by a lack of worries about food quantity*. Basically, this has caused farming to be seen as relatively unimportant. Not only has it become a minority, it has also become just one among others because in the food chain it is simply one of the links.

Along with this feeling of abundance we find an immense lack of knowledge. *We have never eaten so well and we have never known so little about what we eat!* This is another factor creating a *lack of understanding*. Ignorance breeds misunderstanding.

### ***The question of nature***

The fourth major break concerns nature.

While society was being urbanised, the agricultural world believed that, in a sense, it remained the guardian of humans' ancestral relationship with nature. Then suddenly the public opinion woke up and said: "Hey, what you're doing with nature is not what we expected!".

Society realised that the agricultural world had a relationship with nature that was a *relationship of modernity*, that is to say, one of exteriority. It realised, above all, that animals were seen only as machines for transforming plant protein into animal protein. Gone was the romantic view of nature.

There was a kind of awakening which, in France, resulted in extremely forceful debate. Moreover, agronomic research was largely, although not solely, responsible for the extraordinary modernisation of French agriculture. *This question of nature thus arose in both the agricultural and the scientific worlds.*

### ***Definition of the farmer's occupation***

The last difficulty is related to the very definition of farming as a profession. The traditional farmer (*peasant*) of the late 19<sup>th</sup> century became the commercial farmer (*exploitant agricole*) of the post-World War II era. There is currently a trend away from the latter term, although nothing has clearly replaced it. Interestingly, French farmers' unions increasingly use the term *peasant*, because of its historical and social positive connotations.

There is a debate in our country around this term. Farmers are entrepreneurs who put production factors into perspective and develop economic calculation, some say. Why should they not be considered as company managers, a term with important social value in our society?

If everyone were a company manager, I think it would be rather boring. Of course, there have to be company managers, but what is interesting in a society is precisely *being able to name the diversity of that society rather than reducing it*.

### **From the multifunctionality concept to agricultural policy**

It was thus in this context of profound crisis that the concept of multifunctionality emerged at the end of the 1980s. A full decade was needed, however, before the concept was translated into agricultural policy. Those ten years were marked by the following key dates.

It was at the Rio Summit in 1992 that the concept of sustainable development, closely linked to that of multifunctionality, was first highlighted.

In 1994 the Marrakech agreement closed the Uruguay Round of trade negotiations. This treaty laid down a new conceptual framework for public agricultural policy. The idea of uncoupling aid, that is, of dissociating it from quantities produced, was firmly established.

Between 1995 and 1998 the European Union focused on that issue. The Commission submitted for discussion the concept of integrated rural policy, centred around environmental and territorial approaches. A conference was organised in Cork, under the Irish presidency, to validate this debate, but the European Council of agriculture ministers in Dublin subsequently cancelled that guideline.

In parallel, between 1996 and 1999, first the OECD and then the FAO – at the Maastricht Conference in the autumn of 1999 – discussed the concept of multifunctionality. The OECD promoted it; the FAO rejected it.

In France the key date in this debate was unquestionably 1996 when the FNSEA, the largest French farmers' union, called for a new blueprint law: "*loi d'orientation*". It considered that the 1960 and 1962 laws, which still largely governed agriculture, no longer corresponded to the current situation and had to be amended.

Thus, in 1997 and 1999 the multifunctionality of agriculture was at the heart of debate on the blueprint law. The question was: "is this law intended to build French agriculture on 250 000 farms or is it intended to maintain agriculture everywhere in the country?".

Answering this question meant that one acknowledged the fact that agriculture is more than a volume of production. It meant, in the final analysis, that having agriculture on the entire national territory was a *political will* and not only the outcome of an economic logic. Naturally, it meant that the situation was more complex than expected.

All these debates culminated in the agricultural blueprint law of July 1999 and the creation of the "Contrat Territorial d'Exploitation". At just about the same time, during the debate on Agenda 2000, the Council of Ministers in Berlin created the second pillar of the CAP on the basis of rural development and multifunctionality.

## **The concept's five dimensions**

Why develop this notion of multifunctionality as an answer to the agricultural crisis? Because multifunctionality is the way in which we can name the fact that agriculture has an exceptionally rich range of outputs. And this means that this sector is not meaningless but, on the contrary, rich of sense and perspectives. To illustrate this point I shall make five distinctions.

### ***Distinguishing food from non-food***

The first distinction is the fact that the agricultural world produces both food products and non-food products. I won't insist on this distinction since it has always been acknowledged by the agricultural world, especially as regards the question of energy.

### ***Distinguishing production from processing***

The second distinction concerns production and processing. Agricultural producers are expected, collectively, to be producers both of raw materials and of processed, identified and qualified products linked to a territory. We clearly see that the market is expressing strong expectations as far these processed products are concerned, and that there is a revival rather than a decline in this respect.

### ***Distinguishing material from immaterial wealth***

The third, less obvious, distinction is the fact that the agricultural world produces immaterial wealth along with material wealth. What do we mean by immaterial wealth? We mean, for example, landscape, management of the soil and the subsoil, biodiversity, etc. The fact that agriculture produces immaterial wealth has highly important cultural effects that must absolutely be taken into account.

### ***Distinguishing public from private goods***

These immaterial goods have two characteristics that constitute my fourth distinction: the agricultural world produces private goods and public goods. Private goods mean that farmers' production belongs to them (agro-tourism for example).

On the other hand, farmers are considered more and more as agents producing public goods in the course of their private activity: landscape, environment, culture, and so on.

All of these things are in demand. Interestingly, a large number of these public goods cannot stem from strictly public action; they can only be the outcome of public policy implemented by private actors. Thus, the construction of landscape relies on private actors, in a totally private framework, yet it is a public good, and by that I mean *a good which is for everyone's benefit and which benefits to the present and the future generations.*

### ***Distinguishing market from non-market goods***

The fifth distinction is between market and non-market goods. A part of what a farmer produces is for the market and a part is non-market although it



is a valuable asset. I think that the interest of the debate on multifunctionality in agriculture is its emphasis on the fact that *wealth can consist of a non-market good*.

It is therefore a highly important distinction, and that is where the problem lies. How can we ensure that this non-market wealth continues to be produced, not alongside material market production, but through material and market production?

This non-market qualification is thus of interest in two respects. First, it enables us to identify what belongs to the market and what needs to be regulated on an economical point of view. Secondly, it facilitates the construction of a policy dedicated to the remuneration of non-market wealth for the benefit of all.

## **A renovated approach to agricultural policy**

### *A new definition for the farming profession*

That is the advantage of the decoupling-recoupling approach in which this production of wealth is “decoupled” in order to be “recoupled” afterwards. If we refer to the French case, the idea is not to have 20 *départements* that are strictly market-oriented and 50 that are strictly non-market oriented. In all the *départements*, we must have market and non-market productions, material and immaterial wealth, private and public goods, food and non-food productions.

Only this type of approach can give cohesion, coherence and legitimacy to public budgets. That is the ultimate goal of the “Contrat Territorial d'Exploitation”, the immediate aim of which is to reward – through an economic and market-oriented project – the environmental, social and cultural functions fulfilled by agriculture.

Over and above that, this policy is also *intended to recognise a profession* which is, in the final analysis – and that is probably what makes it so original – a profession of synthesis.

This job is not the direct heir of ancestral peasant. It is rather a highly specialised and complex job. It deploys a range of competencies that are not inherited but, more and more often, are learned.

The originality of this profession is its capacity to articulate several missions and different types of know-how – far more than those implied in the definition of the agricultural producer prevailing in the latter half of the 20<sup>th</sup> century. It is the reconstruction of a profession of synthesis, not an equivalent of the 19<sup>th</sup> century *paysan*. I believe that, from this point of view, the farmer is *a very modern entrepreneur*. An entrepreneur who has the particular characteristic of being as much in phase with the market as with the rest of society, through public policies.

In the final analysis, this very strong recomposition around multifunctionality can be seen as an *historical opportunity* to redefine the role of agriculture in modern society.

## **High Quality Products and Regional Specialities: A Promising Trajectory for Endogenous and Sustainable Development**

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### ***Abstract***

*Distinction is the keyword for the definition of high quality products and regional specialties. Four dimensions of distinctiveness exist, which when combined permits us to understand the considerable heterogeneity entailed in the production of high quality products in Europe. By referring to both inter- and intra-regional comparisons, we see that high quality production is relevant within regional economies. Moreover, it has an estimated overall impact on the EU level as a whole. In terms of net value added, this impact is superior to the impact of overall Dutch agriculture. Such an impact might be increased considerably through interlinkages with agro-tourism and the management of nature and landscape. Furthermore, we see that the development of high quality production is basically an endogenous process, upon the basis of which some policy recommendations are made in this paper.*

### **Towards a definition**

In the land that excels in products such as *carne Chianina* (the basis for the well-known *bistecca Fiorentina*), *formaggio Parmigiano Reggiano* and *Chianti* wine, it might appear, at first sight, quite a ludicrous operation to try to define the notion of “high quality food product”. This is especially the case when the one who is trying to do so comes from faraway, *i.e.* from the Netherlands. Nonetheless, at a more general level, the development of a proper definition of high quality and/or regional products is, I believe, quite a useful activity. This is especially the case when the interface between the production of high quality food and rural policy is to be discussed.

Distinction is the keyword for any such definition (Bourdieu, 1986; Barberis, 1992; Allaire and Sylvander, 1995). It is distinction that resides in the distinctiveness of the primary process of production. A key feature here is often the use of (specific) local resources, a keen embedding in local ecology and an ample use of local knowledge (Roep, 2000). Distinction also resides in the distinctive nature of the process of transformation: the artisan nature of the transformation process (as opposed to industrial) often turns out to be a decisive feature here (de Roest, 2000). Thirdly, there may be the distinctiveness in the process of commercialisation: short chains and the central importance of regional markets might be important in this respect (van der Meulen, 2000). Fourthly, we have to include the distinctiveness of the final products. Taste, appearance and/or freshness will be for sure among the important criteria at this level. But it is more than these: there will be a close, albeit dynamic “fit” between the products concerned and the reigning social definitions of quality (van der Meulen and Ventura, 1994; Maffesoli, 1996; Featherstone, 1991). This “fit” is often the outcome as well as the vehicle of strong culinary traditions. Price is equally a vehicle of distinctiveness at the level of the quality products. From recent research we know that a higher price (as compared to non-quality or “bulk” alternatives) contributes significantly to distinctiveness (van Ittersum, 2001).

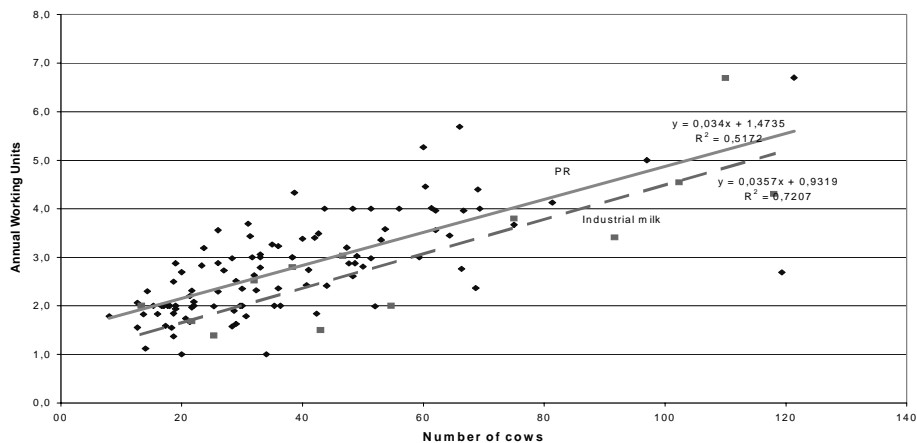
The more a product distinguishes itself along these four dimensions, the more it emerges as a high quality food product and/or as a regional specialty.<sup>1</sup> Hence, there are degrees of distinctiveness – just as there are different trajectories for developing more distinction.<sup>2</sup> Equally it can be stated that the more a high quality or regional product is made distinguishable, the higher the net value added per unit will be on the level of the concerned farms. This finding, then, introduces a fifth dimension of distinction: that is its relevance both for the farm economy and the regional economy. I will illustrate this aspect with some comparisons.

### **On the relevance of high quality and regional products**

In a recent study, de Roest (2000) compared the socio-economic impact of Parmesan cheese (*PR*) production with that of conventional dairy farming specialised in the delivery of “industrial milk”. Figure 1 summarises some of his findings.

Figure 1. **Employment rate per cow in industrial and Parmigiano-Reggiano dairy farms**

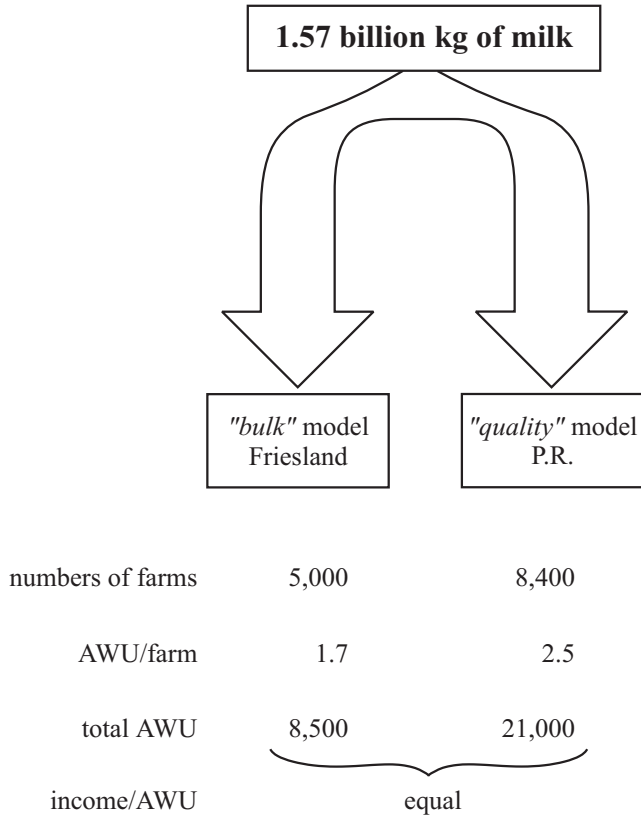
Only farms in the plains



Due to the particularities of producing good cheese milk (suitable for transformation into *PR*), labour input is higher on *PR* farms than on farms producing “industrial milk”.<sup>3</sup> Making good cheese milk requires more work (other circumstances being equal) than producing “plain milk”.<sup>4</sup> Taking into account the herd-size distribution, de Roest concludes “*that the production of Parmigiano Reggiano cheese is able to double the amount of employment available on the dairy farms*” (de Roest, 2000; de Roest and Menghi, 2000, p. 445). Instead of 11 290 AWU, the regional employment in primary dairy production is 21 154 AWU.

The regional impact of quality production is reaffirmed by a comparison that was made between the province of Friesland in the Netherlands and the *PR* area in Italy (Figure 2). Both areas dispose of exactly the same milk quota. In Friesland this associates with a direct employment effect in primary production of 8 500 AWU, in the *PR* area it is 21 154 AWU. Income-levels per AWU are, on average, the same (van Broekhuizen and van der Ploeg, 1999).<sup>5</sup>

Figure 2. Friesland and Emilia Romagna compared

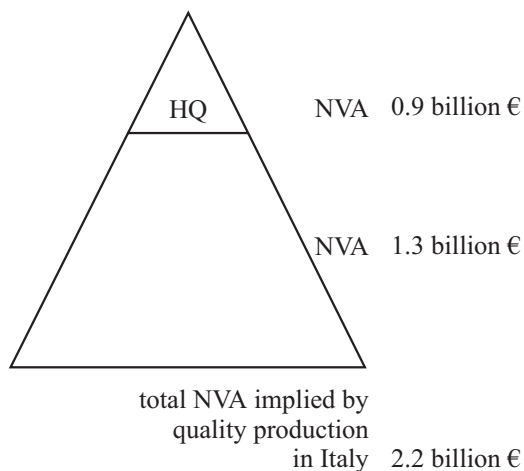


It is important to add that the relevance of quality production to Rural Development is not limited to the generated regional income and employment only. “*Parmigiano Reggiano farms in the plains show [...] a total nitrogen loss of 239 kilograms of nitrogen per hectare [which] compares with 309 kilograms/ha for the industrial dairy farms – a difference in the order of almost 30%*” (de Roest and Menghi, 2000, p. 445).<sup>6</sup> The dimension of sustainability is also highlighted by Ventura (1995 and 2001) who demonstrates that the “resource use efficiency” (notably of energy) is, in the case of *Chianina* meat production, considerably higher than is the case in “industrialised” animal fattening of the feed-lot type. For another high quality meat sector (*Barroso* meat in *Tras-os-Montes* in Portugal), van den Dries (1995 and 2002) shows that per unit of the most scarce resource (*i.e.* irrigation water), employment and income effects are two to three times higher than is the case within newly introduced, more “modern” farming systems in the area. Due to their particular

history and especially due to the high degree of fine-tuning to the local eco-systems, the production systems of high quality food and regional specialities tend to be more sustainable than conventional systems. Taking into account issues of landscape and bio-diversity tends to the same type of conclusion.

So far for *PR* cheese. Italy has 113 officially recognised PGI and PDO products, with another 150 in the process of recognition. Taking all recognised quality products together (including meat, wine, olive oil, etc.) it was concluded (van der Ploeg *et al*, 2002) that, in 1998, these products represented a total net value added (at the level of primary production) of EUR 2.2 billion.<sup>7</sup> This might be broken down as follows: EUR 0.9 billion is to be considered as *delta* NVA, that is, strictly speaking, the extra NVA that stems directly from the fact that we are dealing here with quality products characterised by premium prices (and by a somewhat different cost structure). This extra or *delta* NVA comes, as it were, on top of the NVA that would have been realised if the raw materials concerned had passed through current “non-quality” channels and had therefore received the current market prices (Figure 3).

Figure 3. **Economic structure of high quality production in Italy**



Thus, two types of observations are possible. First, by entering into the high quality segments of the markets, the implied set of agricultural enterprises raises its NVA by some 70% (from EUR 1.3 billion to

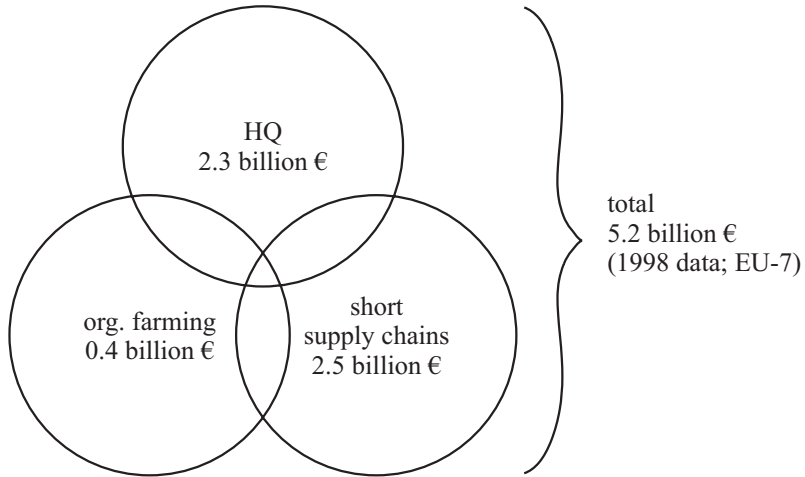
EUR 2.2 billion). Second, not only is considerable extra NVA generated through quality production – but it is quite probable that it is precisely because of this orientation to quality production that agricultural activity as such (that is the basis of the triangle in Figure 3) is sustained and maintained in the areas concerned. Without the upgrading as implied by quality production, this “basis” would probably disappear from the regional rural economy (see also Roep, 2002, who arrives to the same conclusion for the northwestern areas of Europe).

High quality production in agriculture is not a phenomenon that is just limited to the domains of production and transformation. The results of a recent European study of the socio-economic impact of rural development<sup>8</sup> permit a further view on the ways in which high quality production is linked with other domains. Going back to the top of the previous triangle (that is to *delta* NVA resulting from high quality production), we find, in the first place (Figure 4) that at European level at least EUR 2.3 billion *extra* NVA was generated in 1998 through high quality production. At the same time, though, it results that high quality production is closely associated with the creation and use of short supply chains (for further discussions see Marsden, Banks and Bristow, 2000 and Miele, 2001). Through this actively created synergy an additional extra or *delta* NVA of EUR 2.5 billion is created. And finally this constellation increasingly embraces organic farming as well. That makes for an extra NVA of EUR 0.4 billion. Taken together a constellation emerges that accounts for a *delta* NVA of EUR 5.2 billion (van der Ploeg *et al*, 2002).

Within Europe, the Netherlands is often considered to be an agricultural giant. However, if we take into account that in 1998 the agricultural income in the Netherlands equalled some EUR 4 billion, we cannot but conclude that in the meantime another giant has developed. That is, high quality production as a widespread and multi-dimensional phenomenon.

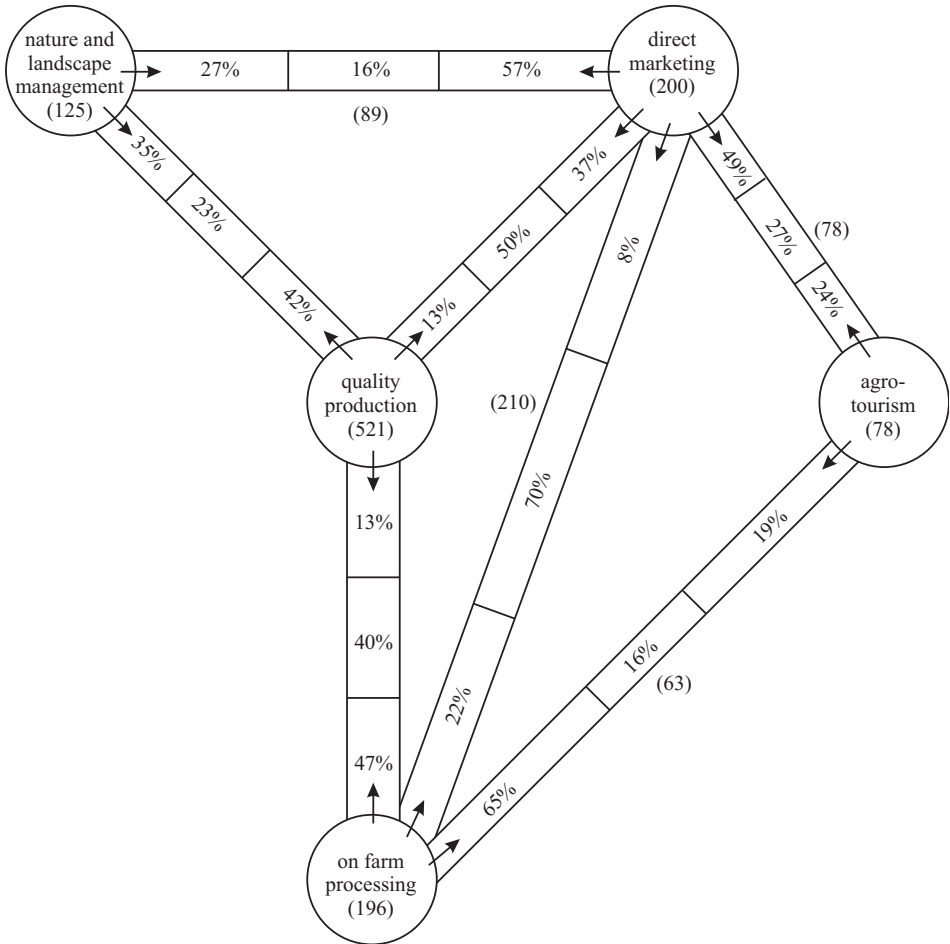


Figure 4. **Interlinkages between different rural development domains**



The newly emerging linkages in which high quality production is increasingly embedded are also shown in Figure 5 (which is based on the outcomes of a European wide survey amongst farmers,  $n = 3\,500$ ; see Oostindie van der Ploeg and Renting, 2002). Apart from the already discussed axis that links high quality production to direct marketing, it shows that new axis are developing that interlink the former with phenomena such as nature and landscape management, on farm processing and agro-tourism. From the 521 producers involved in high quality production, 125 are also involved in the management of nature and landscape. Of these cases, 42% of this newly constructed synergy started from high quality production (which subsequently evolved to include the management of nature and landscape). In 23% of the cases there was a mutual start, while in 35% involvement in nature and landscape management was followed by the start of high quality production.

Figure 5. Interlinking different types of rural development activities

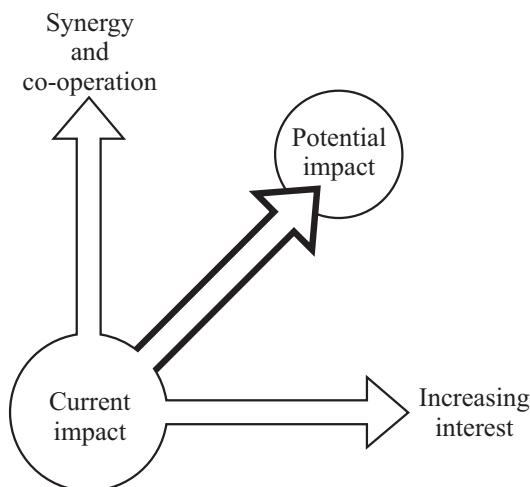


### Prospects and policies

When discussing the prospects of high quality food products and regional specialities it is often argued that in one way or another a kind of “upper ceiling” has been reached. This implies that a further expansion of this segment is not very probable or could even be a kind of self destructive process, in which mutual out-competing would be the key word.

The prospects for further development have been studied in the research programme already referred to. The “jump” from actual to potential impact has been conceptualised, in this programme, as the vector of two different, albeit interlinked processes. These are growing interest amongst other farmers and the active construction of synergy (Figure 6).

Figure 6. **Potential impact as vector of growing interest and creating synergy**



As far as interest is concerned, the European wide survey indicated that apart from those already involved in high quality production, a further 31% of European farmers is interested in a change towards high quality production (going from 10% of Dutch farmers to 46% of German farmers). More telling though is the synergy dimension. At the level of the EU as a whole, farmers who are involved in just one rural development activity derive on average 38% of their farm income from that particular activity. However, farmers who are simultaneously involved in two types of RD activities (through “webs” as illustrated in Figure 5) derive 57% of their income from these activities. And farmers involved in three or more activities obtain 64% of their income from this multiple involvement.

In my opinion these data allow for two types of conclusions. First, they show that by combining different activities (that is through the active construction of synergy) considerable additional income effects might result.<sup>9</sup> That is, multiple involvement in rural development activities as *e.g.* high quality

production combined with direct marketing and agro-tourism, emerges here predominantly as *endogenous* process, that is spurred by the well understood interests of those involved. Secondly, the very presence of this phenomenon of actively constructed synergy, indicates that *beyond* the markets as such, there is room for further development of high quality food products and regional specialties. By combining such activities with other RD activities, an important line of defence is generated vis-à-vis adverse market tendencies (Milone and Ventura, 2000).

The construction of synergy not only depends on individual activities. Synergy might also be constructed at higher levels of aggregation. I will discuss one example, especially because it is here where the (potential) relevance of rural policies of co-operation, and new rural districts are emerging.

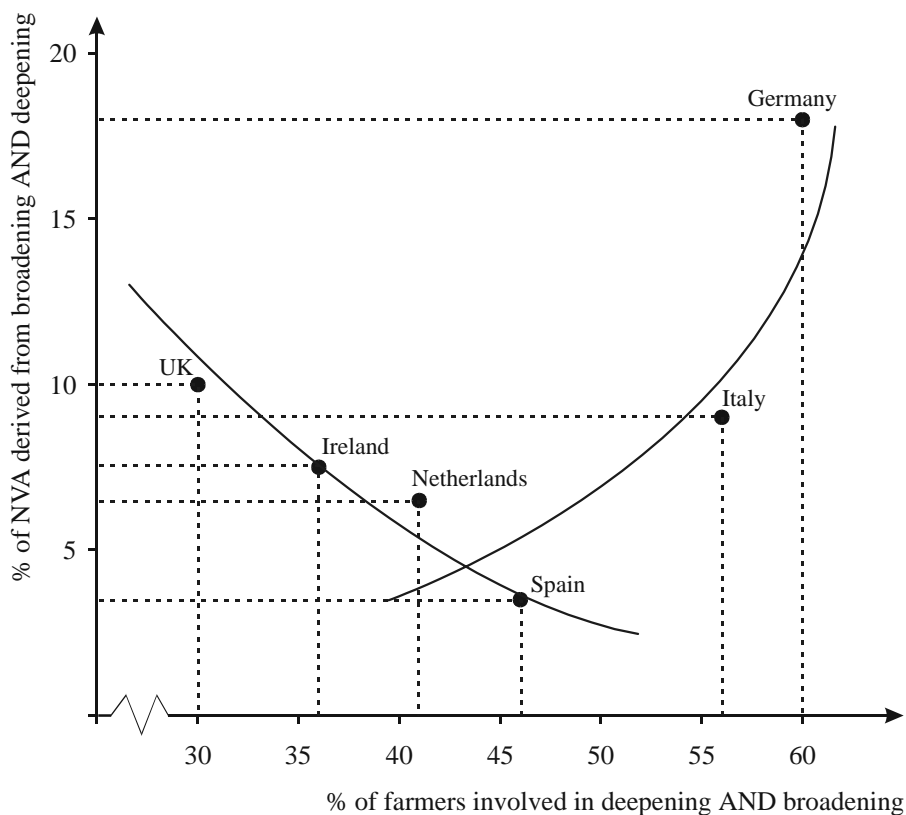
The *Costa degli Etruschi* wine route is the outcome of the concerted action of a range of actors, amongst them wine producers, recreational entrepreneurs, local and regional authorities. It offers tourists the possibility to come to know and to experience the scenic landscapes, the cultural heritage, the wine, the culinary specialties and gastronomic products of the area (Brunori and Rossi, 2000). For the concerned entrepreneurs, farmers included, there is a common set of rules aiming at a high quality supply of services. The creation of the wine route resulted in an unfolding chain of (measurable) direct and indirect effects. One effect of the wine route is a considerable and continual increase in the number of tourists. This translates into an increasing demand for agro-tourist facilities and an increased demand for direct sales. This is followed by increasing sales volumes and an increased value per unit.

Equally there is an increasing awareness of customers for regional specialties, which in turn is translated into an increased demand for bottled wine and an increased demand for indirect sales. This is followed by premium prices and an increased net value per unit. Taking together all these different effects, there is – as a consequence of this joint effort – an *extra* net value added (on top of the already existing NVA of EUR 3 598 500) of EUR 1 079 550 (a prudent estimation) to EUR 1 439 400 (a more optimistic estimation).

Figure 7 refers to the percentage of farmers involved in RD activities (amongst them involvement in high quality production) and to the per cent of NVA at sector level that is derived from these activities. The distribution of countries within this space suggests the presence of two tendencies. The first (going from the United Kingdom to Spain) indeed reflects a downward trend: the more farmers involved, the lower the relative income contribution. But there is as well a reversed trend (one that runs via Italy towards Germany). Here an increased participation in RD activities translates into a growing share of RD

generated income. It is not too adventurous a hypothesis to assume that this again relates to the relevance of rural policies and the formation of new rural districts, that is to areas with an integrated and mutually reinforcing whole of RD activities. In other words, areas of the *Costa degli Etruschi* type (see for a further discussion Iacoponi, Brunori and Rovai, 1995).

Figure 7. **Involvement and income effects at sector level**



Is it possible to create *new* high quality and/or regional products? Is the construction of *new* rural districts possible? Evidence from all over Europe (ranging from the *Scalogni di Romagna* in Italy, via the *Waddenproducten* in the Netherlands to *Lynn beef* in the United Kingdom,<sup>10</sup> shows that this is indeed possible, although the difficulties are often enormous (van der Ploeg, 2002).

On the positive side is the fact that European farmers involved in the creation and further development of high quality products and regional specialities refer to market opportunities as one of the main driving forces for their involvement (83%). Of equal importance are the “suitability of the area” (82%), “personal interests and skills” (80%) and the availability of “necessary assets (land, labour, buildings)” (81%) (Oostindie, van der Ploeg and Renting, 2002). Thus, RD and especially the creation and embedding of high quality food production systems emerges as a market-led development, that links both the global (new market opportunities) and the local (the area, skills, assets, etc.).

On the negative side, though, there is the fact that *restrictive regulations* are seen by 69% of farmers involved in high quality food production as a major constraint for any further development. Interestingly enough, most farmers (75%) perceive the European Union in this respect to be a favourable factor, while only 26% perceive “national government” as favourable.

From here on, some suggestions for adequate rural policies might be formulated.

- 1) The (endogenous and market-led) development of new circuits for the production, transformation and commercialisation of high quality and regional food products runs increasingly counter to different layers of regulation. Supra-national, national and regional policies (especially the ones concerning hygiene and food-safety) not only frequently exclude the development of new regional quality products, but also threaten the consolidation of existing quality production systems. I believe that there is just one satisfactory, albeit at first sight a somewhat radical solution to this problem. That is, to decentralise the responsibility for food safety to the consortia and co-operatives that regulate the different quality production systems. Hence, food safety and especially the way to secure it might differ from one area to another, from one system to another (*e.g.* artisan versus industrial). The existing PGI and PDO structure could very well be used for such an approach (which, *inter alia*, would be perfectly in line with the principle of subsidiarity). For new high quality food products with regional origins, some experimental room needs to be created.
- 2) Rural districts, especially those having a high quality food product as pivotal centre, should be facilitated and strengthened as much as possible. Temporary investment subsidies for small and medium

enterprises that transform and commercialise the high quality products could be an important mechanism to do so.<sup>11</sup> The “second pillar” as well as the modulation mechanism are the proper fields for introducing such a mechanism.

- 3) Public Research and Development activities should be far more focussed on the further specification of existing high quality food products and on the creation of new ones. Especially in the north-west and the eastern parts of Europe there are hardly any such public R&D facilities. Public research mainly follows trajectories and research agendas as specified by large agri-business groups.
- 4) Rural policies should allow especially for the active creation of synergy, both at on-farm level and at local and regional level. Currently, spatial planning policies, agro-environmental schemes, etc., often run counter to the creation of such synergy.
- 5) A last element I would suggest here is that in the context of rural policies, new programmes need to be developed that aim at a wider recognition of the cultural heritage and values of the countryside (high quality food products and the way they are produced being one of the central elements) within European society as a whole.

## Notes

1. Throughout this text I will use high quality products and regional specialities as synonyms. All known high quality products use a regional or local origin as a benchmark for distinction. On the other hand, there are only market changes for regional and/or local products if they distinguish themselves in terms of quality.
2. An interesting example might be derived from the domain of the *Parmiggiano-Reggiano*. Recently a special *PR* has been developed which is made exclusively from milk produced by the old, regional cattle breed, the *vacche rosse*. The same applies for *PR* coming from the mountain areas in the *PR* district. And finally one might refer to *PR* made from organic milk. All these examples refer to a further proliferation along the first dimension of distinctiveness.
3. This evidently concerns the second dimension – artisan production – relevant here are particularities such as forbidding the making and use of silage, the need to have a considerable percentage of luzerne cultivation in the cropping pattern, and the associated need to work with well-ripened manure instead of slurry.
4. The more so since *PR* is made out of “raw milk”. It is not pasteurised, as is the case with industrial cheeses.
5. Indirect employment is, in the case of *PR*, also considerably higher.
6. This difference is partly due to the centrality of alfalfa in the cropping pattern on *PR* farms. It is telling though that de Roest and Menghi (2000) conclude, on the basis of a multivariate analysis, that “*with increasing stocking rates, industrial dairy farms are confronted with a more rapid deterioration of their nitrogen balance than dairy farms that deliver milk for making Parmigiano Reggiano cheese*”.
7. The total GVP at farm level was some EUR 3.5 billion, whilst after transformation, that is at the level of the food market, this represented some EUR 8 billion.
8. This study was carried out in Ireland, England, the Netherlands, Germany, France, Spain and Italy. Its results are summarised in *Living Countryside: Rural Development Processes in Europe*, to be published by Elsevier in September 2002.
9. See for a further theoretical discussion Saccomandi (1998). See also Panzer and Willing (1982) who discuss the differences between economies of scope



and economies of scale. Multi-product firms might obtain considerable cost reductions when one and the same set of resources can be used to generate a multiple range of products and services (see also Scherer, 1975).

10. See respectively Menghi (2002), Roep (2000 and 2002) and Banks and Bristow (2002). See also van der Meulen (1998) on “hidden” starting points for regional quality production.
11. The high degree of monopolisation of the food industry is probably one of the biggest hindrances to the emergence of new high food quality constellations.

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## KEY CONCLUSIONS

### AGREEING ON THE NEED TO EXPAND ACTIVITY BEYOND AGRICULTURE

This international conference on the future of rural policy, organised by the OECD and the Province of Siena, confirmed the important role that agriculture plays in many rural regions despite the fact that it is not clear whether current agricultural policy has effectively promoted rural growth and development. Developing the differentiation and increasing the quality of agricultural products may increase the contribution of agriculture to rural development. Proposals from the mid-term review of the Common Agricultural Policy released by the European Commission on 10 July were regarded as consistent with this objective but provoked debate as to whether the reforms went far enough.

Many of these issues are elaborated in the OECD's *Territorial Review of Siena, Italy* released at the start of the conference. As a predominantly rural province that has enjoyed considerable success, the study provides insight for formulating new rural development strategies. Fabio Ceccherini, President of the Province of Siena has proposed developing a network of other rural areas that are also pursuing, or wish to pursue, development that is based on the full valorisation of a territory's natural and cultural amenities.

This conference concluded that the policy shift requires both a broader definition of the countryside as well as the recognition of the inter-dependence of rural and urban areas. To guarantee the future vitality of rural areas, rural policies should shift from focusing on a single sector – agriculture – to developing a wide range of economic activities.

Two additional key policy changes were identified:

- A shift from distributing subsidies to support specific activities toward mobilising investment in emerging opportunities that take full advantage of local resources and capabilities. Tapping the

potential in rural areas is often hindered by the need for collective action.

- Continuing the shift from top-down incentives to the development of bottom-up projects targeting co-ordinated development. A bottom-up approach stresses the ability of rural citizens to identify problems for intervention, to formulate strategies and to be full partners in implementation.

A critical issue that must be resolved in policy reform is the difficulty in replacing old policies. Successful pilot projects of place-based development in Europe and the Americas hold substantial promise. But can territorial policies, such as the European Union LEADER initiative, the Mexican Micro-region programme, and local pacts and policies in Italy and France, form a comprehensive basis for reform?

It has been suggested that place-based policies are, in any case, likely to do a better job of fulfilling social demands than the current sector-based policies. A demand for analysis to examine the effectiveness of cross-cutting policy was one of the principle outcomes from the conference. These issues will be examined in a follow-up conference to be held in Washington, DC in 2003, organised by the Federal Reserve System and the OECD.

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