

*"Looked at from another point of view, subsidiarity will assume crucial importance in the context of enlargement. The fundamental question is what implications will enlargement have on common policies? The further enlargement goes, the harder it will get to define what really has to be addressed at European level. This is something we should be giving serious consideration, and the principle of subsidiarity will be our guide. Clearly, people will only accept Europe as a legitimate entity if there is a flexible and evolutionary vision of subsidiarity. The Union's priorities must be dynamic, not fixed in stone, and the terms and breadth of its action must be calibrated with flexibility and detail."*

*European Commission (1999a)*



**Subsidiarity,  
the CAP and  
EU Enlargement**

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## FOREWORD

The Swedish Institute for Food and Agricultural Economics (SLI) is a Government-funded agency with the task of performing economic analyses of agricultural and food policy issues.

The analyses provide the Government with long-term and strategic background material for domestic decision-making and international negotiations. In addition, they enhance public knowledge and understanding of the economics of food and agricultural policy. The main area of analysis is the Common Agricultural Policy (CAP), with special emphasis on the need for policy reform and effectiveness, and on the implications of EU enlargement and WTO negotiations. One of the Institute's main tasks is to analyse possible development paths for the CAP – and thereby their economic effects and political practicability. In this report on subsidiarity we explore one interesting path in this perspective. The work was conducted in co-operation with Prof. Kenneth Thompson, University of Aberdeen.

Subsidiarity is the fundamental EU idea that the Union should not take on tasks that can be handled as or more efficiently by individual Member States. EU intervention in decision-making or financing must thus be shown to give added value, compared with national management. What precisely does the EU level add to agricultural policy? And what is lost by its centralisation?

As long as the CAP was almost exclusively about market regulation and trade policy, there was probably not much to discuss. But, as the policy has moved towards direct payments to farmers, the added value in its “common” status becomes increasingly unclear. What is the advantage of jointly deciding the size and structure of direct payments in different parts of the EU and financing them from a common budget? If different countries really have different preferences when it comes to prioritising agriculture at the expense of other sectors or objectives, what common EU interest is there in hindering subsidiarity? And why should environment measures, for nature or countryside conservation purposes – in northern Sweden, the Greek Islands or the Austrian Alps – be decided and financed jointly?

The issue of subsidiarity becomes even more relevant from an enlargement perspective. The enlargement eastwards of ten or so countries will change the EU markedly. Does enlargement change the EU or its agriculture to the extent that a common policy is neither possible nor relevant?

April 2001

Lena Johansson  
Director-General



## TABLE OF CONTENTS

<b>EXECUTIVE SUMMARY</b>	<b>3</b>
<b>1 INTRODUCTION: WHY THIS STUDY NOW?</b>	<b>7</b>
1.1 Study Context	7
1.2 Study Purpose	9
1.3 Previous Studies	10
1.4 Report Structure	14
<b>2 SUBSIDIARITY</b>	<b>17</b>
2.1 A History of the Concept in the Treaties	17
2.2 Definitions and Interpretations	21
2.3 The Political Analysis of Subsidiarity	23
<b>3 SUBSIDIARITY IN THE CAP TO DATE</b>	<b>29</b>
3.1 Introduction	29
3.2 Market Instruments	33
3.3 Direct Payments	36
3.4 Agri-environmental Measures	40
3.5 Structural Instruments	42
3.6 Other Measures	43
3.7 Concluding Comments	44
<b>4 THE ASSESSMENT OF SUBSIDIARITY IN GENERAL</b>	<b>47</b>
4.1 Approaches to Subsidiarity Evaluation	47
4.2 Economic Efficiency: Spillovers and Scale Economies	49
4.3 Efficiency: Destructive Competition	52
4.4 Efficiency: Creating a Level Playing Field	53
4.5 Co-ordination	54
4.6 Inefficiency of Bargaining	55
4.7 Implications of Bargaining for Efficient Domestic Use of Resources	57
4.8 Social Equity	58
4.9 Accountability	59
4.10 The Political Economy of Centralised Decision-Making	61
4.11 Concluding Remarks	62
<b>5 EVALUATION OF THE CAP</b>	<b>65</b>
5.1 Introduction	65
5.2 How Should the CAP be Assessed?	66
5.3 Assessment of Market Interventions from Efficiency Point of View	66
5.4 Direct Payments/Direct Income Support	67
5.5 Agri-Environmental Measures	69

5.6	Common Structural Funds/Rural Development Policies?	72
5.7	Equity and the CAP	73
5.8	The CAP and Political Efficiency/Accountability	75
5.9	Credibility of Policy Co-ordination in Agriculture	78
<b>6</b>	<b>OPTIONS FOR FURTHER SUBSIDIARITY AND THE CAP</b>	<b>79</b>
6.1	Introduction	79
6.2	The Agri-Environmental Policy Option: Description	80
6.3	Agri-Environmental Option: Evaluation	81
6.4	Direct Payments/Modulation: Description	90
6.5	Extended Modulation Option: Evaluation	94
6.6	Extended Modulation: Would It Disturb Competition?	96
6.7	Modulation and Agri-Environmental Payments: Equity	98
6.8	Extended Modulation and Agri-Environmental Payments: Accountability and Political Economy	99
6.9	Subsidiarity Options and International Trade	101
<b>7</b>	<b>EU ENLARGEMENT AND SUBSIDIARITY</b>	<b>103</b>
7.1	Subsidiarity and Previous Enlargements	103
7.2	Background to Eastward Enlargement	105
7.3	The Budget Costs of Enlargement	107
7.4	An Enlargement Scenario: "Fair" Direct Payments to Farmers	109
7.5	An Alternative Enlargement Scenario for Central Europe: Aggregate Direct Payments	113
7.6	Enlargement Scenarios and Subsidiarity Options	116
<b>8</b>	<b>CONCLUSIONS</b>	<b>119</b>
8.1	Conceptual Conclusions	119
8.2	Policy Conclusions for the EU-15	119
8.3	Policy Conclusions for an Enlarged EU	122
8.4	Wider Issues	124
	<b>REFERENCES</b>	<b>127</b>



## **EXECUTIVE SUMMARY**

In the face of new challenges and increasing diversity, the way in which the European Union should operate is coming under new scrutiny. Two of the more pressing challenges are the need to reform the Common Agricultural Policy (CAP) in the face of pressures such as the EU budget, WTO negotiations and food safety concerns, and the prospect of EU enlargement - and therefore extension of the CAP - to countries in Central Europe. As during past periods of EC enlargement and CAP reform, the question of how and by whom policy decisions should be taken is once again a topical one.

Subsidiarity is the concept that government power should be exercised at the lowest efficient level, i.e. that the case for policy-making at higher or more centralised levels needs to be made, explicitly and cogently. With its roots in Catholic and pre-EC thinking, the principle of subsidiarity - at least to national level - has become increasingly important in the Community, along with the processes of its "widening" and "deepening". It was explicitly endorsed in the 1992 Maastricht Treaty, but is still open to a number of interpretations, both legal and economic.

The Common Agricultural Policy was set up as a highly centralised system of price support for a common or single market. Nevertheless, various forms of subsidiarity within the CAP have existed from time to time since its inception, notably with respect to the agri-monetary system and agricultural structural policy. However, the various pressures on the CAP, such as budget constraints and environmental concerns, have led to increased attention, and indeed to some action, as regards subsidiarity and national discretion, most recently in the case of the Agenda 2000 reforms.

The socio-economic assessment or evaluation of subsidiarity may be approached via a number of criteria, including economic efficiency (largely linked to market competition and externalities), social equity (linked to the important EU concept of "cohesion") and political economy aspects such as public accountability and fair and open bargaining. Both the existing situation, and proposed options for change, should be examined in

the light of these criteria. In many cases, it is not at all clear that centralised decision-making in Brussels – even by a Council of national Ministers – is the most appropriate level of decision-making. Many of the problems being addressed by the CAP are highly variable from place to place in the Community, or at least have to be solved within very different national contexts.

Use of these evaluation criteria as regards the CAP suggests that the now-dominant role of direct payments to EU farmers, instead of indirect market support, offers an opportunity to exploit the subsidiarity principle in the more efficient pursuit of social income objectives. Similarly, the rising importance of agri-environmental and rural development components of the CAP cannot be efficiently pursued by a highly centralised policy. Also, from a political point of view, the CAP would be less likely to be subject to the arguments of special interest groups such as farmers if larger parts of it were discussed and determined at national rather than Brussels level.

Two options for the further exercise of subsidiarity within the CAP are analysed in this report, as follows:

- Agri-Environmental Payments towards Non-Farming Objectives and Claimants

In this option, Member States would be given discretion to extend the scope of environmental support from agriculture only to all natural resources in rural areas. Other producers of environmental benefits should be able to participate alongside individual farmers, including groups of individual farmers, local branches of farm associations, environmental clubs, rural groups, other non-governmental organisations (NGOs), and also local or county municipalities. Control and assessment of all these payments should involve the participation of environmental and/or rural groups, local authorities and others having an interest in the delivery of a good local environment.

- The "Extended Modulation" of Direct CAP Payments

In this option, Member States would be given the extended freedom to use the total national “envelope” (budget total) of direct payments completely according to national objectives/criteria. Modulation would thus not be limited to the present 20 per cent, but would be extended to 100 per cent of the national envelope, as long as agricultural and rural objectives (economic development, environmental conservation or enhancement, etc.) are promoted.

In both cases, the wider use of these existing instruments would involve a greater degree of national financing (funding) of CAP expenditures, and more national and local decision-making by a wider range of participants. By better selection of valued natural and social resources, and the changed “rules of the game” for operating these components of the CAP, the use of both horizontal (direct payments) and targeted (structural, agri-environmental) instruments would improve all three of the evaluation criteria: economic efficiency, social equity and political accountability.

The prospect of future enlargements of the EU into Central Europe presents - to both existing and new Member States - new problems and opportunities that relate to subsidiarity. Various features of subsidiarity have sometimes accompanied past enlargements of the Community, notably the continuation of national schemes, and different support prices via the use of “green” money. In the present context, the direct CAP payments to farmers present the greatest budgetary and economic challenge. In this report, a set of “fair” options for the extension of this CAP instrument to the applicant countries is discussed, with the aim of limiting the overall budget cost and unfair farmer-farmer competition. To use uniform per-hectare rates of payment within an expanded EU-27, and to keep within the planned expenditure for 2003, the existing rates in the EU-15 would have to be reduced by, at most, 28%. However, a more attractive option from an economic point of view, since it avoids the distortion of farming asset values which accompanies direct payments, is to aggregate these payments into funding for the development of rural infrastructure and the conservation of natural assets in different parts of the rural EU. This option could be pursued in a convergent manner, i.e. gradual conversion of individualised direct payments to aggregate

forms in the EU-15, while from the start new Member States applied equivalent funds in a more "social" way. Existing and new Member States would have different priorities for the use of such funds, thus reflecting their different technical and social conditions.

The increasing difficulties of operating a highly centralised Common Agricultural Policy in an expanded EU, whose population is increasingly sensitive to food and environmental issues, demand much further use of the subsidiarity principle. Provided that the principle of fair competition is sustained through strict monitoring along state aid lines, this approach should result in greater economic efficiency, improved social equity and better political accountability.

# 1

## Introduction: Why This Study Now?

### 1.1 Study Context

At this point in time, why may it be interesting to re-examine the idea of subsidiarity in relation to the Common Agricultural Policy (CAP) and the enlargement of the European Union<sup>1</sup> (EU)? The CAP - originally intended for a fairly homogenous Community of six countries - was one of the first and is still the most ambitious of the common policies of the European Union. From the 1956 Treaty of Rome onwards, Member States have transferred a considerable amount of power and money to the EU in relation to agricultural policy. The current CAP budget is about 40 billion Euro, and almost all decisions on agricultural and food policy have to be made or approved in Brussels.

However, in recent years, a movement in the opposite direction can be observed. Enlarging the Union implies increasing diversity of the Member States, both with respect to farming conditions and the level of economic development. The latest (1995) enlargement to Austria, Sweden and Finland entailed adding regions with low-productive agriculture (small-scale, arctic or alpine) within high-income countries. A large degree of national flexibility exists in the implementation of the agri-environmental Regulation (2078/92, now 1750/99) and of the Rural Development Regulation (1257/1999). National “envelopes” of farm subsidies allowing different forms of “modulation” have been created as part of the Agenda 2000 CAP reforms. These changes have occurred despite developments in many other policy areas in the direction of more economic and political integration.

The agriculture for which the CAP was originally designed has changed profoundly. The contribution of agriculture to GDP and total employment has shrunk considerably, until, even in most rural regions in the Union, agriculture seldom accounts for more than 20 per cent of total employment. Hence, the future survival of rural regions cannot be linked to agriculture alone. The Rome Treaty objectives, which still ap-

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<sup>1</sup> Throughout this report, the European Union (EU) is used interchangeably with the earlier term European Community (EC), or simply the “Community”.

ply, of assuring food security and boosting agricultural productivity have lost their appeal to the general public and to governments, if not to most farmers. Instead, the public increasingly values the protection of the environment, especially the preservation of biodiversity and the development and revitalisation of rural regions. Social policy is another area where, so far, Community legislation and expenditure play a very limited role.

It is only fair to point out that the CAP has demonstrated a remarkable flexibility in being able to absorb both a wide range of national variability and changing priorities. At its inception, the CAP focussed strongly on farm incomes and relied almost entirely on price support. Recent changes have to some extent responded to the changed economic circumstances and changing values. They have involved both refocusing of objectives and considerable re-instrumentation of the policy, with direct payments emerging as the major expenditure component. However, this has been achieved at expense of high budgetary and economic cost and substantial complexity of the regulatory framework. Hence, further reforms of the CAP are probably unavoidable, and the issue remains whether a more decentralized policy would be a better policy overall.

The fact that the composition of the Community has changed and that its diversity is going to increase even more after future enlargement have profound ramifications for the relative merits of common *versus* national policies. Whereas it is obvious that Member States cannot independently intervene on the same market, it is not equally self-evident that, say, direct income support, especially if it is to some extent decoupled, should be a common responsibility. Pursuing a common income support policy for agriculture when both absolute and relative productivities in farming differ considerably and increasingly between countries poses a considerable challenge. The next enlargement will exacerbate these difficulties. Similarly, commonly designing, implementing and supervising a multiplicity of environmental support schemes for the vastly diverse environmental conditions in Europe is immensely more complicated than fixing a set of commodity intervention prices. Similar arguments could be raised in relation to rural development measures. Accordingly, it

seems worthwhile to re-examine relative merits or demerits of centralised decision making in agriculture.

## **1.2 Study Purpose**

The general idea of subsidiarity in the Community is that the Commission, Council, or other EU body<sup>2</sup>, should not try to do things that national governments can do equally well, or better, by themselves. The CAP was the first and is still, alongside the EMU, the most ambitious of common EU policies. Is this a rational allocation of power from an economic perspective, or could competence between the Member States and the Community with respect to decision making in agriculture be reallocated? The main objective of this study is to examine the aforementioned question in view of the economic, political and social changes in Europe, as well as changes of policy content identified in the introductory section above.

Perhaps the most important reason for re-examining the idea of subsidiarity concerns the next enlargement of the Union. The enlargement will add vastly to the diversity and heterogeneity that already exists in the Union and could exacerbate conflict within the Union by increasing the number of problems and issues. The eastern enlargement constitutes the greatest challenge ever encountered by the Union, due to the fact that the GDP per capita of the candidate countries is only a small fraction of that of the incumbents. GDP is correlated with a number of variables relevant to the challenges of accession, e.g. the level and pattern of private spending, the availability and use of public funds, willingness to pay for public goods such as environmental benefits and food safety, and administrative efficiency.

In connection with past enlargements, Preston (1995) has argued that the problems created by increasing the economic diversity of an enlarged Community were addressed by the creation of new policy instruments overlaid on existing ones rather than by a fundamental reform of the inadequacies of the later. Can the same model can be applied to the eastern enlargement in view of the difficulties of integrating countries at very

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<sup>2</sup> The respective roles of these EU bodies are not clearly distinguished in this report, since the focus is on centralised *versus* decentralised decision-making.

different levels of economic development and the relatively short time available to bridge the gaps?

As with regions, firms and families, having rich and poor countries sharing the same legislation is difficult. However, differentiated or partial integration is not easy. Derogation from the *acquis* will result in tensions and may disturb competition. A related question is: how much flexibility can be allowed without jeopardising the single market? In terms of the CAP, enlargement raises additional difficulties owing to the fact that the applicants are more agricultural than the incumbents.

Future pressures, especially EU institutional and decision-making reform, the need for further CAP reform, and the next enlargement, should imply more changes in the direction of subsidiarity or renationalisation<sup>3</sup>. The purpose of this report is to examine whether this is indeed the case, and, on the basis of explicit assessment criteria, to explore feasible options for further subsidiarity in agricultural policy in both current and potential EU Member States.

### 1.3 Previous Studies

There exist a large number of articles and books on the issue of subsidiarity. It is not possible to offer a comprehensive review of this vast literature here, particularly because the subject has attracted specialists from so many different disciplines. Scholars interested in subsidiarity have included political scientists (Golub, Kersbergen and Verbeek, Jordan, Scharpf), political philosophers (Føllesdal), lawyers (de Búrca, Weiler, Schilling, Vause), especially those scholars interested in law and economics (Revesz, van den Bergh), and economists in general (Smith, Pelkmans, Oates and Schwab).

Many of these scholars discuss the issue of subsidiarity in general rather than focussing on some specific areas of policy making. However, some authors use the concept to assess particular policies, arguing for fewer or more common measures in the area in question. In particular, environmental policy has attracted a lot of attention (for instance Smith 1995).

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<sup>3</sup> These terms are discussed further in Chapter 2.



Subsidiarity and co-ordination of taxes (fiscal federalism) have also been intensely discussed. Van den Bergh (1996) analysed competition policy and Cox (1994) energy exploration and extraction under EU utility procurement rules. Sun and Pelkmans (1995) assessed subsidiarity and EU telecommunications.

Most of the studies take a conceptual or normative approach, i.e. analyse what is an appropriate distribution of power between the EU level and the national states using a set of criteria selected by the author(s) and influenced by the idiosyncrasies of his/her discipline. Others take a positive approach, usually focussing on the politics of subsidiarity, i.e. they analyse the role the concept has played in the evolution of European integration (Golub 1996, Kersbergen and Verbeek 1994, Jordan 2000). This study takes a normative approach.

Of particular interest and importance is a conference on subsidiarity, chaired by the Commission President Jacques Delors, and held in Maastricht in 1991, the same year that the agreement on the Maastricht Treaty was reached. Tracing the concept back to Proudhon<sup>4</sup>, Delors argued that the application of the subsidiarity principle in general would change Community structures completely: *“Logically, currency and defence would be transferred to the Community and would cease to be national affairs, while agricultural policy would again become national”* (Delors, p. 27).

The present allocation of competencies between the Commission and the Member States implies that discussions on agriculture and subsidiarity have been rare. Shorter assessments have sometimes been included in more comprehensive examinations, though in those cases the details of agricultural policy have had to be ignored. Amongst agricultural economists, the underlying (or related) question of how common should be a “common agricultural policy” has arisen in more general debates on CAP reform, and discussed under the heading of renationalisation (see below).

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<sup>4</sup> Pierre-Joseph Proudhon (1809-1865), the famous French socialist-anarchist, who coined the famous term “property is theft”.

The view that the CAP needs to be reformed is shared among a wide range of observers. A number have argued that CAP reform should include an element of subsidiarity, in the sense that more decision-making power or responsibility for implementation should be given to Member States. The Padoa-Schioppa report (1987, p. 12) argued that there was more scope for national income maintenance measures in the agricultural sector.

In the early 1990s, a group of independent experts, chaired by Arne Larsen, was asked by the Commission to consider different ways to reform the CAP. The Larsen report (European Commission, 1994) included the following recommendation: *“In line with the subsidiarity principle, the responsibility for direct income support, i.e. for deciding on criteria for eligibility, on size and on duration of such payments, should therefore be allocated to the Member States, on condition that the payments do not distort competition”*. In addition, according to this expert group, Community financing for direct income support should be phased out.

The issue of subsidiarity in the CAP was also addressed by a number of authors in Kjeldahl and Tracy (1994), who explicitly discuss “renationalisation” of the common agricultural policies. In their words, *“renationalisation implies a shift of competence back from EU institutions to national ones ... in terms of decision-making, of financing or of implementation, or of all these aspects”* (p. 1). Along with the Larsen report, it is pointed out that the introduction of direct payments sets the stage for a renationalisation of the CAP, and that new policy objectives may justify national action since this would allow for more flexibility in the design and implementation. Even if decision-making power is devolved to Member States, distortion of competition should be avoided: a key issue is whether, in case of partial renationalisation, EU institutions could retain sufficient strength to enforce the basic principles of the CAP.

An argument in favour of renationalisation advanced by Wilkinson in Kjeldahl and Tracy (1994) is that common policies are not really completely common anyway: *“so-called common prices were often far from common due to decisions reflecting national objectives”*. Further, *“CAP never had the ambition to remove the need for all national agricultural measures. The*

*Community has always allowed member states considerable freedom regarding national aid from measures de-coupled from the market, which provide durable benefits”.*

Berkhout and Meester in Kjeldahl and Tracy (1994) identify additional reasons to favour limited renationalisation of the CAP. The first one is administrative simplicity. They propose an *encadrement communautaire* or framework agreement by which Member States should be able to adapt a regulation to solve specific national problems. Additional reasons for renationalisation are making EC policy more acceptable and applicable throughout all Member States, and curbing the budget due to more prudent management.

Vaubel (1994b) argues that the CAP cannot be justified on efficiency grounds. He accepts that transfers to farmers may be justifiable as a part of social or environmental policy. But if social policy is the reason, income maintenance should allow for the average level of regional income, which differs greatly between EC member countries. Moreover, if farmers are paid for their environmental services, such compensation ought to take into account interregional differences in preferences.

Gant (1995) has argued that objectives such as preventing rural depopulation, maintaining the appearance of the countryside, and ensuring that farming is carried in an environmentally friendly manner require a closer integration of agriculture in a comprehensive rural policy. He observes: “[g]iven the differences in rural problems between member states, many of these objectives can be tackled more efficiently at a national level but within the context of partnership between the Union and the member states”.

Vause (1995) sees the CAP as an “example of the general inclination toward federalism of local issues in the EU”. Since farming is claimed to result in few international externalities, there is no economic reason for the EU to be so pervasively involved in agricultural policy and regulation. Thus, it may be argued, agricultural policy is an area that should be left for the individual Member States to regulate.

## 1.4 Report Structure

The question whether more subsidiarity would improve the CAP immediately raises two consequent issues: how should subsidiarity be interpreted, and what criteria should be used to evaluate whether an improvement of the policy has taken place? Accordingly, an important initial task of this project is to establish an operational definition of the concept of subsidiarity and to identify criteria for evaluation. Thus, following the introduction in this chapter, the concept of subsidiarity is discussed in Chapter 2. This chapter provides also some discussion on the history of the concept in the EU Treaties, and on the political analysis of subsidiarity.

Chapter 3 analyses how much subsidiarity has existed in the historical development of the CAP and how much of it exists today, including market support measures, “compensatory” direct payments, agri-environmental subsidies, agri-structural funds and farm and food standards.

Chapter 4 elaborates on a set of criteria to be used for evaluation of policy. These include: economic efficiency, including market efficiency and resource allocation efficiency (welfare economics), social equity including “cohesion” (between EU regions and Member States) and policy-making efficiency, including accountability (political economy) and speed. Chapter 5 applies these criteria to the CAP, focussing on the major components of the policy: market regulations, direct payments, environmental support and structural policies.

Chapter 6 takes this discussion further and examines in more detail whether a greater reliance on subsidiarity than is currently the case would result in a better CAP. The possibility of decentralising policy making is discussed with respect to the areas of environmental measures and direct payments, in terms of “options” by which the ideas of subsidiarity may be put into practice within the CAP of the future.

Many arguments in favour or against national *vs.* common decision-making cannot be analysed in an institutional vacuum. The outcome may, for instance, depend on the efficiency of local administration. Ac-

cordingly, to resolve the issue or to substantiate some arguments it may be necessary to rely on examples. Especially for Sweden, cases of rural and environmental policies before accession can be compared with similar environmental and rural policies within the CAP: changes in the policy formulation and implementation, cost of policy administration, type of measures, production effects, etc.

In Chapter 7, this discussion is extended to the new EU entrants. The analysis includes a general overview of the condition in the selected countries and an in-depth follow-up of the proposals formulated in Chapter 6. The essential issue is the role which the CAP should play in the process of European integration. Could stronger reliance on subsidiarity constitute a way out of a range of difficulties that would arise if the present CAP were applied without modification to applicants? Chapter 8 provides some concluding discussion.

To summarise, this study is based on general, theoretical discussion of concepts and evaluation criteria, substantiated or illustrated by analyses and suggested options at sub-sector level. The ambition is to achieve a mixture of the general/comprehensive and the selective/detailed. However, the ambition is not to advance detailed proposals to replace existing regulations. Indeed, we discuss the issue of subsidiarity regardless of the present distribution of legal competence between the Commission and the Member States. Our approach is hence economic and not judicial.

Finally, our approach is to a large extent forward-looking. This complicates the analysis, and a few *caveats* apply. At the end of the day, the impact of more subsidiarity in agricultural policy-making according to the options that are advanced in Chapter 6 will depend on what use Member States would in practice make of the increased room for policy discretion at the national level. It is hardly possible, and perhaps not even meaningful, to attempt to predict the future behaviour of Member States in this respect. Instead we aim at identifying the scope of potential improvements using both general argument and illustrative cases. By their very nature, the latter relate to specific countries and situations and are thus selective.



# 2

## Subsidiarity

### 2.1 A History of the Concept in the Treaties

It is common to trace the notion of subsidiarity to the body of Roman Catholic social doctrine (Kersbergen and Verbeek, 1994). The Catholic tradition of subsidiarity was presented in the 1891 encyclical of Pope Leo XIII, *Rerum Novarum*, and developed in Pius XI's 1931 encyclical *Quadragesimo Anno*. According to Føllesdal (1998), *Rerum Novarum* had a dual aim: both to protest against capitalistic exploitation of the poor and to protect the Catholic Church against socialism. The Church allowed and indeed required state intervention in the social field, hitherto exclusively a domain for the Church. At the same time, the state was prohibited from absorbing the individual and the family. In *Quadragesimo Anno*, fascism was opposed by stressing the limits on legitimate state interference and by downplaying the state's duties of intervention (Føllesdal 1998).

According to Jerneck (1994), subsidiarity relates to socio-political ideas about the relationship between the individual and society. Jerneck argues that the Catholic Church tried to find a middle ground between socialism's view of an encompassing state and the individualistic perspective advocated by political liberalism. The idea was to take into account the interest of the state as well as the independence of the individual, and to strike the right balance between the two. The role of the state should primarily be subsidiary, or supportive, in relation to the individual, and its assertive power should be secondary.

The principle of subsidiarity came into vogue after the Second World War, and its focus was on finding the right balance of power between different political entities rather than between the individual and the state. The post-war discussion had a direct impact on the repartition of power between state level and federal level in Germany, whose constitution contains a paragraph on subsidiarity and defines the legal sharing of competences. The general clause is in favour of the *Länder* since their competence is presumed, while the competences of the central power are listed limitatively. In the UK and France, certain powers have been recently devolved to regional authorities, while in Sweden there is a very

high degree of local and regional decision-making, including a large measure of fiscal competence. However, in these cases, ultimate power resides with the central legislature.

The principle of subsidiarity was a guiding principle in the integration process of forming the Community. As long ago as 1951, Article 5 of the European Coal and Steel Community (ECSC) Treaty stipulated that that Community should exert direct influence on production only when circumstances so required (European Parliament, 1999). Subsidiarity is also reflected in the Treaty of Rome, although the term does not appear explicitly in the text. In the absence of an explicit rule for the distribution of power, one of the provisions of the Treaty of Rome (Article 235) has been used to justify the actual delegation of competence to the Community, and extensively to justify Community legislation in new areas (Jerneck, 1994).

According to Jordan (2000), subsidiarity made its first explicit appearance - though still not by name - in the First Environmental Action Programme adopted in 1973. The programme recognised no less than five possible levels of action, the Community level being one of them: *[a]ctions likely to be more effective at the Community level should be concentrated at that level; priorities should be determined with special care"*.

Again without mentioning the subsidiarity principle by name, the 1975 European Commission's Spinelli Report on Economic Union advocated an expansion of Community powers only where Member States could not effectively accomplish the desired tasks. The theme of the Report was that individual Member State action and Community action should complement each other, rather than compete with each (Vause, 1995).

The subsidiarity principle as a general constitutional rule was for the first time expressly mentioned in the Draft Treaty on European Union, which was adopted by the European Parliament in 1984. Paragraph 9 of the Preamble stated: *"Intending to entrust common institutions, in accordance with the principle of subsidiarity, only with those powers required to complete successfully the tasks they may carry out more satisfactorily than the States acting independently"*. Furthermore, the Draft clarified the practical



effect of the subsidiarity principle on Community action: "[t]he Union shall only act to carry out those tasks which may be undertaken more effectively in common than by the Member States acting separately, in particular those whose execution requires action by the Union because their dimension or effects extend beyond national frontiers" (quotations from Vause, *op. cit.*).

The Draft Treaty considered that the establishment of the subsidiarity principle would constitute both a guarantee against centralisation and overly extensive public intervention, and a means of avoiding overloading of the central authorities. However, the Draft was too ambitious for the Member States to approve. As a result, the Member States agreed to the 1986 Single European Act (SEA) as a more modest statement of reform. The principle of subsidiarity was introduced into the SEA only in the area of environmental protection (Article 130 R)

In the 1992 Maastricht Treaty, the question of the appropriate level of decision-making is addressed both in Article 1 and in Article 3b (Article 5 in the 1996 Treaty of Amsterdam). However, the language varies, and it is only in Article 3b that the term subsidiarity is used:

*In areas which do not fall within its exclusive competence, the Community shall take action, in accordance with the principle of subsidiarity, only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States and can therefore, by reason of the scale or effects of the proposed action, be better achieved by the Community.*

A somewhat different definition is given in Article 1 of the Maastricht Treaty: "decisions should be taken as closely as possible to the citizens". It has been reported that at "a Seminar which took place in Maastricht before the Treaty Agreement, all the jurists present, including the President of the Court of Justice, affirmed that subsidiarity is 'political in essence' and not legal. As a result the European Council should be the judge in the last resort. This has been reaffirmed by M Delors in a press conference in Brussels prior to the Lisbon Summit" (British Management Data Foundation, 1992, p. xiv).

More detailed guidelines on the meaning and implementation of the subsidiarity principle were agreed by the European Council in Edinburgh in the annex attached to its Conclusions (Weiler, 1997). The Council set a number of so-called subsidiarity guidelines. The first guideline counsels the institutions to consider whether the problem addressed by a proposed Community measure has transnational aspects, which cannot be satisfactorily regulated by action by Member States. The second guideline calls attention to whether a failure by the Community to act would conflict with the requirements of the Treaty (such as the need to correct distortion of competition, or avoid disguised restrictions on trade, or strengthen economic and social cohesion) or would otherwise significantly damage Member States' interests. The third guideline requires the Council of Ministers, before acting, to find that the Community measure would produce clear benefits by reason of its scale or effects compared with action at the level of the Member States. This simply restates the principle of subsidiarity, though it perhaps has the merit of specifying that the comparative advantage of Community over Member State action must be "clear", i.e. the proposed measure must be markedly superior to the Member State alternative (Weiler, 1997).

The guidelines were later on incorporated into Interinstitutional Agreement on implementing subsidiarity in 1993 and finally included in the protocol added to the Treaty of Amsterdam (de Búrca 1999). In addition to guidelines already mentioned above, the protocol prescribes that the form of Community action shall be as simple as possible, consistent with satisfactory achievement of the objective of the measure and the need for effective enforcement. The Community shall legislate only to the extent necessary. Other things being equal, directives should be preferred to regulations and framework directives to detailed measures. Directives as provided for in Article 189 of the Treaty, while binding upon each Member State to which they are addressed as to the result to be achieved, shall leave to the national authorities the choice of form and methods.

The present legal basis of the principle is thus: Article 5, second paragraph (3b) of the EC Treaty, in conjunction with Article 2(2) and the 12th recital in the preamble to the European Union Treaty. Under Article 5 of the Amsterdam protocol, Community action is justified where both as-

pects of the subsidiarity principle are met: the objectives can be better achieved by action on the part of the Community (the effectiveness criterion); and the objectives of the proposed action cannot be sufficiently achieved by Member States' action (the necessity criterion) (European Commission, 1999a).

## 2.2 Definitions and Interpretations

Is there an agreed definition of "subsidiarity"? Lord Mackenzie-Stuart, a former President of the European Court of Justice, who participated in the 1991 conference on subsidiarity mentioned above, argued that, despite all reports on the principle, no one has really settled down to define it. Or to put it differently, he calculated that it was possible to find 30 different definitions. On a different occasion, he characterised the principle as a "*prime example of gobbledygook*".

Subsidiarity is even somewhat differently defined in the Treaties. While Article 5 (formerly 3b) concerns only the relationship between the Community and Member States, the Preamble, when stating that decisions should be taken as closely as possible to citizens, covers intra-state relationships and possibly even the relationship between society and state (Schilling, 1995). Moreover, Article 5 invokes the notion of *efficiency* whereas the Preamble simply expresses a general principle.

One commentator has described subsidiarity as a principle of governance by which actions to accomplish legitimate government objectives are ideally taken at the lowest level of government capable of dealing with the underlying problem (Vause, 1995). Similarly, the principle has been called "*a maxim of sound administration inherent in any multi-tier system, be it federal or regionalised state or an International Organisation*" (Schilling, 1995).

Identifying five different levels of decision-making - local, regional, national, EU and global - the principle of subsidiarity could be applied between any two of them. To take an example, a recent paper by Rollo and Winters (2000) invoked the principle of subsidiarity in the discussion of international trade negotiations.

A CEPR report (1993) suggests that subsidiarity *"is a principle for allocating power upwards as well as downwards, but it incorporates a presumption in favour of allocation downwards in case of doubt"* (p. 4). On the other hand, Sun and Pelkmans (1995) claims that *"a priori, subsidiarity is neither decentralist or centralist"* but that the underlying idea begins with the premise that problems of information and preference revelation, as well as regional and local differences in preferences between voters, prevent central government from supplying an optimal set of public goods. Subsidiarity is thus strictly speaking not the same thing as decentralisation/decision-making power at the lower level; rather an imperative to analyse accurately at what level decisions should be taken. Moreover, power should only be centralised if it can be shown that this is really the best solution.

Moreover, as observed by Føllesdal (1998), the centralising effect of the principle of subsidiarity depends on whether it is interpreted negatively (or proscriptively) as a legal immunity, or whether it is interpreted positively as a prescription. The principle of subsidiarity can proscribe centralised action in the absence of comparative efficiency, thus protecting the sub-units from intervention by the central unit. According to Føllesdal, this "negative" version of the principle of subsidiarity, entrenching the powers of sub-units, finds expression in the Maastricht Treaty as a prohibition on intervention except under certain conditions. Alternatively, intervention from the central unit may be *required* when it is comparatively more efficient.

Generally speaking, subsidiarity is about principles for choice between centralised (common) policy and decentralised (national policies) regardless if a common policy is already at place or not. Moreover, subsidiarity is a matter of degree (how much power?), of nature (power to do what?), and of scope (in what areas?). Almost certainly, an optimal degree (arrangement) of subsidiarity occupies an intermediate position between complete centralisation and complete decentralisation. We may distinguish between *full* subsidiarity, which exists when Member states have full freedom to make decisions (within a EU framework), and *partial* subsidiarity when Member States must make specific proposals for approval by the Commission or Council before they can be acted upon

(and/or centrally funded). Subsidiarity may also be mandatory (Member States must take decisions) or optional (they may do so).

However, when the issue of subsidiarity is raised, the concept is often used as to mean giving more power to the lower level, in the present context to the Member States. In this report, subsidiarity will be used in that sense. When, for example, we discuss how subsidiarity in agriculture could provide scope for higher efficiency, with subsidiarity we mean that power is given to Member States. This power can refer to decision-making, financing and/or implementation. We will intermittently use the term “decentralisation” for the same purpose.

Further distinctions may be drawn between different types of subsidiarity as observable amongst Community Member States and elsewhere. *De jure* or mandatory subsidiarity may be said to exist where there is explicit legal recognition that certain types or sets of decisions must be taken at lower level, and where an appeals mechanism exists to determine disputes. By contrast, *de facto* or voluntary subsidiarity relies on common or historical practice, which may occur by default, in that no decisions are made at higher level, so that smaller units are “forced” to take action; or higher authority may explicitly devolve decision-making powers, while retaining the right to take back these powers with or without notice.

### **2.3 The Political Analysis of Subsidiarity**

This study applies primarily a normative approach to subsidiarity. However, it may be worthwhile to pay some attention to the political and ideological conditions under which catchword such as subsidiarity was able to acquire its contemporary legal significance and to its function in the process of European integration. Kersbergen and Verbeek (1994) argue that an *“analysis of the politics of subsidiarity may not only clarify the evolution of the subsidiarity on the European agenda, the timing of its adoption and distinctive formula that was eventually chosen, but will also allow for a consideration of some possible consequences of the adoption of subsidiarity.”*

According to Kersbergen and Verbeek (1994), Christian Democratic members of the European Parliament put the theory of subsidiarity on the European political agenda in the 1970s. The authors observe that this was motivated by the effort to enlarge the competence of the European Commission, and it was only in the 1990s that subsidiarity evolved into a principle of curbing of the potential expansion of the power of the Commission. The latter use of the concept played a decisive role in the success of Maastricht Conference and in the ultimately successful efforts to dispel widespread popular concern about the Maastricht Treaty (Schilling 1995). It has even been suggested (Cass, 1992) that subsidiarity was the word that made the Maastricht Treaty possible. Since that Treaty sealed the creation of the economic and monetary union, which represents a significant move towards EU centralisation, there was a need for countervailing forces.

Golub (1996) observes: *“As has often been the case during times of significant change in the Community, actors with seemingly irreconcilable views avoided deadlock by agreeing upon language with multiple meanings. Inclusion of the subsidiarity principle in the treaty simultaneously satisfied those who sought to limit or even reverse the accretion power in Brussels and those who favoured re-inforcing Community authority”*. A minimal definition on subsidiarity *“was a touch of genius”* that permitted political actors to present an accord despite almost insuperable ideological disagreements. At Member State level, defendants of more authority at the Community level such as France and Germany, and opponents of such developments such as the UK, both cheered adoption of the subsidiarity principle (Kersbergen and Verbeek, (1994).

According to de Búrca (1999), the reasons for the introduction of subsidiarity as a formal norm of EU law include the fear of excessive centralisation and of the inexorable increase of Community action and influence: *“It was partly a combination of ... concerns over the loss of political authority at Member State level, over the negative impact on domestic political life of the perceived degree of adequate political community at EU level, which influenced the decision to introduce subsidiarity as a formal norm into the EC Treaty in 1992”* (De Búrca, 1999, p. 12).

According to the Amsterdam Protocol: *"The criteria referred to in the second paragraph of Article 3b of the Treaty shall relate to areas for which the Community does not have exclusive competence"*. The CAP is generally assumed not to fall within this category (see below for discussion). Hence, from the formal point of view, the CAP does not qualify for an assessment from the point of view of subsidiarity. However, the Protocol also states that *"Subsidiarity is a dynamic concept and should be applied in the light of the objectives set out in the Treaty."* Moreover, as argued by the Commission (1999a) in its *Better Lawmaking* report to the Council: *"We have to continue to ask ourselves the question whether the proposed action cannot be tackled well enough by the Member States and whether the task should instead be addressed at Community level. The answer will of course depend on circumstances and needs. This is why Article 3 of the protocol on the application of the principles of subsidiarity and proportionality annexed to the EC Treaty ... indicates that subsidiarity is a dynamic concept"*.

Taking this view of subsidiarity, it is difficult to find convincing arguments for restricting the application of the concept only to the present distribution of competencies. In the introductory chapter, while motivating our study, we identified several changes altering the underlying dynamics of agricultural policy making: the changing nature of agriculture, emerging new priorities for agricultural policy, re-instrumentation of the CAP, and last but not least the challenge of enlargement.

The Commission itself identifies the enlargement as a fundamental circumstance in assessing subsidiarity. *"Looked at from another point of view, subsidiarity will assume crucial importance in the context of enlargement. The fundamental question is what implications will enlargement have on common policies? The further enlargement goes, the harder it will get to define what really has to be addressed at European level. This is something we should be giving serious consideration, and the principle of subsidiarity will be our guide. Clearly, people will only accept Europe as a legitimate entity if there is a flexible and evolutionary vision of subsidiarity. The Union's priorities must be dynamic, not fixed in stone, and the terms and breadth of its action must be calibrated with flexibility and detail"* (European Commission, 1999a).

Existing legislation is not the product of a consistent application of the principle. According to the CEPR study (1993), the requirement of unanimity has meant that the extension of competence has been guided by political opportunities rather than by any explicit economic or legal principle. Golub (1996) argues that states often implicitly invoked the principle of subsidiarity to achieve the short-term political goal of killing a proposal to act in relation to a problem which they felt should be addressed nationally but subsidiarity was not really deployed strategically to build a coherently structured *acquis communautaire*. Hence, it is difficult to find any rational argument against reconsidering of existing legislation from a subsidiarity point of view. Why should the present distribution of competences, being a product of more or less accidental historical development, once and for all pre-empt possibilities of assessment of a policy in a specific field from the point of view of subsidiarity?

Moreover, even if the present allocation of competence would have been a result of past applications of the principle, circumstances could have since changed in ways which suggest that the legislation be repealed or amended (as we argue in chapter 1 is the case for the CAP), or that the institutions simply erred in their judgement that they needed to act in place of the States (Weiler 1997). In addition, although the subsidiarity provision of the Maastricht Treaty requires only prospective application of the principle, Wieler argues that consensus in political and academic quarters alike is that the institutions should also re-examine legislation already on the books. Moreover, the principle of subsidiarity may demand retroactive application for consistency's sake. *"The Community may find it awkward to enforce existing legislation when analogous proposals for future legislation are being amended, withdrawn or defeated (or new legislation possibly even invalidated) on subsidiarity grounds"* (Weiler, 1997).

It is well known that areas that can be covered by exclusive Community competences are nowhere explicitly defined. Schilling (1995) discusses *inter alia* whether the legislative competences for the establishment of a common organization of agricultural markets (Article 40(2) Treaty of Rome) are exclusive. As far as the establishment of a common organization of agricultural markets is concerned, the Community competence is exclusive with the minimal contents of paragraph (a) of Article 40(2)



only. The exercise of Community competence is prescribed only in the limits of this paragraph, and, therefore, irreversible only within these limits. Moreover, “... of the Community competences granted to achieve a certain end, only the competences to establish a common customs tariff, a common commercial policy and common rules on competition in the framework of the common agricultural policy can be considered as exclusive” (Schilling, 1995).

This is not the place to discuss all the legal aspects of this issue, but from the economic view it is important to discuss all policy areas from the angle of subsidiarity. Legal expertise also takes this stance. Van den Bergh (1999) argues that “In the era of ever expanding European law, which increasingly limits the scope for legislative action by Member States, it is necessary to ask fundamental questions about the role European institutions are playing and about their capacity to exercise the powers they enjoy in a way that enhances economic welfare”. Similarly, according to de Búrca (1999), the relevance of subsidiarity inquiry cannot be restricted by defining general policy areas such as agriculture, free movement of goods etc., and deeming them to be either for the Community alone or for the Member States to decide on. “Particular policy issues need to be dealt with as they arise, and the question whether a particular issue should be decided at national level or at Community level – or indeed at any other level of political authority, regional, transnational, local or international – will best be addressed individually on their own merits rather than by categorisation in advance within broad spheres.” (p. 8).

A common situation in the EU is that Member States must submit plans (such as rural development programmes) for Commission and/or Council approval. In this case, subsidiarity depends on where “the decision” is said to lie: with the drafters of the proposals, who determine criteria, boundaries, etc. (often within EU limits), or at EU level when approval is finally given, perhaps after several revisions. The realisation that economic and policy decisions are seldom made in isolation over time or in context, but form part of a decision-making *process*, contrasts with the simpler legal approach, and further complicates the discussion of subsidiarity.



# 3

## Subsidiarity in the CAP to date

### 3.1 Introduction

The Common Agricultural Policy (CAP) was the first European policy and remains, alongside EMU, the most far-reaching. In line with the EU arrangements outlined in Chapter 1, the Commission enjoys the sole right of proposing CAP legislation in the EU. In the Council of (Agricultural) Ministers, as the central legislative body of the EU, CAP legislation is agreed by qualified majority voting, subject to the “Luxembourg compromise” which allows Member States to exercise an effective veto if their “very important interests” are concerned. The details of the various Council regulations are in practice implemented by the Commission after consultation with Member States and consideration within the various Management Committees staffed by the Member States and chaired by the Commission.

By its very name, the *Common* Agricultural Policy (CAP) implies a single set of measures operated by a centralised authority. However, the significance of the original CAP, as it was established in the Treaty of Rome as the only mandatory policy of the newly created European Economic Community, went much further. The CAP permitted the very formation of the EEC by establishing the necessary *quid pro quo* for removal of barriers to internal trade, notably across the Franco-German border, thus creating a “common market” in at least manufactures and foodstuffs.

Of course, the CAP has never been a completely common or centralised policy. As observed by Wilkinson (in Kjeldahl and Tracy, 1994), “... *common prices were often far from common due to decisions reflecting national objectives*”. Moreover, the CAP never had the ambition to remove the need for all national agricultural measures. The Community has always allowed Member States considerable freedom regarding national aid in measures which are de-coupled from commodity markets, and which provide durable benefits. At the request of Member States, and with a degree of co-financing, short-term disaster relief has been available from EU funds in cases of severe agricultural crises such as widespread flooding and disease outbreaks. The use of national tax systems to influence

farm income support in particular Member States (e.g. Germany) has been widespread. It is possible to trade milk quotas within member countries but not across national boundaries (Gant 1995). All these features indicate current features of subsidiarity in the CAP.

The nature of the original CAP, as determined by the Stresa Conference in 1958, emphasised its role as a "cornerstone" of the EU by constructing a set of "common market organisations." These involved support for market prices of farm commodities by means of variable import levies and (eventually) a Commission-controlled system of "intervention" stocks and export subsidies. The Council of Ministers annually considered a set of Commission proposals for "target", "basic" and other official support prices fixed in a common (if artificial) currency - the "unit of account", later to become the Ecu, and then the Euro - for most agricultural commodities<sup>5</sup>. Thus the CAP between the 1960s and the 1990s was born as a top-down system of support for market prices on a Community-wide level.

The CAP is financed by the European Agricultural Guidance and Guarantee Fund (EAGGF, or FEOGA by its French title) of the EU budget, which is made up primarily from direct Member State (i.e. taxpayer) contributions, plus import tariffs, including those on agricultural products. The Agricultural Fund finances in full (i.e. 100%) the expenditures on intervention purchases, export subsidies, and most other market aids (such as consumer subsidies), and also the more recent direct (compensatory) payments to farmers. CAP funding is thus rather fully centralised, and, since the Agricultural Fund takes up about 50% of the total EU budget, any changes in this situation are of crucial significance.

The present CAP relies on complicated legislative machinery and a large bureaucracy. Not only are several levels of legislation involved, but regulations are also very detailed, requiring much consideration at both

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<sup>5</sup> The original CAP covered the main farm products such as cereals and most other arable crops including sugar, dairy products, most livestock and meats, and several "Mediterranean products", e.g. wine, olive oil and some fruits. A theoretically common sheep and goat meat regime was introduced in 1980. Farm products *not* covered by a CAP commodity market regime (but of course subject to Community legislation as regards internal and border health regulations) include potatoes, several fruits and vegetables (many of significance to countries in Central Europe), and (as an "industrial product") wool.

EU and national level. Council and Commission regulations set out in great detail how policies should be implemented.

### **Box 3.1 Main features of the present CAP**

*The common market organisations for agricultural products in the CAP rest on three principles*

- *A common market with common administrative prices*
- *Community preference, i.e. domestic production should have preference over imported goods*
- *Common financing*

*Market prices are supported by import protection (tariffs, levies and quotas), intervention purchasing into public stocks, and export subsidies ("restitutions"). Even after the reductions made in the 1992 and 2000 reforms, internal EU prices for most farm commodities are still, on average, higher than world market prices, and for many products there is surplus production (sometimes after taking into account preferential imports, e.g. of sugar and beef). To avoid undermining price support, these surpluses must be removed from the market by intervention storage (which can only be temporary) or exported, preferably at times and to destinations that minimise the necessary subsidy expenditure.*

*While, prior to the reform, the consumers shouldered the heaviest burden of the support to agriculture as prices, the taxpayers' contribution has increased considerably. Formerly, taxpayers had to bear the burden through the financing of the intervention system and the excess supply sold on the world market, and the ratio of taxpayer to consumer cost was about 30:70. With the introduction of direct "compensatory" payments, the taxpayer burden has increased, and the ratio has altered to around 50:50. After the Agenda 2000 reforms, about 40 per cent of EU farmers' income (from farming) in the cereal sector comes from direct income support.*

*Compensatory/direct payments are intended to offset (although not fully) the loss of income due to reduced support prices. For arable crops, they are paid per hectare. For each member state, compensation is payable for notional production from a national base area of cultivation using a reference yield level. The compensation is 63 euros per tonne of cereals, and is conditional upon participation in a scheme of arable land set-aside (currently 10%). Small-scale producers – those that produce a maximum of 92 tonnes of cereals per year – are exempt from set-aside. Farmers receive direct payments not only on the land cultivated but also on set-aside areas. In addition, all farmers receiving direct payments must agree to respect environmental rules decided nationally. The same type of system applies to grazing livestock, i.e. mainly beef cattle and sheep (and dairy cows following Agenda 2000 decisions).*

National legislation only serves to fill in the details that are not spelled out in Council and Commission regulations. It is possible to make national derogations from Community rules, but Commission must approve such derogations either *ex ante* or sometimes *ex post*.

Alternative approaches to an agricultural policy for the new Community were theoretically possible. A system of deficiency payments (supplements to market prices, paid directly to farmers, and increasing their gross returns to a pre-determined guaranteed level), such as that operated by the United Kingdom before joining the EEC, could have been adopted. However, this would have required major budgetary resources, and complex administrative systems not then in existence in the six original Member States. Extensive input subsidies, on fuel, animal feed, farm investments and even land and labour, might have been chosen (as is now seen in some Central European countries), but again would have needed major funding, and would have allocated support (even more) unevenly amongst Community farmers.

Again, a "structural" approach to the farming industry would have meant major support for capital investment, land holding reorganisation and farmer retirement. These measures have indeed been adopted in part, as part of the Guidance Section of the EU's Agricultural Fund, but the defeat of the Mansholt Plan indicated the limits to this approach. Finally, a system of direct income payments to farmers based on need or some other form of "entitlement" might have been adopted in the early years; but again this would have had major funding and bureaucratic implications.

The various decision-making powers related to the CAP can be categorised as:

Market instruments: prices, supply control, tariffs, and export subsidies. Nearly all these are *not* "subsidarised". Exceptions include 'green' agri-money (with which countries could maintain different support prices), and implementation of quotas and set-aside, where national options exist.

Direct payments: e.g. less favoured areas, national (Sweden/Austria), compensatory (MacSharry/Agenda 2000), agri-environmental and "rural development". The definition of the eligibility characteristics of these payments represent a degree of subsidiarity, in terms of the regions and farm types defined, the nature and targets (on both "tax" and expenditure sides) of modulation, etc.

Structural funds: e.g. processing and marketing schemes, and 'Objective' programmes. Member states have much freedom to determine the extent, level and nature (e.g. grants or loans) of expenditure from these funds within their borders.

The rest of the *acquis communautaire* (technical standards, etc.): Derogations (e.g. for slaughterhouse conditions) represent an example of partial subsidiarity. Standards can be "common", harmonised (within a range) or mutually accepted.

Each of these aspects is treated in more detail below.

### **3.2 Market Instruments**

*Price support* in the CAP is subject to EU-level decision. The Council of Ministers decides on support prices on a proposal from the Commission. Formerly, prices were set every year, but in recent years, a multiannual decision has set prices for a longer period, e.g. up to 2006 in Agenda 2000.

As outlined above, the basic principle of a common market organisation for agricultural products has limited the scope for subsidiarity in this core characteristic of the CAP. Nevertheless, a number of exceptions have been created (or have existed since the start of the CAP) to take account of national demands for special treatment. Some of these have at times threatened to undermine the very CAP itself. Neville-Rolfe (1984, p. 5) goes so far as to call common pricing a "particularly frail" pillar of the CAP.

The main departure from common pricing and towards national pricing has been the system of agri-monetary or "green" prices which allowed Member States to set support price levels different from the "central"

level. As is related at length elsewhere (e.g. Harris, Swinbank and Wilkinson, 1984), green currencies were invented in 1969, after only a few months of common pricing. They were applied to cereals, beef and veal, and to dairy products, when the French franc was devalued within the post-war Bretton Woods system of fixed exchange rates, and the German deutschmark was revalued. Without further action, this would have implied that CAP support prices (and thus market prices also) would have risen in France and would have fallen in Germany. For various reasons, both countries decided that they could not allow this to happen, and continued to apply the old exchange rates against the then common “unit of account” for the purpose (*inter alia*) of intervention purchases and external trade measures. However, the resulting price differentials between the two countries (and with other Member States such as Italy) would have led to major trade distortions. Thus, new border taxes and subsidies called “monetary compensatory amounts”, or MCAs, were introduced to restore the value of exports and imports of farm products to the “common” level at internal EEC borders (with two MCAs applicable to Franco-German trade flows).

Over time, many complicated adjustments were made to the agri-monetary system, mainly in attempts to limit its scope (e.g. to enforce gradual transition back to a single level, and to exclude certain products) and to take account of complexities such as third-country trade. However, the extreme instability of international exchange rates during the 1970s continually increased or added to existing MCAs, with a price differential of over 40 per cent existing at times between certain Member States. Interestingly, the budgeting of MCAs, i.e. the funding of MCA subsidies and the receipt of MCA taxes, was kept part of the Agricultural Fund, while the Commission held the initiative in proposing changes to the artificial “green” rates, though only back towards the common level.

From a decision-making point of view, the agri-monetary system allowed countries to protect their agricultural sectors, at least for a time, from some of the unwelcome consequences of a currency evaluation or revaluation, and hence provides a clear example of subsidiarity. Domestic political arguments – both at the time of currency changes, and subsequently, when green rate adjustments became possible at subsequent



price-fixings – could be more easily dealt with, perhaps not least because of the increasingly complicated nature of the system, which tended to obscure realities from home constituents. However, the economics of the system are clearly opposed to the operation of the principle of comparative advantage that underlies the EU as a whole and is enshrined in the Article 39 of the Treaty of Rome as regards the CAP itself. In more practical terms, as Harris, Swinbank and Wilkinson (1984) note, “the critical question becomes: at what level are [common] prices to be harmonised?”. In effect, the agri-monetary system avoided the need for a clear answer to this basic question, but the effect of this partly decentralised decision-making was to raise the average support price, by between 10 and 15 per cent.

The achievement of the Single Market in 1992, with abolition of regular internal border controls, made it impossible to operate the agri-monetary system in respect of price levels, since MCAs could not be collected. However, the use of “old” exchange rates in converting Ecu-denominated aids into national currencies continued as regards direct payments, at least for those countries which benefited thereby, i.e. those whose currencies had devalued. The introduction of the Euro in 1999 has meant the virtual discontinuance of the agri-monetary system. Member States whose currencies have been fixed against the Euro and each other now have no scope for using devaluations or revaluations, while for “non-participating” countries the market value of their currencies – usually, at a particular time of year, to fix direct subsidy rates - will be used.

The other market price instruments of the CAP – external tariffs and export subsidies – have been virtually unaffected by subsidiarity, due to the need to maintain a common front in international GATT (now WTO) negotiations, from a legal as well as a economic and political standpoint. Hence different national levels of tariffs have been impossible. Export subsidies have always been a more *ad hoc* type of CAP instrument, and it might be argued that the use of this instrument has favoured one Member State over another by the type or timing of particular decisions. However, these decisions have been made in the Management Committees, i.e. centrally.

The well-known failure of CAP price support to meet its Rome Treaty objectives without excessive budget cost has been well documented. The main policy response since the 1980s has been supply control, notably in the form of milk marketing quotas, and later set-aside for arable crops. In principle, the application of maximum permitted supplies could be carried out on a strictly centralised (i.e. common) formula, with no scope for national decision-making, or even influence. In practice, various adjustments have had to be made in response to pressures from various Member States, e.g. special quota “awards” such as extra milk quota to Ireland, or forage maize area for France, and sometimes these have taken the form of devolved decision-making powers. One example is the choice of method for applying milk quota, either at dairy cooperative level, or at individual farm level. Clearly Member States will use whatever method suits them better. The absence of cross-border trade in milk quota might be taken as an example of subsidiarity, except that the Commission itself was originally hotly opposed to any quota trade at all. On the other hand, the rules on inter-regional quota trade (“ring-fencing”) within Member States are determined by countries themselves.

### **3.3 Direct Payments**

*Compensatory/direct payments.* Although some forms of direct payments - rather than indirect market support instruments - have existed in the CAP for many years, they grew to major prominence in the 1992 MacSharry reforms, and were again increased in value and extent in the Agenda 2000 reforms. Council decisions and Commission regulations set the rules for direct payments, while Member States’ agencies make the actual payments to beneficiaries in accordance with these Community rules. Since the payments constitute, by definition, compensation for price reductions, the amount that each Member State has at its disposal is given by a “technical calculation”. The calculation is based on the cultivated area in each Member State in the base period (1989-91) multiplied by the average yield per hectare in 1986-90 (decided at the EU level). Sweden has thus a base area of 1,737 million ha that should not be exceeded, and an average yield of 4.02 tonnes per hectare. If the national base is exceeded, every farmer sees his/her eligible area reduced.

Member States have some discretionary power when it comes to deciding on the specifics of direct payments to farmers. As in the case with the calculation of the aggregate figure for individual Member States, it should in principle be a technical question of calculating how much every farmer loses through the price cuts. However, this would require an enormous administrative burden and detailed data such as production figures for individual farms. Thus, in practice, compensation to the individual farmer is calculated on average acreage yield in the region in which he/she is located. The subdivision of the total national area into regions is made by individual Member States but has to be approved by the EU.

The relevant legislation (EC Regulation No 1251/1999) reads as follows:

*For the purpose of setting average yields to be used for calculation of the area payment, each Member State shall establish a regionalisation plan setting out the relevant criteria for determination of the separate production regions in order to arrive at distinct homogenous areas. With this in mind, Member States shall take due account of specific situations in drawing up regionalisation plans. They may in particular adjust average yields in line with any structural differences between production regions.*

The formulation “in line with any structural differences between production regions” provides freedom for Member States to differentiate payments according to the geographical location of farmers, subject of course to the approval of the Commission. Member States have adopted very different approaches to arrive at definitions of “homogenous areas”. At the one extreme, the whole of Denmark is a homogenous area. Every Danish farmer receives the same compensatory payment per hectare irrespective of where the farm is located. At the other, Italy has a large number of “homogeneous regions” and as many hectare payments. However, only two countries, France and Sweden, have made use of the possibility to make adjustment in line with “any structural differences between production regions”.

*Sweden is divided into six "homogeneous areas" (five up to 1999) and the adjustment due to "structural differences" took the form of over-compensation of farmers in areas with low average yields (in Northern Sweden) by detracting from areas with higher than average yields (Southern Sweden). There is thus a non-negligible element of regional redistribution in the distribution of compensatory payments in Sweden. This resulted from a purely domestic political decision.*

With the introduction of *modulation* in Agenda 2000 (see Section 6.7), Member States' decision-making power over direct payments has further increased. While the MacSharry reforms of 1992, as just mentioned, opened up an opportunity for some differential application of direct payments in different Member States, a common system of payment rates has, to a large extent, been applied across the Member States. This has been extended (mainly via increased payment rates) in the Agenda 2000 reforms. But, in the latter, the application of "modulation", i.e. the re-direction of "high" direct payment totals to agri-environmental and other targets, allows Member States to propose to the Commission their own rules for the criteria to be adopted in both the definition and the application of these funds. Modulation thus represents a significant element of decentralisation. Up to 20 per cent of the national amount of direct payments can be redirected by Member States. Still, the beneficiaries of the redirected payments have to be farmers.

The responsibility for *administering* direct payments is national. Farmers apply for direct payments nationally. In Sweden, the County Administrative Board (*Länsstyrelsen*) handles applications, carries out the necessary administrative controls and takes the actual decision on payments. The National Board of Agriculture designs the rules and instructions that the County Boards have to follow, and makes the actual payments to the farmers. The Commission closely monitors Member states' administration of payments.

As with production quotas, the various types of direct payments to farmers that exist within the CAP have opened up opportunities for national decision-making within an EU framework. The earliest forms of these payments – to certain Mediterranean crop producers on the basis

of their areas – allowed little scope for manoeuvre except the securing of the system for specific enterprise types in the first place, and perhaps some statistical juggling thereafter. However, the introduction of “less favoured areas” (LFAs) in Directive 75/268 gave much more scope, including variable levels of co-financing, which was fixed at 25 per cent FEOGA reimbursement for all (of nine) Member States except Italy and Ireland (35 per cent).

Moreover, Member States were given rather wide scope for designating LFAs, both by the various definitions contained in the Directive, and in subsequent national proposals for Commission approval. In later years, LFAs were extended by request from several Member States. The Commission has clearly come to feel that the system has got out of hand, and needs to be brought under firmer central control, at least in terms of objectives and eligibility (e.g. according to environmental criteria) if not in terms of area designation. Following Agenda 2000, there are several areas of current discussion surrounding regional area payments such as LFA compensatory amounts. One example is in Scotland, where the long-standing requests from deer producers to have their animals included alongside cattle and sheep may be agreed to.

The reform of the Agricultural and Structural Funds as part of the Agenda 2000 package has introduced new elements of national decision-making, or at least proposal-making, in the form of rural development measures. Council Regulation 1257/1999 consolidates and updates many of the older measures on farm investment, marketing and restructuring, and the MacSharry “accompanying” measures on the agri-environment, farm forestry and young and older farmers. In most of these areas, Member States must bring forward for Commission approval national or regional schemes to implement the broad aims of the Regulation. Rural development plans for nearly 50% of EU countries and regions were approved for Structural Funding by the STAR committee by mid-August 2000 (*Agra Europe*, 15 September). Few problems of Commission approval have arisen during this exercise of subsidiarity.

### 3.4 Agri-environmental Measures

Potter (1998, p.105) has commented that “[t]he entry of the EU into agri-environmental policy-making came comparatively late in the day”, i.e. not until the mid-1980s, when, as part of the new agricultural policy, Regulation 797/85 permitted (but did not force) Member States to grant aids to farmers in environmentally sensitive areas “to encourage the introduction or continued use of agricultural production techniques compatible with the requirements of conserving the natural habitat and ensuring adequate incomes for farmers” (Commission, annual 1985, p.92). Regulation 1760/87 authorised a 25% reimbursement from Community funds – a move away from complete nationalisation. Over the next five years, Germany, Italy, Denmark and the Netherlands enrolled farmland in significant amounts (relative to their national farmed areas) under the 797/85 scheme, often based on pre-existing national measures. In France, the new EU legislation was regarded much less favourably, and not exploited to any great extent until the 1990s, when it became to be seen as a method of maintaining farm incomes (as indeed stated in the Regulation). The episode clearly indicates the possibilities of “voluntary” agricultural subsidiarity, including those of widening the scope of the CAP and of reluctance (whether mistaken or otherwise) by individual Member States to exploit opportunities.

The “accompanying” Regulation 2078/92 within the MacSharry CAP reforms introduced a new set of co-financed agri-environmental schemes, alongside other schemes for aid for afforestation and early farmer retirement. Under Regulation 2078, all Member States were required to implement “multiannual zonal programmes”, providing aid to farmers who undertook to carry out one of the following requirements:

- substantially reduced agri-chemical use, or organic farming
- more extensive crop or livestock production
- environmentally friendly farming practices
- upkeep of abandoned land
- long-term environmental set-aside
- land management for public access and leisure activities.

The breadth of the list reflects the different priorities and opportunities in different Member States. For instance, France wanted a focus on abandoned land, in order to hinder “desertification” of rural areas. In Southern Member States, the new agri-environmental policy was seen as a more “horizontal” income-boosting measure (Potter, 1998, p.118). According to a Commission official (Wilkinson, 1994, as quoted by Potter, 1998, p. 123), the decentralised and permissive nature of the Reg. 2078 programme was a cause for concern, threatening an “embattled agricultural policy, allowing each Member State to support its farmers according to national objectives”. Tangermann (quoted in Potter, p 123) agreed in detecting “a strong tendency” to utilise (i.e. distort?) the new measures in an effort to sustain agricultural expenditure. However, Potter (1998, p. 123) considers that “[a]ctual evidence for this subtle subversion of agri-environmental policy is not easy to find”, but that “a price appears to have been paid in terms of a loss of central administrative control”. He suggests that “a game is being played which has as one of its objectives the maximisation of EC receipts” (which is surely not an acceptable policy aim). Possibly this is a feature of the inherently complicated business of the agri-environment, where it is not clear if (e.g.) reductions in fertiliser use are unequivocally beneficial to the environment, or whether land should or should not be abandoned. On the other hand, it may be an inevitable aspect of any exercise of subsidiarity in agricultural policy.

Preparation of the environmental programmes is via five-year programmes, prepared by national governments, and co-financed on a 50:50 basis for most Member States. The implementation of the Regulation involves extensive monitoring and if necessary control by the Commission, with associated costs. Farmers are primary beneficiaries of this type of support. The diversity of programmes that have been applied under Reg. 2078/92 appears substantial. In the Netherlands, for instance, 65% of the entire Regulation 2078 budget has been devoted to demonstration projects and training courses for farmers (see Deblitz and Plankl, 1998). Often-used measures include conversion to organic farming, reduction of inputs, protection and maintenance of local breeds, maintenance of extensive grassland, conservation of areas with biologically rich habitats.

Moreover, the scope of agri-environmental measures is not the same in all countries: for instance, in Italy, measures related to forest (EU Reg. 2080) were considered as part of the global agri-environmental scheme. In France, general measures (*prime à l'herbe*) are used, with management linked to the common frame of support premiums (Skerratt *et al.*).

Great diversity can also be observed with respect to institutional procedures, used in operating Reg. 2078, with significant variations according to Member States. There is an important difference between national schemes, with a country-wide menu of measures, and local schemes (ESAs in UK; *opérations locales* in France) in which the menu of measures and procedures are locally defined. In the French context, for instance, some schemes (*prime à l'herbe*) are prescribed by administrative procedures and application conditions, with no place for negotiation, whereas for other schemes (*opérations locales*), much of the effective content is linked to local negotiations and adaptation to specific contexts (Skerratt *et al.*).

Concerning the general application of agri-environmental regulations, Member States can choose either to delegate to the regional authorities, or to keep some national schemes, managed directly by the central government. In either case, however, the state can retain a degree of control on the financial commitment and have practical ways of managing the framework (Skerratt *et al.*).

### **3.5 Structural Instruments**

The main example of subsidiarity in the CAP as a whole has existed within various frameworks since the 1960s in the form of agricultural structural policy, in which expenditures have been funded on a fixed cost-sharing basis by the EU budget (the "Guidance" Section of the EAGGF) and the appropriate national budget. Despite the labels "structural" and "guidance", the purposes and therefore the allowable uses of these funds have varied widely. Originally, the funding was intended for investment in farm and farm-related enterprises (e.g. land improvement, holding amalgamation, farmer retirement, as in the still-born Mansholt Plan of 1969) or food processing and marketing.



Some of the Mansholt proposals were included in much-reduced form in the 1972 structural Directives 72/159-161, dealing with farm modernisation, farm cessation and land reallocation, and socio-economic guidance, respectively. Unlike the earlier Regulations, these Directives involved national legislation (sometimes modified, sometimes new) as regards implementation. "[I]n practice, the performance of the Member States [was] highly variable" (Harris, Swinbank and Wilkinson, 1984, p. 222-3), and "it is difficult to discern a consensus view amongst the Member States that the directives should be enthusiastically supported".

Shortly after the (transitional) enlargement to include the United Kingdom, Ireland and Denmark, the scope of co-funded structural policy was widened to include extra area and livestock payments to farmers in less favoured areas, for the primary purpose of "the continuation of farming, thereby maintaining a minimum population level or conserving the countryside" (Directive 75/268). On-farm investment was increasingly linked to whole-farm development plans for particular groups of producers (e.g. young farmers) and away from eligible items such as tractors and dairy buildings. In the later 1970s, dissatisfaction with these farm- and farming-specific instruments led to the "integrated" development and Mediterranean programmes, which included all three structural funds (agric. "guidance", regional and social) for particular regions.

Other structural measures included support for producer organisations, commodity-specific measures (often to discourage the supply of products in surplus), and funding for information networks.

### **3.6 Other Measures**

As well as its array of market support and direct payment measures, the CAP involves a vast range of quality, safety and other legislation which is intended to secure the operation of the Single Market in farm and food commodities, and the protection of animal and human health. Harris, Swinbank and Wilkinson (1984) comment that "[f]ew activities of the European Community have led to more controversy than has its activities in the realm of food legislation" - a statement even more true today than 16 years ago. In addition to the original measures over provisions for regulating intra-Community trade both in normal and abnormal

situations, numerous pieces of legislation have been adopted to cover labelling, certification, animal welfare, etc. The legal and administrative frameworks are highly complex and often cumbersome, due at least partly to the need to consult widely with the farming and food industry over “once-for-all” changes, and the highly technical nature of the scientific criteria to be employed in setting and comparing standards.

While agricultural policies in the EU are predominantly common, there are also significant measures that are decided upon by individual Member States. Some of these measures must be submitted annually for Commission approval as “state aids”. Measures that are funded by Member States themselves include agricultural advice and extension, vocational training, R&D policies, infrastructural investment, soil improvement, environmental enhancement, compensation for natural disasters, and various social security schemes.

Evidence on Member States’ aid to agriculture is scarce and incomplete. But various sources agree that expenditures on agriculture, in individual member countries are considerable when compared to CAP expenditure. Both in absolute terms and as a percentage of gross value added in agriculture, national aids have been fairly constant over time (van der Zee 1997).

**Table 3.1: National Aids as Shares of Gross Value Added in Agriculture, 1988-90**

<b>B</b>	<b>Dk</b>	<b>FRG</b>	<b>Gr</b>	<b>E</b>	<b>F</b>	
8.5	8.1	20.0	3.2	1.3	9.0	
<b>Ir</b>	<b>It</b>	<b>Lux</b>	<b>Nl</b>	<b>P</b>	<b>UK</b>	<b>EC-12</b>
4.4	12.9	15.5	6.4	10.1	8.6	9.6

*Source: van der Zee (1997), App. 8.8.*

### 3.7 Concluding Comments

The above account of the EU’s Common Agricultural Policy in the light of the concept of subsidiarity shows the increasing importance of the latter concept as the problems of applying a centrally controlled and uniform policy across an increasing number of Member States became apparent. Admittedly, the original CAP was put to a severe test in the early

1970s by the market turmoil of that time and the entry of the UK and two other countries with systems of agricultural support very different from that in the Six. The solution found was not to alter the basic instrument of market price support, but to give Member States a restricted ability to request modifications to the level of that support, subsequent to exchange rate movements. Derogations awarded to entrant states were mostly time-limited, and pressure was exerted to “harmonise” these different measures with those of the mainstream CAP, if not to abolish them altogether.

Only slowly did the idea of national freedom to design and implement individual national instruments of agricultural policy take place. Partly, this was because agricultural structural policy – which required countries to propose individual grant schemes and programmes which complied with rather general EC Directives – was restricted to a small percentage of the overall FEOGA budget. Further subsidiarity in agricultural policy accompanied the beginnings of agri-environmental policy, first by purely national measures, and then by pilot EC schemes such as voluntary set-aside and farm woodlands.

With the MacSharry reforms, further opportunities for subsidiarity became available with the direct payments to farmers. However, few efforts were made to exploit these opportunities. A number of reasons may be suggested for this reluctance. First, the 1992 CAP reform legislation was agreed under great pressure in terms of both the EU budget and the faltering Uruguay Round, and allowed little flexibility to individual countries. Second, the reforms were complicated enough in themselves without further difficulties in national decision-making, which might also have strained ministerial responsibilities, budgets and boundaries, e.g. between agricultural and environmental departments. Third, Member State governments may have been reluctant to lay themselves open to accusations of favouring or disfavouring their own farmers by setting up special subsidy systems open to challenge from Brussels and/or other Member States, or their own farming constituents, respectively. Although Agenda 2000 has further widened the scope for national decision-making in terms of modulation and national envelopes, Member States have so far not taken full advantage of this extension.

In recent years, a succession of European “food scares”, such as those regarding bovine spongiform encephalopathy (BSE or “mad cow” disease), swine vesicular disease (SVD) and *E. coli* 157 infection, have resulted in much greater policy attention being paid to product safety in the EU food supply chain. In addition, the desirability of fostering higher quality in European food and drink, with the objective of improving the competitiveness of EU food production both at home and in third countries, is being actively promoted. Both these new policy areas have affected the CAP, though responsibility for food safety at EU level has been placed within the Directorate-General for Health and Consumer Protection, and with the proposed European Food Authority, rather than the Directorate-General for Agriculture and Rural Development.

With these new areas of EU policy come new questions of national *versus* EU decision-making, complicated by the need to make urgent decisions in the case of livestock disease or food contamination. In such cases, Member States must be able to take immediate action to limit health dangers. However, such action, or subsequent fines or compensation, affects the operations of the Single Market, and may have major trade and budgetary effects. Thus endorsement at EU level is necessary, using a pre-determined notification and approval procedure. Politically, the situation of *ex post* consideration at EU level is quite different from the *ex ante* procedure of Commission proposals for reform of market or direct subsidies being circulated for consideration at Member State and NGO level. Thus subsidiarity takes on a new form, with the Commission and Council being forced to decide on national decisions already taken.

Thus subsidiarity in the CAP to date has developed slowly and patchily, taking root not as a conscious strategy for CAP development, but as a consequence of switching support – mainly under WTO pressure – away from price support to direct payments. The “compensatory” nature of these payments has so far restricted their application both as regards eligibility (farmers only) and purpose (mainly farm development, diversification and product marketing, with little true rural development). However, with continuing reductions in price support in the current Agenda 2000 programme, and likely to intensify after the 2002 review, the time for further progress in this direction seems ripe.

# 4

## The Assessment of Subsidiarity in General

### 4.1 Approaches to Subsidiarity Evaluation

In Chapter 2, we discussed the allocation of power between Member States and the Community in fairly general terms, and we introduced the concept of subsidiarity. In Chapter 3, it was then shown that there has been an element of subsidiarity in the agricultural policies of the EU, despite the “communality” of the CAP. In the next chapter (5), we explicitly address the *rationale* for pursuing agricultural policies jointly. To be able to answer such a question, we need to establish a set of criteria to be used for the assessment, and this chapter is devoted to that purpose.

The answer to the question of why agricultural policies are actually pursued in common lies in the domain of political economy. But, as was stated in the introductory chapter, this report focuses on the *economic* aspects of the issue, and here we discuss criteria according to which the allocation of competence between the Member States and the Community could be examined and assessed, using concepts primarily from that (economics) discipline.

The principle of subsidiarity is a rule of governance in a multi-tier system, in our case consisting of the Community level and Member State level. There are different approaches to the question of appropriate allocation of competences. According to Dehousse (1998), two main avenues in the literature concerning the discussion on implementation of the principle of subsidiarity can be identified: firstly a substantive one, which primarily focuses on the definition of the conditions which should be met for the Community action to be justified; and secondly a procedural one, laying down the steps which must be taken by the institutions in undertaking their subsidiarity assessments. The Amsterdam Protocol tries to develop these two approaches in a parallel fashion. It lays down substantive guidelines as well as procedural requirements.

Gráinne de Búrca (1999) identifies three approaches, which are not necessarily mutually exclusive, to the question of the appropriate level for

any given type of policy. One focuses on *process*, and entails examining the type of decision-making procedure that is likely to take place at a particular level, and who the parties involved in such decision-making could be. A second approach focuses primarily on *outcome*. The relevant question would then be whether a decision taken or a policy formulated at a given level is likely to be *effective* in dealing with the issue it was assigned to address. A further aspect of the question of appropriateness relates to the *willingness* of particular political fora to take action in certain matters.

It could be claimed that the issue of which level of decision-making is appropriate for making a particular decision could be assessed by using criteria specified in the Amsterdam Treaty including the Protocol on subsidiarity and proportionality. However, it is not easy to apply the principle in a straightforward way. Schilling points out that it is unclear in which way criteria such as "sufficiently achieved" or "better achieved" are to be judged. Scharpf (1994) argues that, due to the extreme differences in the economic development and financial and administrative capacities of Member States, it may always be possible to argue that the objectives of the proposed actions cannot be sufficiently achieved by Member States. Moreover, there will hardly be any field of public policy for which it will not be possible to demonstrate a plausible connection to guarantee of free movements of goods, persons, services and capital.

Several studies on the allocation of power in the EU have focused mainly on the efficiency aspect, most commonly including economies of scale and spillovers, for instance Smith (1993, 1995) and Van den Bergh (1996). Earlier, the so-called Padoa-Schioppa report (1987) addressed the question of the relevant level of decision-making from an economic perspective.

The CEPR (1993) also has its focus on economic outcome/efficiency in its approach to subsidiarity. But the report includes also two additional criteria: equity or fairness in distribution, and political efficiency and accountability. The first and second of these could be said to be "traditional" economic criteria. But, according to the CEPR, it is also helpful to give explicit attention to accountability since there have been increasing

concerns over “government failure” and the “transaction costs” of public intervention. Persson, Roland and Tabellini (1997) take a similar approach as they discuss what the division of labour should be between national level and European level.

While, as stated by de Búrca, different approaches are not mutually exclusive, the approach followed in this report is focussed on the approach that emphasises *outcome* (or substance issues rather than procedural issues) and (economic) *efficiency* of policy formulated at a given level. Following the example of the CEPR report we will also add two additional criteria: equity and accountability. We will, moreover, follow the criteria used in the CEPR report fairly closely.

## 4.2 Economic Efficiency: Spillovers and Scale Economies

Let us start with the perceived benefits of centralised decision-making, in terms of economic welfare and resource allocation. Applying the principle of subsidiarity to an analysis of competition policy in the EU, Van den Bergh (1996) identified the following reasons in favour of centralisation: the need to cope with externalities (spillovers) between legal orders (in our case Member States), the possibility of achieving scale economies and transaction costs savings by extending the size of jurisdiction, and the danger of destructive competition between legislators. We consider similar arguments. In this section, we analyse spillovers and economies of scale.

*Externalities* or *policy spillovers*<sup>6</sup> provide the main economic efficiency argument for higher-tier assignment. These effects arise when the policy measures adopted at national level have economic effects that cross national boundaries and may in some cases have negative implications for living standards in other countries. Where actions of each national gov-

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<sup>6</sup> Spillover is a wider concept than *externality*. An *externality* arises whenever an individual's production or consumption decision directly affects the production or consumption of others *other than* through *market prices*. Spillovers include third-party effects that may operate through markets. An example of spillover can be taken from the discussion on macroeconomic co-ordination: if Country A increases public spending, this will lead to an increase in world-wide interest rates (we can assume that Country A is large or that we have a two-country world). Higher world-wide interest rates will affect investment etc. in Country B. This effect is not an externality (the effect on country B is through the effect on market interest rates) but *could* be used as an argument for centralising or co-ordinating fiscal policies. Agglomeration or knowledge spillovers between firms and industries are a well known feature of local/regional economic development.

ernment (or more general locality or legal order) have consequences which are felt outside its territory, it is unlikely that the policy decisions taken by national governments will fully reflect all the costs, and benefits of particular policy choices, in particular of non-residents are unlikely to be given adequate weighting (Smith 1993). In such a case, independent national policies will produce inefficient results. There is agreement in the literature that it is these sorts of effects that can motivate centralisation.

Olson (1969) argues that the government function should cover a sufficiently large area to include within its boundaries all those people likely to be significantly affected by its policy decisions. In particular, production of public goods should be attributed to the level of government that has jurisdiction over the area in which that good is 'public'. Accordingly, goods that are public at the European level should be provided at that level, whereas the costs of public goods which benefit only a subset of the community should be borne by that subset (compare discussion in Føllesdal (1998).

*Economies of scale and scope.* Some public goods cost less or are more effective if provided by the centre than by several separate localities/states: national defence is an obvious example. Other examples could be the provision of research and development. A central authority may have a larger number of highly educated individuals and individuals with special expertise needed to formulate policies. Provision of standardized administrative procedures (including rules and instructions) can improve the quality of decisions by enhancing decision-making skills and administrative capacity. A related argument suggested by Van den Bergh (1996) is that scale economies may be important in the production of the information needed to formulate and/or enforce legal rules. Some information relevant to the entire EU can be most efficiently provided by Community institutions.

Administrative economies of scale and scope arise from the interaction of two opposing influences. On one hand, centralisation allows more specialisation and, hence, more gains from division of labour. On the other hand, the problem of communication and control will generally in-



crease more than proportionally with size. Generally speaking, larger the information content of policy implementation for example about local needs and circumstances, the greater will be the case for decentralisation (Smith 1993).

Moreover, there are also likely to be *diseconomies* of scale with centralisation. Common decision-making *per se* may be associated with costs. Speed and easiness of making corrections and alteration may be impaired. Thus, even if, from a purely theoretical perspective, a case can be made for centralisation, the practicalities needed in order to achieve centralisation may be such that there are in the end no efficiency gains to be made. Centralisation may require large bureaucracies (high transaction/administrative costs), detailed regulations and far-ranging administrative controls in order to ensure that policies really are common. The *quality* of decision-making may thus suffer. Even if economies of scope may emerge when the Community is involved in several disciplines, the effectiveness may be undermined by expectations that it contributes to an excessively wide range of policy domains as argued by the Padoa-Schioppa report.

A related issue is raised by Sun and Pelkmans (1995), who argue that whether regulation is assigned to the EU, Member State or concurrent level may in part be determined by the way in which regulatory authority/ies implement/s it. Different methods and different degrees of efficiency and effectiveness of implementation could imply different distribution of competencies.

An advantage of *decentralised decision-making* is that states (or more generally, local authorities) may be better informed about conditions that affect the local implementation of policies, and have better knowledge about local *preferences*. Better knowledge about the *effects* of policies may also give an advantage to the state/local authorities. Decentralisation implies that policies can be more flexible and responsive to local conditions, while centralisation relies on rules on equal treatment of states/localities, and central authorities tend to prefer simple and relatively uniform policies (cf. the discussion on environmental measures in Chapter 6). Centralised policies are in practice less regionalised than de-

centralised. Van den Bergh (1996) takes a similar view, arguing that decentralisation makes it easier to cope with informational asymmetries between the decision-making/regulatory body and regulated firms.

### **4.3 Efficiency: Destructive Competition**

A different source of economic spillover relates to the possibility that cross-country economic considerations (of the prisoners' dilemma type) may induce countries to apply inefficient policies in area that are purely national in character. This issue has been discussed in case of social policy (social dumping), tax harmonisation (tax paradises) and especially environmental policy (pollution havens) using fairly similar arguments. The discussion involves two issues: risk of destructive competition between states (legal orders) and the argument that different level of taxation in general, environmental or social standards/taxes or subsidies etc. are detrimental to the functioning of common market because the competition is distorted. Let us address both arguments in turn. The discussion below is very brief. More specific comments are offered in the next chapter while discussing the CAP.

The issue whether taxation should be harmonized in general is an old question in the economic literature. In a seminal article, Tiebout (1956) argued for tax diversity since this would allow people to vote with their feet by moving to jurisdiction where the laws are best adapted to their preferences. Similarly, Brennan and Buchanan (1980) see competition among jurisdictions as a powerful constraint on the undesirable expansionary tendencies of the public sector. Hence, competition by these arguments can serve its welfare-enhancing "disciplinary function". In reality, however, the conditions for Tiebout competition are not met. There is neither a sufficiently large number of legislators to choose between, nor perfect mobility (Musgrave, 1997).

A second body of literature contends that inter-jurisdictional competition is a source of distortion in public choice (Oates and Schwab 1988). The argument goes that the prisoners' dilemma type of interaction between states would lead to under-regulation ("race to the bottom") without federal intervention. In their pursuit of new industry and jobs, state and local officials will impose suboptimally lax environmental or

social standards as a means of attracting jobs and tax revenues. In such a case, federal minimum standards, preempting less stringent state standards, would be desirable. Cumberland (1981) argues, for instance, that national standards for environmental quality are needed to prevent excessive degradation of the environment that would result from state or local standard setting.

This argument has been criticised by Revesz (1997a) who claims that the race to the bottom argument appears to assume that states (or more generally jurisdictions as similar arguments have also been raised in the American debate) compete over only one variable. But under any plausible scenario, jurisdictions compete over a variety of regulatory and fiscal variables. If regulations in one field are federalized, the competition would shift to another arena and the reduction in social welfare implicit in the race to the bottom argument would not be eliminated. Moreover, as argued by Van der Bergh (1999), there is little empirical evidence supporting the claim that the race is actually taking place.

#### **4.4 Efficiency: Creating a Level Playing Field**

European lawyers tend to see differences in taxation as well as different social and environmental standards as detrimental to the functioning of common market, and therefore generally favour centralisation (Van den Bergh 1999). Distortion of competition could represent a kind of policy-induced spillover. If country A subsidises its production of a particular good, directly or indirectly, this could affect country B and would thus represent such a spillover. Would that represent a problem for country B? Not from a pure efficiency point of view. The traditional economist's analysis would be that the spillover is *positive* for country B since its terms of trade improve. However, the real world is somewhat more complicated, in the sense that country B's producers are likely to be losers and it may not be politically possible or desirable to accept this. In politico-economic terms, country A's subsidy to agriculture could therefore be seen as a *negative* spillover for country B. If countries were free to subsidise their own agriculture, competition would most likely become distorted.

The key argument behind the demand for harmonisation is that disparities in legislation will cause unequal competitive conditions, and that centralization is, accordingly, needed to deny comparative advantage to states with low level of social protection, lax environmental standards etc. The cost of complying with any regulation is, however, only *one* component of the total costs of production. Other factors, which have a significant effect on production costs, are unlikely to be (or incapable of being) harmonised. Thus, rather than eliminating cost differences, the harmonisation of standard has the effect of conferring a comparative advantage on states with lower non-harmonisable components of costs. Given that costs of production have many non-harmonisable components, such as wages, labour productivity, infrastructure etc., it is not clear why some factor should be singled out for a special treatment (Revesz 1997b).

Accordingly, the goal of creating a “level playing field” will not be reached, since some countries will keep an advantage in terms of age of plants, energy sources, access to raw materials, atmospheric conditions, wages, labour productivity, and so on. The ultimate answer to the “unequal conditions of competition” problem is to eliminate the possibility of competitions over any of these costs. Such comprehensive Community intervention would equal an outright rejection of the subsidiarity principle (Van den Bergh, 1999).

Similarly, Cnossen (1990) argued that it is the net burdens and benefit of subsidies, procurement policies and administrative rules and regulations that matter in evaluating the distorting effect of government intervention. *A priori*, there is no reason to assume that the tax harmonization *per se* will improve resource allocation or competitive conditions. Moreover, taxes that appear identical on paper may diverge widely in practice due to differences in effective enforcement (Cnossen, 1990).

#### **4.5 Co-ordination**

Even *if* centralisation could produce a better outcome than uncoordinated policies, must power really be centralised? Why can the necessary co-ordination not be achieved by agreements between independent states/localities? Both centralised and decentralised but co-ordinated

forms of decision-making could in theory end up with the same, or similar, policies. Is it necessary to centralise power in order to achieve the potential benefits of co-ordination?

Under co-ordination, states/localities retain the right to determine policies as they wish, subject to negotiation with other localities; under centralisation they may be constrained or can be overruled. Co-ordination faces different difficulties, one of which is reaching an agreement at all. Another is that there may be incentives not to abide by agreed rules, and it may be difficult to monitor the implementation of a particular policy by the state/locality.

The advantage of centralisation is that it provides a more *credible* mechanism for achieving co-ordination than agreements between independent localities on their own. *“Centralisation enables the benefits of policy co-ordination to be realised when it is not credible that simple co-operative agreement will achieve these”* (CEPR, 1993, p.55).

Gatisos and Seabright (1989) discuss circumstances in which policy co-ordination or harmonisation will be adequate to deal with the problem of cross-country policy spillovers. Where it is difficult to monitor compliance with international agreements (for instance where there implementation requires a large amount of judgement based on information that other parties to the agreements are likely to possess), signatories to international agreements to implement national policy taking international externalities into account may not have confidence that the other signatories will comply. Where this is the case compliance is likely to become an increasingly unattractive strategy, for usual prisoners' dilemma type of reasons. The key issues in deciding the function that need to be assigned to the Community level are thus those of information and monitoring.

#### **4.6 Inefficiency of Bargaining**

An important aspect of “common” policies is that these, of course, have to be negotiated between Member States. A highly relevant issue in the discussion on subsidiarity is therefore whether such negotiations produce “efficient” outcomes or not. There seems to be a tendency for bar-

gaining to produce inefficient outcomes, and it is a reasonable assumption that negotiations on the EU introduce an element of inefficiency that would not be present if policies were national.

There has been a tendency for more and more decisions to be based on bargaining in our economic system. Johansen (1979) makes the point that, even if sometimes game theory may be able to show that there can exist unique solutions to a bargaining process given the balance of power and preferences of parties participating in the game, in reality we should not expect elegant and unique solutions. A bargaining process is normally diffuse and unstructured. Bargaining is often likely to lead to outcomes that are not efficient in the Pareto sense, in contrast to what most bargaining theories assume or imply.

It is an unavoidable aspect of negotiations that information is incomplete, particularly about the other party's preferences. There are incentives to distort the information exchange. Most bargaining situations cannot be seen in isolation from other bargaining situations. Many situations repeat themselves from year to year, and it may be rational for a bargaining party to sacrifice something in the current round of negotiations in order to gain something in a later round. An efficient way of bargaining, seen from the perspective of the individual party, is to make demands and threats credible by committing oneself completely, if and when this is possible. A bargaining process may therefore easily take the form of a race in which the parties compete to become the first to commit themselves so that no retreat is possible. There is no collective rationality in this process. This feature of negotiations contributes to the unpredictability of the outcome of negotiations.

Bargaining will often be an inefficient decision-making procedure in the sense that it tends to distort the information basis for decisions. Moreover, bargaining tends to use or waste resources in the process, particularly by delaying decisions for reasons which are not technically necessary, and it will more or less frequently lead to breakdown and failure to realise potential gains, and threats will sometimes be carried out.

#### 4.7 Implications of Bargaining for Efficient Domestic Use of Resources

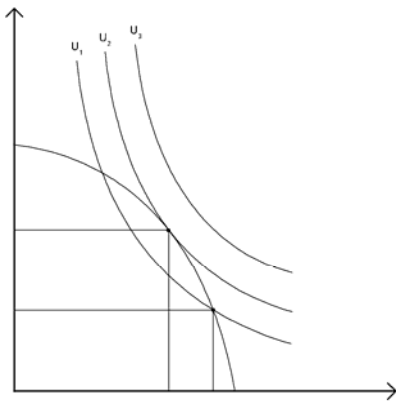
Arguments developed in the preceding sections indicate that in the absence of significant spillovers, a common policy is not more efficient than a set of independent national policies. However, taking into account the inefficiency of bargaining that was discussed above, a common policy may even be less efficient than a set of national policies. Assuming that preferences across Member States are different, a common policy must be, depending on the voting procedure in use, either a compromise, and hence not an ideal solution for anybody, or a package deal where the policy accommodates national diversity (mainly by adding national demands) at the price of being immensely complicated and/or costly. Renationalisation or increased subsidiarity is potentially enhancing welfare if preferences differ and the Member States can use the resources more efficiently.

Efficient allocation of resources, in our case public money, implies equalization of marginal net benefits across relevant uses of resources. Assuming that Member States are pursuing present policies efficiently, one can expect that net benefits will be equalized over *allowable* use of resources. However, if preferences differ between Member States, the allowable uses of the resources may, due to inefficiency of bargaining, be different than (some) Member States would have chosen on their own. Accordingly, the marginal net benefit should be expected to be lower than it is the case for the other societal use of resources. The more different the preferences, the lower will the net benefits be. Consequently, the more restrictions on the use of resources are relaxed, the more could efficiency be expected to increase. The argument for increased subsidiarity, developed in Chapter 6 is based on this presumption.

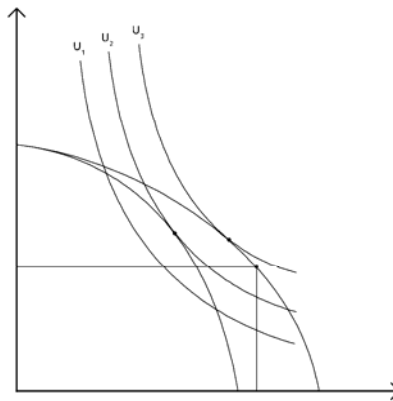
In Figures 4.1 and 4.2 respectively, the implications of differences in preferences for efficiency are illustrated. In Figure 4.1, we assume that there are no spillovers and that preferences differ. Accordingly the allocation of resources between commodities 1 and 2 enforced by the common policy is different from that which the particular Member States would have chosen independently (see the tangency between social preference function and production possibility frontier). As can be seen,

a lower level of utility ensues. In Figure 4.2, we assume that there are spillovers between Member States. In such a case, common policies produce an efficiency gain that accrues to the Member States. This is illustrated by the shift in production possibility frontier. This situation may produce a welfare gain for the Member States even if preferences differ, providing that the shift is big enough.

**Figure 4.1**



**Figure 4.2**



## 4.8 Social Equity

Centralisation may facilitate redistribution both within and between localities. In the case of decentralisation, redistribution within localities may be frustrated by the mobility of its citizens, since, for example, the richest ones will tend to move away from the most redistributive localities. A centralised authority would not face this difficulty to the same extent. Centralisation can also be expected to increase the extent of transfers between localities since the willingness of states to make transfers outside their own borders is weaker than their willingness to make internal transfers. If transfers between countries are an objective, centralisation could thus be helpful.

It could be argued that objective of cohesion does not necessitate a set of common policies. Inter-governmental transfers could accomplish the redistribution. A case for centralisation could however rest on the argument that inter-state transfers have to be “dressed up” in common poli-



cies (Hooghe and Keating, 1994). Thus, if inter-state redistribution is an objective, common policies may be the only politically possible way to achieve it, even if this is a less economically efficient way.

However, as also pointed out by Hooghe and Keating (1994), purely distributive programmes are difficult to sustain. Such programmes risk not getting sufficient support in the Council. Instead, once a distributive measure is in place, all Member States have an incentive to extend it to recipients in their own countries. As a result, programmes expand beyond the original intentions. A good illustration of this phenomenon is the fact that more than half of arable land (55%) is classified as less favoured or that Structural Funds programmes covered (during the preceding period) about 51% of EU population.

#### **4.9 Accountability**

Assuming that decision-makers are benevolent social planners, i.e. do not have personal objectives and act solely to enhance social welfare, accountability is closely related to efficiency. By moving the process of decision-making closer to the citizens, the benevolent social planner may become a better planner by, as argued above, being able to acquire a better knowledge of the relevant preferences and the cost of fulfilling them. Relaxing this very restrictive assumption, the question emerges whether accountability is enhanced or impaired by centralisation. Accountability relates to the possibility of voters to monitor the elected officials. This issue is discussed below. A closely related issue connects to the question whether centralisation creates a systematic bias to the advantage of organised special interest groups. This issue is often discussed in the framework of political economy models. In such models, politicians are assumed to pursue own objectives such as being re-elected, and respond to the pressure of competing interest groups (see next section for discussion).

Decentralisation allows voters in a country to decide collectively to replace their government if they are dissatisfied with its performance. Voters in one state/locality can collectively replace their government while centralisation is bound to reduce this mechanism. Citizens in a state/locality can also vote with his/her feet if they are dissatisfied with

the policy package (taxes, public goods) provided by the state/locality. Such an “exit” option is weakened by centralisation. In small governments access to politicians is likely to be easier and information about politicians’ activities is likely to be more available (Inman and Rubinfeld, 1998).

If the mechanism of accountability works reasonably well, centralisation can only diminish its effectiveness (CEPR) since it implies that the decision to replace the decision-making body depends also on the views of other Member States whose preferences may differ considerably. At the same time, the claim that centralisation may lead to weaker accountability does not tell us much about the kinds of distortions in public policy that result. These depend on how those who implement public policy react to their freedom of manoeuvre (freedom from accountability).

In the literature, it is generally assumed that the European voters are less well informed about EC policies than about policies in their home country because language barriers, sheer distance and the non-transparency of the EC decision making-process raises the cost of information, and because the larger the size of the electorate and the indirect nature of democratic control reduce the incentive to be informed (Vaubel, 1994a).

Moreover, accountability is reduced by the way decisions are made in the EU, where bargaining is constantly taking place on a wide-ranging agenda. Such a bargaining results in package deals where sacrifices in one area are offset by gains in others. Furthermore, bargaining often involves considerations of the future or/and of the past. A Member State may support another’s position in expectation of future reciprocity (shadow of the future) or as a “repayment” of past favours (diffuse reciprocity). In such a situation, a policy outcome in one specific area may be a result of a very complicated process and be thereby much less accountable to the preferences of constituencies than what decentralised policies would have been.

Centralisation could, however, help voters to monitor the visibility of decisions. Whether this would really be the case will depend on a number of factors, including the political culture of the jurisdiction con-

cerned, shared language and media, etc. It is often argued that the CAP, Structural Funds etc are under considerable scrutiny from Brussels involving monitoring, evaluation and fraud control.

#### **4.10 The Political Economy of Centralised Decision-Making**

In political economy models, it is frequently assumed that domestic policies are guided by opportunism rather than by benevolence. According to pressure group theory, small effective groups are more important for policy formation because of their comparative advantage in controlling free riding. The logic of collective action suggests that concentrated industrial interests with large stakes in the outcome will overwhelm the large number of consumers/taxpayers, each with relatively small stakes in the outcome of a particular policy, in the political process.

A key issue in assessing merits of centralisation is whether centralised decision-making will strengthen the influence of organised special interest groups at expense of consumers and taxpayers. Whereas some scholars, (compare discussion in Johnson and Libecap, 2000), do not perceive a bias to the advantage of organised interest groups as a political failure, most researchers would consider such a bias being a political malfunction.

Opinions as to whether a bias exists are divided. For instance, it is often claimed that, as a result of public choice problems, a state-level political process will systematically undervalue the benefit of environmental protection or over-value its costs, whereas at the federal level the calculus is more accurate. Similarly, the danger of regulatory capture is often advanced as an argument against decentralization (see discussion in Revesz (1997a) and Van den Bergh (1999)).

Weiler has advanced a similar argument, focusing directly on EU decision making. This goes that, compared with traditional national structures, the EU's institutions and legislation often guarantee greater access by diverse and under-represented societal groups such as environmentalists, particularly at the agenda-setting stage of policy development.

The argument that centralisation creates an advantage for disorganised groups has been criticized by Revesz (1997b) who points out that it is not clear why the disadvantages these groups are facing at the national level not should be replicated at the federal level. Van den Bergh (1999) observes that industry generally prefers the centralised decision-making process, which provides support to the belief that regulatory capture may be even more worrisome at the central level.

According to a long-standing view that goes back to James Madison, centralisation reduces the influence of pressure groups, because in larger state they tend to block each other, (see Vaubel 1994a for discussion). However, as several authors have argued, in the EU this is likely to be true only for pressure groups that are confined to the local and national interest but not for groups that share common interest through the Community. The opposite may be the case: Community-wide special interests save transaction costs at whose expense they obtain regulation, protection and subsidies. According to Vaubel (1994a), pressure groups that represent regionally homogenous interests can obtain more subsidies, regulation and protection from central government than from lower levels of government, because centralisation increases the information cost of other members of ruling coalition and weakens their incentives to be informed, and because centralisation raises the costs of political information for individual consumer and taxpayers. Moreover, EU centralisation reduces the transaction costs of rent-seeking by focussing lobbying on one instead of 15 governments. Moreover, in the case of the EU, centralisation offers additional advantages for organised groups since they can lobby a bureaucracy rather than politicians. Andersen and Eliasson (1991) claim that the EC system is now more lobbying-oriented than any national European system.

#### **4.11 Concluding Remarks**

The main *conclusions* relating to economic efficiency aspects are that, when scale economies and spillovers between countries are important, centralising policies may yield benefits. Those functions, which Community itself needs to exercise, are those where there are substantial cross-country externalities and where national governments cannot easily be monitored by other national governments. But centralisation also

entails costs since accountability may diminish. Thus, it offers scope for policies to deviate from the best intentions of the constituent localities and may create a systematic bias to the advantage of organised pressure groups.

Hence, one could conclude that there may exist a *trade-off* between the co-ordination benefits of centralisation and the accountability benefits of decentralisation: *“the balance of advantages is likely to vary greatly from case to case. There are no simple punch-lines about centralisation, and therefore none about subsidiarity”* (CEPR, p. 56). *“The principle of subsidiarity claims, however, that, when in doubt, decentralisation should be preferred”* (ibid. p 47). Persson *et al.* (1999) also emphasise the difficulties of drawing clear-cut normative conclusions about centralisation/decentralisation. In the next chapter, we analyse the balance in case of agricultural policy.



# 5

## Evaluation of the CAP

### 5.1 Introduction

In this chapter, we explicitly address the *rationale* for pursuing agricultural policies jointly. Central questions when we examine the CAP from this angle are: what is gained by replacing a set of national policies by a common policy? Could something be gained if Member States regained competence (of decision-making, of financing and/or of implementation) in (some areas of) agricultural policies? We attempt to answer these questions using the criteria developed in the previous chapter.

The short review of the literature provided in Section 1.3 indicates that economists tend to argue that there are no reasons for agricultural policies to be pursued jointly. Neither the existence of “spillovers” nor the presence of scale economies provide a sufficient rationale for centralised agricultural policies. Since it has been argued that a purely theoretical perspective suggests no reason to pursue common agricultural policies, we could in principle dismiss the subject at this point. But the CAP is a reality, and it is this reality we now discuss. Moreover, the discussion about merits and demerits of policy centralisation in agriculture in the literature is very general. It could be argued that the answer to the question whether policies need to be pursued jointly may depend on both policy objectives to be achieved and the instruments involved.

Pursuing this approach, it seems appropriate to discuss whether some key CAP components: market intervention, direct payments, agri-environmental measures, and structural policies, need to be pursued jointly or whether from efficiency point of view a case for decentralisation can be made. We also discuss how the CAP could be assessed in terms “equity” (cohesion) and “accountability”. The discussion here lays the ground for Chapter 6, where we discuss options for a partial decentralisation of some of the components of the CAP. Efficiency aspects are discussed separately for the above-mentioned components of the CAP. Equity and accountability are treated together.

## **5.2 How Should the CAP be Assessed?**

The rationale for centralisation is usually discussed from the perspective of efficient/non-distorted policies, as was done in Chapter 4. The implicit starting-point of this analysis was that efficient policies are pursued at the outset (in individual countries), and the question is whether overall efficiency can be further increased by pursuing such efficient policies jointly. However, the origins and development of the CAP are a very different story. In the member countries building the EC, agricultural policies were characterised by many distortions (Tracy, 1982), and the joint policy, the CAP, is widely considered to be inefficient as well. Whether these inefficiencies are incurred as the costs of pursuing the equity and other goals of national and EU policies is not here the point: rather, it is that assessment must be directed at or between realistic policies and not at some theoretical (lack of) policy.

Taking into account the fact that the CAP is, as pointed out above, distorting the use of the resources, two types of efficiency-related questions emerge. The first type of question connects to the merits of centralisation and involves the kind of issues that were discussed in Chapter 4. The second question is whether a subsidiarised CAP would be less likely than the present CAP to produce distortion of the use of domestic resources. Those two efficiency questions involve a quite different set of arguments and will be discussed separately: efficiency of policy co-ordination and efficiency of domestic resource use. In this chapter, we discuss primarily the first of the two efficiency issues. The second is discussed in more detail in Chapter 6 in relation to specific proposals for increased subsidiarity that are advanced in the report.

## **5.3 Assessment of Market Interventions from Efficiency Point of View**

As described in Chapter 3, market intervention and price support under the CAP include intervention prices, import tariffs and export subsidies. In the EU, these are centralised. As long as price support is provided, it is completely logical to have a joint policy. The rates and levels of intervention prices and export subsidies have to be the same in all Member States, export subsidies have to be the same, etc. It should also be evi-



dent that tariffs *vis-à-vis* non-EU countries cannot be subsidiarised. A case for decentralisation to Member States cannot be made in this policy area, as long as the general principle of the common or single market is adhered to, on the economic grounds of exploiting comparative advantage.

Market intervention as a component of the CAP serves a dual purpose of stabilisation of prices and supporting of the farm income. The former of those objectives cannot, by the same logic as above, be subsidiarised. Whether the latter objective could be moved to the national level depends on the policy measures involved. As long as income objective is pursued relying on market interventions, it must remain a common responsibility.

Moreover, the reforms of the CAP in the 1990s have opened up a venue for increased responsibility of Member States. As argued in the introductory chapter, changes in policy instruments have consequences for the relative merits of common versus national policies and recent changes have made it possible to decentralise. According to Larsen, the introduction of *direct payments* to secure a desired level of farm income has fundamentally changed the situation: "*It is now possible to separate the responsibility for the administration of the internal market from that of maintaining farmers' incomes.*" (European Commission, 1994, p. 39-40).

#### **5.4 Direct Payments/Direct Income Support**

Whether direct payments (compensatory payments) should be the subject of a common policy may depend on the *rationale* for delivering the payments as well as *modalities* of those payments. The compensatory payments originated to replace price support, which resulted from the pursuit of a farm income objective. Accordingly, the payments should be seen as permanent direct income support and hence fall under social policy (Rabinowicz 1999). In this area, it may be difficult to find justification for common policies. With exception of the Social Charter, the Union does not have a common social policy. For example, social insurance systems in general are the responsibility of Member States. There are no evident spillovers or scale economies to be made by pursuing centralised

policies in the area of direct income support. The case for a common social policy is, hence, weak (See CEPR, 1993 and Padoa-Schioppa, 1987).

Above, we quoted some observers who have argued that supporting farmers' incomes should be a national responsibility, not a joint one. A similar point has been made in a Commission report which discusses the possibility for Member States to shoulder a larger share of the financing of direct aids; it is argued that subsidiarity should prevail in this area. The rationale for this is, the report argues, that direct aid constitutes interpersonal redistribution and that *"According to the subsidiarity principle, interpersonal redistribution is better implemented at the level of Member States rather than at the level of the EU"* (European Commission 1998).

In spite of the fact that farm income objective was, in reality, the main objective of the CAP, the concept is rather vague and allows for various interpretations (von Witzke, 1986). In particular, such a fundamental issue whether fairness should be assessed in absolute or relative terms has not been resolved. One could argue that the relative income interpretation is more reasonable. (It has, for instance, been used in the Nordic countries before joining the EU). At risk of stating the obvious, pursuing an objective of achieving different levels of income in different countries is hardly a meaningful task for a common policy. Pursuing the same level of income in countries with different incomes outside agriculture will not constitute a reasonable policy either. Vaubel (1994b) (compare Chapter 1) argues that if social concerns are the reason, income support should take into account for the average level of regional income, which differs greatly between EC member countries. Finally, as discussed in more details in section on equity, the CAP has not been able to deliver on this account.

Looking at the purpose of the payments there is, according to the argument above, no reason for including them in a common policy. However, in spite of being ultimately motivated by direct income support, the payments are not linked to social indicators at a farm household level but to agricultural production. In other words, payments are not decoupled. Decentralisation of direct payments may concern, however, both how they are distributed and how they are financed. The *risk* with

decentralisation is that competition could be distorted. It is the sheer *size* of direct payments (about 28 billion Euro in 1998) in relation to the value of output that makes this a real risk. Hence, the risk is substantial. This is discussed at some length in Chapter 6.

### **5.5 Agri-Environmental Measures**

Most common arguments for policy co-ordination in the field of agri-environmental policies include transboundary pollution and market distortions. The main cross-border effects of agricultural environment are: tourism (in case of attractive landscapes), water pollution (mainly in the Low Countries around the Rhine) and birdlife (loss of migrating varieties through pesticides and loss of habitat). Otherwise, most agri-environmental externalities tend to be local or public at the national level.

Jordan (2000) observes that, to get around the obviously national scope of establishing parks and exploiting natural resources, several authors have suggested that the concept of transboundary pollution should be expanded to include “psychic spillovers”, preservation spillovers or “heritage” alongside physical and economic spillovers. This connects to the concept of existence values where consumer derives utility from a pure knowledge of preservation of some species or habitats regardless if he or she ever will have an opportunity to visit the place or observe the species. However, as also argued by Jordan (2000) if the idea were taken seriously, this would remove all limits on EU action – literally any policy which appealed to the emotional sentiments or sense of European or human heritage of any actor could be imposed on a reluctant Member State, a majority of whose citizens may have registered different psychic concerns through their choice of domestic laws.

The major argument in favour of divergent environmental standards across Member States is that decentralized decision making may better satisfy preferences. Hence, the presumption for decentralization rests on differences in preferences over environmental protection, and differences in costs and benefits of such protection. Assuming that environmental quality is a normal good, demand for environmental quality will tend to rise with higher incomes and richer states will then, other things

being equal, wish to implement more nature-friendly environmental policies than poorer Member States. As a consequence of common environmental policies, inefficiencies may ensue if location-specific circumstances and regional diversity are not taken into account. Cnossen (1990) has argued that tax diversity in general is preferable by being able to accommodate different social preferences.<sup>7</sup>

The main reason for having a common policy in these areas appears to be historical. Present environmental regulations have originated as “accompanying measures” in 1992 CAP reform and can, to a large extent, be seen as “corrections” of environmental problems created by the CAP itself; see Chapter 3.

Both arguments related to policy-induced spillovers, the race to the bottom and the impact of unequal subsidisation on the functioning of the internal market, that have been discussed in Chapter 4, have also been a subject of an intense debate in connection to environmental policies in agriculture. However, the former invokes also a discussion of race to the top in environmental subsidies or the claim that, without common agri-environmental policies, the Member States would try to out-compete each other in agri-environmental subsidies.

Starting with the first issue, Oates and Schwab (1988) note that there are circumstances where environmental competition might lead to downward pressure on standards. Markussen et al. (1995) present a model where under certain circumstances regions will compete by undercutting each other standards. As a opposite view, one could invoke general argument advanced by Revesz, quoted in the previous chapter, namely that if Member States or localities would like to compete each other to attract jobs etc, they can always move competition from harmonised variables to non-harmonised ones. In agriculture, this could be easily accomplished since profitability of productions depends on a multiplicity of factors, many of which have been left to the Member States to decide.

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<sup>7</sup> Tax diversity takes into account differences in preferences for one tax over another in various Member States, which reflects differences in economic and social structures, different perception on the role of taxation, differences in the acceptability and feasibility of various taxes.

Moreover, it should be observed that the argument over tax/subsidy competition implicitly assumes mobility of resources. Taxation of mobile tax bases requires more coordination than the taxation of immobile bases (Cnossen, 1990). Land, the primary factor in agricultural production, is immobile. Environmental support is often linked to land or grazing animals. Hence, the need for policy co-ordination appears less accentuated in this field. Competition in lax environmental standards or (related issue) harsh animal welfare regulations could be possible in case of grain fed livestock, since such a production is mobile. However, there is no evidence that the Member States have attempted to compete each other to the bottom. On the contrary, considerable disparity in the standards can be observed and the trends for more environmental and animal friendly standards can be observed.

The second issue, fair competition, is potentially more disturbing because, unlike the case of direct income support, which could be decoupled from production (even if this is not the case at present), many environmental benefits are actually related to agricultural production of some kind. Production may therefore be a precondition for delivery of the benefit. The need to avoid distortion of competition may hence be stronger in agriculture than in other sectors. The issue is also discussed at some length in Chapter 6. Present agri-environmental policies are already under criticism of disturbing the competition. Wilkinson (in Kjeldahl and Tracy, 1994) observes “..., as many if not most farming practices fulfil the rather broad ‘environmental criteria’ of Reg 2078 and income support is one of the aims of this regulation, this instrument has introduced enormous scope for Member States to support some or indeed many of their farmers through measures which are at least potentially trade-distorting”.

While relying on arguments developed in the previous chapter about the need a level playing ground, it could be argued that environmental costs constitute only a part of total costs and that it is that latter that determines the competitiveness. Moreover, richer countries are generally affected by higher levels of environmental pollution than less developed countries and have higher preference for environmental protection. At the same time, the higher productivity of firms located in rich countries, and the greater ability to pay of their consumers or taxpayers, allow the

advanced countries to adopt stringent environmental standards. However, if these same standards were also applied in less developed countries, they would either destroy the competitiveness of their firms or overtax the ability to pay of consumers and taxpayers.

## **5.6 Common Structural Funds/Rural Development Policies?**

To the extent that policies in this area are motivated by equity/cohesion and thus represent transfers from richer to poorer countries, there is a role to be played by the EU. An EU role in the co-ordination of transfers among the regions within its borders may be warranted, but may not provide a convincing case for centralisation as such. It may be difficult to design a common rural policy efficiently. Efficient selection of projects requires detailed local knowledge that central authorities may not have. Lower tiers may, furthermore, have an incentive to misrepresent in order to manipulate the resource allocation. Further arguments against centralisation relate to the possible mismatch between the preferences between the central authority and lower-level jurisdictions (CEPR, 1993). On the other hand, a good case for centralisation could be made, especially taking into account conditions in the CEECs.

However, common policies are hardly an efficient long-term solution for coping with administrative weaknesses encountered in the candidate countries. Investments in institution building and human capital development would seem more appropriate. Such investments are also taking place within the framework of SAPARD etc.

An additional argument in favour of common structural policies (similar argument were advanced with respect to agri-environmental policies) that has been made in Swedish debate is that the rigour of preparing rural development/regional programmes to be approved by the Commission improves the quality of the policies in question. The same logic has been repeated with respect to evaluation of the policy, at least in case of Sweden. For instance, it has been claimed that more monitoring and control has improved the quality of similar programmes in comparison with pre-accession situation.

If this argument is universally valid, *all* economic policy making should be centralized. But it is hardly believable that rural policies are so complicated that Member States are not able to manage them on their own. The argument may, however, have some validity for the CEECs, which lack experience with certain types of policies, as could be the case for agriculture, compare above. Moreover some of the economies of scale stemming from learning by doing and accumulation of experiences in larger organisations could be exploited simply by exchange of information and experiences.

### **5.7 Equity and the CAP**

Centralisation is likely to make it easier to achieve redistribution *between* countries, and centralised policies can also achieve more uniform policies across Member States, as is basically achieved with the CAP. Uniform policies operated by a centralised authority are applied throughout EU Member States, although, as was shown in Chapter 3, Member States have retained some discretion in some areas. Does the CAP's uniformity then mean that "equity" is achieved?

This is a difficult question to answer, not least because there are many aspects of equity and redistribution within the context of the CAP: redistribution between farmers, between farmers and non-farmers, between regions, and between countries. Strictly speaking, only the last mentioned kind of redistribution is a matter for subsidiarity considerations.

While there is an implicit aim of redistribution from non-farmers to farmers in the Amsterdam Treaty since the CAP is to "ensure a fair standard of living for the agricultural community", there is no explicit objective concerning redistribution between countries. There therefore does not seem to be a case for centralisation of agricultural policies on the ground of achieving inter-country redistribution. But even if there is no explicit aim of the CAP in achieving inter-country redistribution, it is an objective of the Treaty to achieve economic and social cohesion, as well as solidarity between Member States.

There is widespread recognition that the CAP does not achieve above-mentioned objectives. The CARPE report (Buckwell *et al.*, 1997) argues

that the distribution of costs and benefits of the CAP is one of the aspects of the CAP that is most difficult to justify. Although the CAP may be uniformly applied in all countries, it is widely recognised that it has not been able to achieve “equity” in terms of equitable incomes in agriculture in different regions of the Community.

The difference in gross value added per annual work unit (GVA per AWU) in agriculture between different regions is very large indeed as illustrated in table 5.1 below. Whereas some countries have incomes more than twice the EU average other have incomes lower than the half of the average. Moreover, it could be observed that incomes outside agriculture vary far less than in agriculture where a common policy is in place.

**Table 5.1 GNP per capita and Gross Value Added per AWU, 1988, EU12 =100**

Region	GNP per capita	GVA/AWU
Denmark	144	248
Holland	105	296
Belgium	104	243
UK: England	97	192
UK: Wales, Scotland, NI	82	155
Ireland	65	111
Germany North	127	176
Luxembourg	124	181
France: North and Central	134	218
Germany South	136	109
France East	108	157
France West	98	145
France South	105	119
Italy: Lombardy	131	150
Italy: NW/NS	115	75
Italy Central	110	67
Spain North	73	81
Spain Madrid	75	69
Italy South	67	71
Spain East	61	71
Spain Central/South	50	83
Spain North/west	52	36
Portugal	31	23
Greece	35	48
EU12	100	100

*Source: European Commission, 1993*



Moreover, the Larsen report (European Commission, 1994) argues that the existing transfers between Member States due to the CAP cannot be justified with reference to difference in income positions, since most of the net beneficiaries are high-income countries (p. 40). The CARPE report makes a similar observation with respect to the redistributive effects of the CAP. The report compares the ranking of beneficiaries if the CAP (expressed as a percentage of GDP) and the ranking of GDP per head. Three countries can be classified as below the average income and losers from the CAP while three are two countries that stand out as having above average incomes and gainers from the CAP. The report concludes that the *“distributive effects of the CAP could be improved”* (p. 90).

Moreover, even if policies are common for the EU as a whole, the simple fact that the composition of agricultural output differs between countries may imply that equity (however defined) is not achieved since different products receive different levels of support. To apply common policies in unequal circumstances may well produce different – not common – results.

## **5.8 The CAP and Political Efficiency/Accountability**

In the previous chapter, we discussed in general whether centralisation strengthens organised pressure groups. A conclusion that emerges from the discussion is that the benefits of centralisation go to regionally homogenous interests groups. Farmers belong clearly to this category, and there exists an extensive literature in this field of political economy that is specific to the CAP. In this literature, it has been argued that the centralised bargaining process inherent in the CAP has *increased* the strength of the farming lobby and has created a bias in favour of farmers. Winters (1995) argues that public confusion about whether the Commission, Council or national governments are responsible for agricultural policies relaxes political constraints. Koester (2000) argues along similar lines. Milward (1992, p. 316) argues that without “Europeanization” the political power of the agricultural interest would have been weaker: *“(a)s the CAP increasingly relied on the machinery of intervention prices, levies and rebates, so did the farmers’ own purchasing and marketing organisations acquire*

*even more official role as the executive of the Community than they had acquired as executives of national policy”.*

Senior Nello (1989) puts forward several reasons for the strength of the EC farm and food lobbies *vis-à-vis* consumers and taxpayers, such as their closer and more intricate relationship with members of the EC decision-making institutions, and the peculiarities of the CAP decision-making process, in particular the preponderant role played by DG AGRI.

The CAP differs from many common policies at the EU level by being commonly financed. This is argued to constitute an additional source of bias to the advantage of organised farm interests. The EU negotiations on price fixing of agricultural products have been likened to a “restaurant bill” problem. The costs of high agricultural prices are borne by consumers and the EU budget. The benefit for the individual country is more or less proportional to its production. Because the marginal Euro of the EU budget is levied proportionately to GDP, each national government has the incentive to seek price rises in any commodity for which its share of EU production exceeds its share of GDP, (Winters 1994). Mahé and Roe (1996) have argued that the restaurant effect prevents substantial reforms of the CAP. De Gorter and Pokrivcak (2000) have criticized this argument, by considering not only countries that have vested interests in increasing farm support prices (net beneficiaries) but net contributors as well. However, their model is based on the assumption that Member States have single-peaked preferences with respect to redistribution to farmers, rather than aiming at maximising the net return from the budget. This seems as a highly objectionable assumption.

In contrast, Bernstein (in Kjeldahl and Tracy, 1994) has claimed that *“when twelve ministers of agriculture meet in the Council of Ministers in Brussels their aim is to get most for their farmers. And when they disagree they solve problems by using more money – at least as far it is possible within the framework of financial guideline”*. A former EEC commissioner, Ralf Darendorf, has said that the CAP *“is little more than an instrument for Ministers of Agriculture to get for their farmers in Brussels and in the name of Europe what they would not get at their national Cabinet tables”* (quoted in Howarth, in

Whetstone, 2000). Similarly, Berkhout and Meester (in Kjeldahl and Tracy, 1994) argue that, if Member States became more responsible for financing the market regulations, as is common under the structural policies of the EC, the Community budget might be managed more prudently, supporting the presumption that the bias exists.

Moreover, farm lobbies tend to reject renationalisation. If the policy would not create a bias, then at least some of the farm lobbies would argue for national policies. *“Vested interests prefer control to be central rather than local because they are then further from the electorates who eventually must pay the bills, which is why there is always resistance to any idea that smacks of renationalisation of agricultural policies”* (Whetstone, 2000). Hence, if decision-making were transferred to Member States, that bias would be reduced.

Finally, farmers as a pressure group benefit from the fact that centralised decision-making may make it difficult to *change* policies that are deemed inadequate. According to a model of the joint decision trap developed by Scharpf (1995), the institutionalised obligation to co-operate forces governments to adopt conflict-reducing strategies, which allow only incremental changes and compromises, and at best marginal distributive effects. The joint decision system favours the beneficiaries of the status quo and is likely to block (all) reform(s) (Benz and Eberlein, 1998). Elliot and Heath (2000), argue that the CAP does not reflect the EU’s current balance of power, but rather a bygone power balance, take a similar view. They argue that centralisation protects subsidies not from *economic* but from *electoral* competition.

We may thus conclude that, if agricultural policies were to be decentralised, the balance of power would change – there will be a different sort of bargaining, and, depending on the actual circumstances, this new bargaining process could lead to less distorted policies. The issue is discussed in more detail in relation to the specific policy proposals advanced in the next chapter.

## 5.9 Credibility of Policy Co-ordination in Agriculture

The issue of having national rather than common policies in agriculture boil down to the fundamental questions whether co-ordination in the field of agricultural policies is credible. If policies are not centralised, could countries agree and abide by common rules not to introduce measures that distort competition? Or would the incentive to “shirk” be too strong, implying that centralisation is necessary?

In the EU, national support to domestic economic activity in general is constrained by the common rules on so-called state aids and competition. The Rome Treaty provisions state that a policy measure is to be considered as a state aid incompatible with the common market, if (a) it is granted by a Member State or through state resources in any form whatsoever, (b) it distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods, and (c) it affects trade between Member States.

When the Common Market Organisations of the CAP were set up, the Treaty provisions on competition were declared *also* applicable to agricultural production and to trade in agricultural products (Van der Zee, 1997, p. 151). Some exceptions have been made as to what is considered state aids, such as schemes designed for the conservation and protection of the environment. But, according to Van der Zee (1997), there is considerable confusion over what is and what is not permitted.

In concluding this section, we emphasise that, since the system regulating state aid seems to perform adequately for other sectors, there is no evident reason why the same rules could not be applied to the agricultural sector. A complicating factor in the case of agriculture is, however, that subsidies are very large in relation to output. Kjeldahl (in Kjeldahl and Tracy, 1994) has argued that the role of the Court as a last resort for enforcing respect for the Treaties could become more pronounced if a wider range of national policies were applied in the future. Hence, the key issue is whether, in case of partial renationalisation of the CAP, EU institutions could retain sufficient strength to enforce the basic principles of the CAP.

# 6

## Options for Further Subsidiarity and the CAP

### 6.1 Introduction

In Chapter 5, we argued that from the point of view of efficiency there is no obvious reason why EU agricultural policies, other than the common market and trade instruments, should be centralised. In principle, reform of the CAP could therefore take the form of (close to) full decentralisation. Action at the EU level could be limited to setting an appropriate framework, including the definition of the rules needed to preserve the integrity of the single market and to avoid market distortions. Trade policies vis-à-vis third countries would also have to be handled at the Community level. Apart from this, Member States could design their own agricultural policies.

Even if reform does not move that far, efficiency improvements could arguably be achieved if Member States were given a stronger say in several areas of the CAP. In this chapter, we therefore discuss various ways in which the CAP could be partly decentralised and what could be gained by doing so.

We choose two areas for further analysis. We start with environmental measures since this involves less far-reaching modification to the present CAP, and then consider direct payments. Following an argument by Van den Bergh (1999) that many heavily debated issues in European law, such as the assessment of the principle of subsidiarity and proportionality, require answers to questions that are ultimately empirical, we attempt to provide some empirical evidence for both cases.

As pointed out in Chapter 5, a discussion of subsidiarity in relation to the CAP is more complicated than it is in the case of “non-distortionary” policies. This fact has implications for how we structure our discussion. The analysis is based on the set of criteria developed in Chapter 4 and applied in Chapter 5, but is organised somewhat differently. It starts with an attempt to demonstrate that the subsidiarised option has the potential for improving efficiency in the domestic use of resources. Next,

we discuss whether increased subsidiarity, if fully exploited by the Member States, would constitute a distortion of competition. Finally, we ask whether these improvements are likely to occur, taking into account changes in the balance of power between domestic pressure groups and the increased accountability of subsidiarised policies. The potential for efficiency improvements is discussed option by option. Equity and accountability are discussed for both options together. In terms of standard welfare economic theory, the logic of our argument can be illustrated in Figure 4.1, Chapter 4.

## **6.2 The Agri-Environmental Policy Option: Description**

Environmental problems related to European agriculture are enormously diverse. Political preferences with respect to prioritisation between different environmental problems within agriculture are also highly divergent, as demonstrated by the diversity of environmental schemes in use (Deblitz and Plankl 1998). Accordingly, there are few arguments for having joint policies. The present design of EU agri-environmental regulations accommodates this need for diversity by considerable flexibility as to the choice of programmes in agriculture. The Commission has indeed stated that *“the decentralized approach is the only feasible way of designing (environmental) programmes. However, Community policy needs to be applied, meaning that: integrity of CMOs must be assured and distortion to the single market prevented; common policy must apply with regard to CAP, including integration of environmental concerns”*. (Commission Working Document – DG VI)

The flexibility of agri-environmental programmes within EU agricultural policy is considerable but could be further increased by three additional elements related to (i) the scope of environmental support, (ii) the identity of eligible providers, and (iii) forms of support evaluation.

For (i), it is suggested that Member States should be given discretion to extend the scope of environmental support from being restricted to agriculture only to apply also to natural resources in rural areas. In some countries, such as Sweden, the government has formulated a set of ambitious environmental objectives. Five of these are related (partly or exclusively) to agriculture. It seems reasonable to extend environmental sup-

port to all types of projects related to these agriculture-oriented objectives. In general, EU regulations should allow the extension of “agri-environmental” support to all activities related to rural use of land and water.

In addition (ii), Member States should be allowed to encourage other producers of environmental benefits to participate alongside individual farmers in the delivery of environmental services. Such providers could include groups of individual farmers, local branches of farm associations, environmental clubs, rural groups, other NGOs, and also local or county municipalities. Different contractual forms should also be allowed.

As regards (iii) above, due partly to the fact that agri-environmental programmes are co-financed, implementation of Reg. 2078/92 (and now the Rural Development Regulation 1257/99) is not fully subsidiarised. The EU decides now how much should be controlled. Types of control mechanism other than detailed checking of the fulfilment of environmental obligations should also be allowed, such as control and assessment through local participation by environmental and/or rural groups, local authorities and others having an interest in the delivery of a good local environment.

In terms of decision-making, changes to agri-environmental policies along the lines suggested could mean the following. The decision on the overall size of agri-environmental payments, each country’s “envelope”, would remain an issue that is decided upon at the EU level, i.e. in the Council. Member States would decide on how the national agri-environmental envelope is allocated between different domestic uses. The Commission would be responsible for monitoring Member States’ policies, and in particular for assessing compatibility with the rules governing the internal market.

### **6.3 Agri-Environmental Option: Evaluation**

#### *Do Preferences Differ?*

Increased subsidiarity in the field of agri-environmental regulations is potentially welfare-enhancing if 1) preferences between countries differ,

and/or 2) if Member States can be more efficient in the use of resources in order to achieve stated objectives, and 3) if national policy would not disturb competition or generate other types of spillovers. Whether allocation of resources really improve if decisions should be decentralised will, of course, depend on what countries would actually do with the freedom to design agri-environmental policies. The first of those conditions is addressed below.

Prediction of how agricultural policy may change in each of the Member States in response to increased policy discretion is, of course, hardly possible. The difficulty is not only the sheer amount of information that would be required for making such an analysis but also the speculative nature of the question. However, considerable differences in policy preferences between the Member States can be observed.

Comparing four Member States with respect to the greening of the CAP, Lowe et al. (1999) find that in Denmark in the 1990s the main political focus turned to consumer questions both in terms of the consumption of healthy and tasty food produced in an acceptable way and the consumption of a "natural" landscape. Almost all political parties in Denmark have pursued such middle class, consumerist values, including parties that hitherto championed agrarian interests. On the other hand, Ireland appeared to present a picture of a somewhat reactive policy debate, led and dominated by farmers and state agencies, and with a relatively low level of public environmental concerns. In particular, efforts under the Habitat and Birds Directives to secure workable conservation designations on rural land foundered on local and populist politics which respond with tenacious hostility against any restrictions being placed on private property. Portugal's relative weak national debate on agri-environmental problems was argued to stem from the perspective which sees modernization of agriculture as an unfinished process, and from the assumption of an essential compatibility between agriculture and environment. In Italy, there were widespread anxieties over the risks posed by intensive agricultural practices. In contrast, the role of the agriculture in the countryside has not become a significant public issue.



Hart and Wilson (1998), commenting on a very low budget allocation to the UK agri-environmental programme compared with other Member States, see this as an indicator of a continuing productivist ethos among many UK agri-environmental decision-makers. As a result of the lack of spending commitment to agri-environmental schemes, the UK has come under repeated criticism not only from national lobbying organisations, but also from the Commission itself. However, recent UK government decisions have significantly raised the available agri-environmental budget.

Lowe et al. (1999) argue further that the present CAP in which payment to farmers is a norm suits those countries that see the CAP as essentially a means of income transfer to rural areas where the main problems are those of economic decline and abandonment. It suits much less those countries that see the CAP fundamentally as a market or trade discipline and whose main concerns come from agricultural intensification and who pursue a progressive environmental policy.

#### *Sweden Before and After Accession*

Before the accession, Sweden had agri-environmental policies that were fairly similar to those in the EU. Hence it is possible to make reasonable comparisons for the purpose of eliciting possible advantages and disadvantages of common versus national agri-environmental policies. However, relying on one country only may impair the generality of the conclusions, which have to be interpreted with great caution.

In the previous landscape conservation program (called NOLA), the environmental unit of the County Administrative Boards (CABs) contracted with farmers with land of high natural and cultural value and established management plan adapted specifically to their land. Farmers are now required to formulate their own application, while earlier they needed only the contract which they had agreed upon together with the CAB. The previous policy was targeted on areas with highest biological values while the new system is more general.

The present EU environmental system has been criticised in Sweden for being too complicated to manage for both authorities and farmers. Ac-

cording to a study by Kumm (quoted in Kumm and Drake, 1999), based on interviews with 100 randomly chosen farmers, the transaction costs involved are about 10 per cent of actual compensation (see evidence in Whitby (2000)). The share of transaction costs is considerably higher for farms that receive less support than for those who receive more support. Many of the interviewed farmers who had landscape management agreements before Sweden's entry to the EU felt that the CAP compensation program is more complicated.

An investigation by Dahlström and Johansson, (quoted in Kumm and Drake, 1999) in three municipalities in South-eastern Sweden with considerable grazing-dependent landscape values showed that only two thirds of the land classified as having high environmental value is covered by support schemes. The equivalent proportion under the previous system was substantially higher (80-90%). A suggested reason for this is that farmers choose not to participate because they consider the present system too difficult to join and to quit.

In some parts of Sweden (e.g. Gotland), the problem of abandoned pasture has increased in recent years. Local administration attribute this, at least partly, to complicated application procedures which deter older farmers with valuable land from applying for support and to inability of the county administration to engage in proactive policies (County Administrative Board Gotland, 2000).

Both the present and the former programmes seem to have limited effects on the environment in the short run (Kumm and Drake, 1999). The majority of farmers manage their land in the same, or nearly the same, way as they would do without environmental compensations. Hence, the compensation program implies that many farmers are paid for a service they have already produced.

The control of programmes is extensive but is focussed on monitoring rather than on a deeper evaluation. (The total cost of administering agri-environmental support amounted in 1999 to almost 200 million SEK; National Board of Agriculture). It is a common opinion among Swedish environmentalists (including public authorities; Bodegård, pers. comm.)

that there is “too much checking if right application formula has been used” and too much mechanical registration of indicators. Moreover, once established and approved, the rules are too inflexible to cope with various contingencies. For example, farmers recently had to be fined during a year with unusually good weather conditions when livestock could not eat the entire bumper grass crop, and farmers consequently failed to fulfil the grazing requirements. Since farmers had done their best to comply, there was much justifiable discontent.

The strong emphasis on control seems also affect the choice of the programmes. In the early stage of implementation of Reg. 2078/92 in Sweden, more creativity was allowed. Later on, a fear of failure in the implementation of the system pushed the National Board of Agriculture in the direction of more standardized rules, with emphasis on simple-to-administrate projects and easily verifiable tasks.

#### *More Efficient Use of Resources?*

Extension of the scope and eligibility of agri-environmental support is likely to enhance the efficiency by increasing environmental benefits of applied resources. Starting with general arguments, if projects are compared between different sectors and different providers on the basis of comparisons of cost and benefits, redistribution towards environmental projects with higher cost-benefit ratio is likely. New agents will have to out-compete the incumbent users of funds, and are hence likely to contribute new ideas and design of activities. Accordingly, a re-allocation from wide and general measures with relatively light obligations (and presumably limited environmental benefits) to projects with higher value for money is likely to follow from the suggested changes in agri-environmental policies.

Some of the environmental benefits that are produced (or preserved) by agriculture, such as biodiversity, may also be threatened elsewhere in the society. The very concept of biodiversity is difficult (Metrick and Wietzman, 1998). Hence, similar criteria should be used for biodiversity on farmland, forest, water etc. Since environmental projects in agriculture are not systematically compared with other sectors, the relation between costs and benefits is probably weak.

Moreover, many environmental improvements produced by methods oriented towards agriculture (such as reduction of fertilizer run-off by cultivation of catch crops) could also be produced outside the sector (for instance by wetlands) or by investing in water purification facilities. Such methods may be more cost-efficient.

The suggested changes of agri-environmental policy may, by extending the support to other providers than individual farmers, also contribute to more efficient contract design. The whole idea of contracting environmental goods from farmers is fairly new. A need to develop more efficient forms of contract taking into account the asymmetry of information is substantial (Slangen 1996). A preference for decentralisation follows from the need to cope with informational asymmetries between regulatory agencies and regulated firms (Van den Bergh 1996). Contracts between farmers and the society could be arranged through intermediaries such as environmental or rural development groups. Such groups may possess an information advantage in having better local knowledge of the environmental impact of specific policies and of the opportunity costs. Furthermore, the penalties for defecting on contracts with the local community are probably much higher than those for cheating a central bureaucracy. A search for more efficient contracting would be facilitated if discretion were moved to the national level.

An additional weakness of present agri-environmental policies relates to the delivery of environmental benefits. While some agri-environmental problems like soil compaction can be tackled by addressing single farms, many other environmental issues related to agriculture require participation from several or even many farms, e.g. reduction of habitat fragmentation and maintenance of ecological networks. This low separability is due to jointness of production of environmental goods provided by farmers. This is a widespread and important feature with regard to landscape and habitats. A further point concerns the “integrated” nature of agri-environmental policy. Bereks and Folke (1998) have criticised looking at natural resources as if these are separate and discrete elements. Skerratt et al. (2000) also argue that the current agri-environmental approach is too piecemeal, and claim that there is a clear need to place the farm in its parish or community level, and to involve groups of farms.

The agri-environmental components of the CAP at present are static and rigid and not capable of coping with institutional diversity.

According to Hagedorn et al. (2000), jointness of production requires a governance structure that is able to co-ordinate the activities of a group of landowners participating in the production of a common good: it is often inadequate to orient agri-environmental support only to individuals. Several studies have emphasised the importance of local knowledge and institutional dynamics for ecosystem management. Ostrom (1995) states that, since many ecological processes occur at small, medium and large-scales, institutional arrangements that can cope with this level of complexity also need to be organised at multiple scales and linked effectively together. Rural development and agri-environmental initiatives often originate from single individuals strongly committed to particular cause such as restoration of a particular wetland or a special high-value nature area. Gadgil and others (quoted in Olsson and Folke, 2001) emphasise the need to establish adaptive co-management systems, i.e. flexible community-based systems of resource management tailored to specific situations, and supported by and working in collaboration with relevant governmental agencies, educational institutions and where appropriate NGOs. Co-operatives may be an appropriate solution because they use local knowledge and adjust to local conditions (Hagedorn et al. 2000).

According to a World Wildlife Foundation opinion (pers. comm.), structural change and declining numbers of farmers pose a considerable challenge to preserving biodiversity in the long run, especially in a sparsely populated country such as Sweden. Hence there is a great need to test non-conventional solutions and providers of agri-environmental benefits. Moreover, it should be possible for County Administrative Boards (CABs) to engage in the production of environmental benefits. EU rules make it impossible for CABs to engage in proactive policies to stimulate support applications from those farmers who possess the most valuable land (biologically rich habitats or valuable cultural remains).

However, applying the above criteria to the option, it could be concluded that allowing for greater flexibility with respect to scope and eli-

gible providers of environmental benefits could make the decision process more complicated, thereby increasing transaction costs. The total costs of implementation of the schemes are already considerable, as stated before. According to Falconer and Whitby (1999), who investigated the transaction costs of implementation in several Member States, the overall costs of agri-environmental schemes are significantly underestimated if they are equated to compensation costs only. Other costs typically add around 20-30% but well over 100% in some cases. The increased costs could be compensated by increased adjustability to various contingencies. However, integrating agri-environmental measures with environmental policy in other sectors of the economy may complicate policy integration within agricultural policy, i.e. policy integration across different components of the CAP.

Additional complications connect to property rights, and the “end of contract problem” (Whitby, 2000). Related to this is the need for continuity. Present programmes last for five years, often for good reason. Re-contracting with farmers in an uncertain market or policy environment may cause costs and problems. However, non-farmers may have difficulties in contracting for such a long time because they may lack secure land contracts.

Finally, there is at present very little subsidiarity in the implementation of agri-environmental policies, and the rules are not flexible. The danger is obvious that, in spite of extensive collection of various indicators and ambitious gathering of information, the most fundamental questions, whether the support is reliably producing the intended effects, and whether the benefits are in line with society’s willingness to pay for these benefits, remain unanswered. Allowing the Member States to opt for long-term evaluation, preferably in terms of cost-benefit analysis rather than short-term monitoring, or to decide the balance between the two elements (monitoring and evaluation) by themselves, should increase efficiency.

#### *Spillovers or Policy Co-ordination Efficiency*

Chapters 4 and 5 discussed competition in environmental subsidies and the impact of unequal subsidisation on the functioning of the common

market. The option presented here implies that the present rates of agri-environmental subsidies are unchanged; the proposal only allows for wider scope and provision. Moreover, most environmental subsidies are paid to land or to animals grazing on land, i.e. resources that are immobile across countries. Hence there would not be much point or possibility for the Member States to compete in agri-environmental subsidies.

The second question, of unequal subsidisation, is potentially more serious. What makes the issue complicated is the fact that many of the environmental benefits of agriculture are linked to agricultural production and hence potentially distort common market competition. Sustaining non-competitive production for the sake of biodiversity or landscape management will unavoidably affect production (cf. Lehman, 1988) and hence will have an impact on competition.

The option may imply that the heterogeneity of agri-environmental support that is already considerable can be expected to increase further: see Ostenburg (2000), who demonstrates that substantial variation can even be observed within the same Member State (in this case Germany). With less control on implementation, there may be some danger that “ecological window-dressing” will increase, i.e. more money will be paid to projects with dubious environmental value or be paid even if no additional benefit is produced.

It should be noted, however, that most of the environmental programmes included in Reg. 2078/92 aim at extensifying production, being thus less production-enhancing than previous support. Promoting environmentally friendly production would in most cases result in lower intensity and hence lower production. Evaluation of experiences with Reg. 2078/92 in Germany (Ostenburg, 2000) indicates that participation in agri-environmental schemes was high in regions with relatively poor natural conditions. Moreover, an analysis of farm accounts showed that farms that participated in Reg. 2078/92 schemes reduced land use intensity and production, starting from a comparatively low level. In intensively used areas, such schemes had only limited effects, while in less favoured regions they contributed to the maintenance of extensive land use. Hence, it is not very likely that more subsidiarised policies in this

area will result in more production-linked support compared with present conditions.

Moreover, it could be argued that the CAP contains a number of other instruments that, in some sense, distort competition, such as LFA allowances. Supporting agriculture in less favoured regions represents a deviation from the principle of comparative advantage as a norm for resource allocation. Those instruments are there for the same reason as environmental support, namely because political preferences for balanced regional economic and sustainable development have played a bigger role than an emphasis on economic efficiency of commodity production alone. Accordingly, the issue has been and still is how to strike a balance between functioning of the internal market and preservation of the environment.

Nevertheless, in a situation with a more nationally oriented policy, it would be essential that the Commission or Court of Justice should be able to survey and enforce national assistance which targets environmental objectives, in order to avoid or minimize distortion of competition while promoting genuine environmental goals. Kjeldahl (in Kjeldahl and Tracy, 1994) has argued that the role of the Court as a last resort for enforcing respect for the Treaties could become more pronounced if a wider range of national policies were applied in the future.

#### **6.4 Direct Payments/Modulation: Description**

In Chapter 2, we mentioned that a shift of competence back from EU institutions to national ones could be in terms of decision-making power, financing or implementation, or a combination of all of these aspects. A discussion of a shift of competence for direct payments to Member States touches on all. As we have argued before, there is no compelling reason for pursuing an objective of income maintenance measures jointly. At present, there is some scope for national decision-making and implementation, since the 1992 reforms opened up an opportunity for differential application of direct payments in Member States (see below). However, the overall level of direct payments is decided at EU level, and financing is fully centralised. One could envisage a number of possible options (and variations thereof) for decentralisation of direct payments:



- Member States could be given stronger or even full say in the application and use of direct payments (modulation), but financing remains common.
- Member States have a stronger/fuller say in the application/use of direct payments but payments are co-financed.
- The level of direct payments is fully subject to national decision. These could be nationally financed either in part (co-financing) or in total.

Each of these alternatives is likely to lead to different outcomes in terms of incentives for the actors involved (government, farmers, various interest groups etc.) and for the way resources will be allocated, and thus, ultimately, for efficiency and distribution. To take all these implications into account would be an arduous task and we have to be selective and to simplify.

In the following section, we therefore discuss the first and fairly straightforward alternative: modulation. We do this for the sake of simplifying the analysis and at the same time we recognise that, in order to reap more significant benefits from decentralisation, it is necessary to include the financing aspect of direct payments. We try to make the case that modulation could lead to improved efficiency and accountability even if financing remains centralised. We address the financing aspect in a later subsection.

#### *Extended Modulation: Description of the Option*

The horizontal Rural Development Regulation (EC 1259/99) allows Member States to apply modulation on a discretionary basis. Three alternative bases for modulation by holding are allowable: labour force, overall prosperity (farm income), or total quantity of aid. Under the Regulation, up to 20 per cent of the direct payments can be modulated. Funds made available from modulation of aid remain available to Member States in the form of supplementary Community aid to be used for the four accompanying measures of the CAP: early retirement, compensatory payments (less favoured areas or areas subject to environmental

constraints), afforestation and the agri-environment. Member States can supplement these funds, but there is no co-funding requirement.

Let us assume that Member States are given the extended freedom to use the total national “envelope” (budget total) of direct payments completely according to national objectives/criteria. Modulation would thus not be limited to the present 20 per cent, but would be extended to 100 per cent of the national envelope. Member States would be given full freedom as long as they promote agricultural and rural objectives (economic development, environmental conservation or enhancement, etc.). While only farmers are eligible under present rules, other individual/groups could be eligible as long as their activities contribute to these objectives. Member States would for example be free to apply a wider definition of “rural development” than the traditional one, which is more or less related to food production. They would also be free to decide on the criteria according to which support would be given. However, in this option, there would be no change in financing, which would remain common.

In terms of decision-making, modulation along the lines suggested could mean the following. Price support is not affected and remains centralised. The decision on the overall size of direct payments, each country’s envelope, also remains an issue that is decided upon at the EU level (i.e. Council). Member States can decide on how the national envelope is allocated between different domestic uses. The Commission would be responsible for monitoring Member States’ policies and in particular for assessing compatibility with the rules governing the internal market, the same role which it has today *vis-à-vis* the structural funds. Alleged infringements of Community rules could of course be brought ultimately to the European Court. The Commission and the Court would have the same roles as they have in monitoring competition in other sectors of the economy.

#### *Fully Subsidiarised Direct Payments and Financing*

We have argued above that, the further decisions on *how* the envelope for direct payments are decentralised, the more efficient, equitable and accountable could policies become. The most radical option for decen-

tralisation would be that Member States were also totally free to decide on the level of direct payments, and that at the same time these payments would be fully financed by Member States. As we have made clear earlier, this freedom should remain within the parameters of an agreed framework to avoid distortion of competition, for example, that total payments do not exceed the present level.

The more preferences differ between Member States, the more different policies could be pursued, and thus the more welfare-enhancing could decentralisation along these lines potentially be. In the modulation case discussed above, Member States were supposed to be free to use the envelope for direct payments for expenditures (other than compensating farmers) that aimed at promoting rural development. But when Member States are given the freedom to also decide on the size of the envelope, they can make expenditure trade-offs between the agricultural/rural sectors and all other sectors of the economy. If overall national objectives could be achieved through a redirection of spending away from agriculture in favour of other sectors, Member States would be free to do so. Individual countries would be able to allocate resources in such a way that social marginal return is equalised among all possible resource uses. As long as preferences differ at the outset between countries, welfare would improve. Moreover, since Member States decide on the level of expenditures, and spending is domestically financed, countries would have the additional freedom to reduce taxes.

If rules were changed in this way, the bargaining game would change markedly. Support to agriculture would be scrutinised by non-farmer interest groups, who would like to have a share of available resources. Although nothing can be taken for granted, it is likely that this process would lead to another allocation of resources in many countries than what is the case today. The fact that farmers are opposed to decentralisation suggests that they suspect that present national/EU spending does not totally reflect overall national priorities.

A less far-reaching option would be to allow Member States to decide the level of spending (up to the ceiling defined by the national envelope), while financing would not be completely domestic, but co-

financed. This case resembles the present structural funds, which are co-financed (in general 50-50). There is a ceiling for the EU financing, and Member States may choose the actual level of spending (between zero and 100). In practice, all countries except Sweden make use of financial resources up to the ceiling. The consequences of this option would resemble those in the more far-reaching options we have just discussed. The incentive to change priorities would however be somewhat weaker. It is likely that Member States would provide more direct payments compared with the case of complete domestic financing, since these would be shouldered not only by domestic taxpayers but also by the rest of the Community. The resource flow from the EU would strengthen the case for direct payments compared with other uses of these funds. But the requirement of co-financing from Member States nevertheless implies that domestic budgetary/taxation considerations would impinge on the decision.

## **6.5 Extended Modulation Option: Evaluation**

Modulation is potentially welfare-enhancing if 1) preferences between countries differ, and/or 2) Member States can be more efficient in the use of resources and 3) competition would not be disturbed. Whether allocation of resources really improves if decisions on how direct payments should be distributed will, of course, depend on what countries would actually do with the freedom to modulate, and this cannot be known for sure.

Countries' positions in EU negotiations provide an indication of their real preferences, and it is quite clear that Member States have had different negotiating positions on a number of CAP issues. For example, in the Agenda 2000 negotiations, the UK was not keen on the idea that modulation should be used in such a way that compensatory payments to large producers were capped in favour of small ones, while France was in favour of such a measure. France was also in favour of cross-compliance (that direct payments should be linked to employment and environment) while the UK rejected that idea.<sup>8</sup> There were also different posi-

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<sup>8</sup> The option to limit payments to larger farms and transfer resources to the structural funds was discussed in Sweden but never carried through.

tions among countries on the proposal to apply degressivity, that is, a gradual reduction, over time, of direct payments.

The major reason for possible improvements of efficiency emanates from shortcomings of the present use of direct payments, whose rationale has been ill-defined since their inception in 1992. The criticism of the present system of compensation payments has been extensive and it is not possible (and perhaps unnecessary) to present it in detail. In particular, it is difficult to justify permanent fixed rates of compensation for a once-for-all change in policy, and Buckwell *et al.* (1997) have argued that these payments should be transformed into forward-looking (and transitory) assistance. Falconer and Ward (1999) identify three central rationales for modulation: first, to accelerate agricultural restructuring and facilitate movement towards an efficient sector that is better placed to compete in the world market; second, to improve the distribution of agricultural support; and third to draw a rural dividend from CAP expenditures by releasing additional financing for the implementation of measures under the RDR.

The Swedish National Audit Office has conducted an extensive evaluation of the Arable Area Payments (1999a), and concluded that the scheme has not contributed to but rather reduced productivity growth in cereals and oilseed production. This result is directly contrary to the ambition to improve competitiveness in agriculture. Farm family incomes were affected to a relatively small extent. The farmers that had already the highest incomes received most of the arable area payments (see more analysis on this point in section on equity). Moreover, due to the weak relation between changes in the prices to farmers and the price to consumers, the impact on consumers of lower grain prices has been negligible.

The need for rural development policies is substantial. Technological advances, the Single Market and globalisation will continue to put pressure on the traditional activities of the more disadvantaged regions, particularly in terms of manufacturing and service scale. Furthermore, fiscal pressures are putting great strain on central financing of the public sec-

tor, which now plays a critical role in maintaining the economic life of rural regions (Thompson 1997).

The present rural development policies are too narrow. Only Article 31 within the Rural Development Regulation 1259/99 is (partly) devoted to more narrowly defined rural development measures. In general, rather than trying to counteract those processes that historically have contributed to the emptying of the countryside, namely declining employment in agriculture, rural development policies should concentrate on promoting the competitiveness of rural regions, by enhancing their advantages and unique features (economic, social, environmental) while counteracting their disadvantages.

## **6.6 Extended Modulation: Would It Disturb Competition?**

If modulation were to lead to different application of direct payments in different countries, could it lead to distortion of competition? It should be recalled that, in the option that we are discussing, the decision on the size of the national envelope is taken at the EU level. In this respect, there would be no change compared to today. The national envelopes would represent a *ceiling* to support to the agricultural sector in individual countries that cannot be exceeded. Member states would only decide on how the envelope is used. Seen from a *macro* perspective, competitive conditions would therefore not be affected. A “race to the top” in arable land/livestock subsidies is prevented by the construction of the option. Moreover, immobility of land and land-based livestock production makes the very idea behind such a race pointless.

But would the fact that Member States might allocate their national envelopes in different ways distort competition? When discussing agri-environmental taxes and subsidies and the need for a level playing field, we argued that environmental costs constitute only a part of total costs and that it is the latter which determines competitiveness. In case of direct payments, the issue is somewhat more complicated since they are large in relation to total farming incomes. If compensation payments could be fully decoupled, the distortion of competition would not arise. This is, however, not the case as confirmed by numerous studies (Guyomard *et al.* 1996; Lansink and Peerlings, 1996; Moro and Sckokai

1998), even if the impact on production is lower than in case of price support.

However, as long as Member States do not introduce support schemes that are more linked to production than are present area payments, no insurmountable problems should arise. Let us say that Country A uses most of the envelope, as hitherto, to pay farmers compensatory payments, while Country B instead decides to allocate most of the resources to rural development. Would that constitute a problem from the perspective of competition? It could represent a “problem” for the individual farmer in Country B (since he/she would receive less payment) but not for Country B as a whole since the actual allocation of resources would more fully reflect national preferences. And, it would not necessarily pose a problem for Country A as long as Country B’s allocation does not increase its production. Policies supporting rural activities are arguably less linked to farm production than are direct payments.

Moreover, unequal subsidisation is probably less problematic than it may appear at the first sight. The major justification of concerns about the impact of unequal subsidisation is the fact that differences in profitability tend to trigger reallocation of resources. However, agricultural land, the primary production factor in agriculture, is not mobile. Moreover, if the land most likely to go out of production receives landscape support or other environmental support, the reallocation of land-based production would be limited. In such a case, the main impact of unequal subsidisation will tend to show up as differences in land values.

In practice, the option we are discussing would face a number of difficulties. If Member States were to change the allocation of resources compared with the present situation, the conditions for different agricultural products may change even if the total amount of support were unchanged. It could prove difficult to design common rules that take care of countries’ concern that the markets for individual products may become (more) distorted. Rules to avoid distortion of competition may thus have to be very detailed. It is of course the fact that direct income support to farmers is very large in relation to farm output that makes for such complications.

These issues would have to be thoroughly analysed and discussed if Member States were given more freedom to use envelopes according to their own criteria. But, in our view, there is no clear reason why the monitoring function of the Commission should be less effective in this area than it is for the non-agricultural part of the economy, although there appears to be a reluctance on the part of at least some Member State to supply state aid data to the Commission for agriculture (e.g. Commission, 1999b)

### **6.7 Modulation and Agri-Environmental Payments: Equity**

Redistribution between countries will not be affected by the options discussed above since the allocation of EU funds between Member States will not be changed. Looking at the distributional effects of the agri-environmental option, present rules encourage larger, more entrepreneurial farmers to apply. Those farmers have appropriate skills and face proportionally lower transaction costs. Older farmers are often discouraged by the complexity of rules (WWW pers. comm.; County Administrative Board Gotland, pers. comm.). Allowing inter-mediation by environmental NGOs which can approach smaller farmers could result in re-allocation to low-income groups.

Distribution of direct payments according to the size of the farm at present is very uneven. Some large farm businesses, notably in the cereal-growing heartlands of eastern England, have received very high levels of compensatory payments. *“There can only be a weak economic case for continuation of these payments, given an unconvincing justification on distributive grounds and the delivery of few if any public goods from the social perspective”* (Falconer and Ward, 2000). Table 6.1 below shows Swedish data. As is evident, approximately 5 per cent of recipients receive a third of the support and 20 per cent receive two-thirds. The largest 2 per cent of the farms received 18 per cent of the payments. Hence, the scope is large for increasing equity in income redistribution, should Member States wish to do so.



**Table 6.1 Distribution of Direct Payments by Farm Size, Sweden, 1996**

Farm Size (ha)	Number of recipients	Share (%)	Amount	Share (%)
Under 2	319	1	1	0
2 – 5	2135	4	13	0
5 –10	5590	9	53	1
10 –20	11782	20	202	6
20 – 30	8753	15	244	7
39- 50	11594	20	511	14
50- 100	12884	22	1058	29
100- 200	4896	8	889	24
Over 200	1262	2	669	18
Total	59 215	100	3640	100

Source: Swedish National Audit Office, 1999

### 6.8 Extended Modulation and Agri-Environmental Payments: Accountability and Political Economy

In Chapter 5, we discussed whether the present institutional arrangements surrounding the CAP create a bias to the advantage of farmers. Although the views are somewhat divided, the argument is probably sound that farmers as a pressure group are strengthened by centralised EU decision-making. The limited accountability of the CAP (e.g. lack of clarity over who is responsible for a decision) and the opaqueness and complexity of its decision-making process are likely to create a bias in favour of those who are able to invest in gathering of information, i.e. organised pressure groups. By increasing the accountability, the bias should diminish.

It is clear that the “rules of the game” for interest groups would change if national governments were to decide on the allocation of payments. If other interest groups are introduced into the game and compete for the same resources, they may counterbalance the rent-seeking activities of farmers, at least to some extent. Based on pressure group theory, it could be argued that environmental NGOs and rural groups would be strengthened. Lobbying costs are probably lower at national level. Hence, lobbying may become more affordable for groups with limited resources. Moreover, the existence of potentially accessible funds could

create an incentive for non-organised groups to organise themselves and to invest in lobbying for redistribution.

The influence of pressure groups is, however, also likely to depend on the institutional setting and may hence differ between countries. An important issue is whether there is locally generated setting of agri-environmental priorities, or national setting with local-level re-interpretation over who is consulted and at what stage in the policy-making process. In a number of countries, environmental ministers and agencies are politically too weak to have a significant involvement in relation to agricultural ministries. An exception is Denmark, where a very strong Ministry of Environment and Energy has played a significant role. In Italy, environmental issues relating to agriculture may be of concern to as many as five ministers, which makes co-ordinated intervention difficult and favours the much more unified perspective of the agricultural interests (Lowe *et al.*, 1999).

According to Lowe *et al.* (1999), the relative strength of farming and environmental lobbies differs between Member States. The environmental lobby is only weakly developed in Portugal. Denmark stands out in terms of having a highly organized and efficient environmental lobby: it is the only country of the four countries analysed by the authors, in which voluntary environmental groups act as effective partners with state agencies in the development of agri-environmental policies and programmes. In other countries (with exception of some regions in northern Italy), environmental groups tend to be marginalised by the farming lobby. Whitby (1996) points out that, historically, the farm organizations have worked closely with the government on agricultural policy. However, since the early 1990s, when agriculture's negative impact on the environment became firmly part of the political agenda, environmental NGOs have played an increasingly influential role in agricultural policy making.

Evidence from pre-EU environmental policies in Sweden (Liden, pers. comm.) suggests that the position of farmers was relatively weak *vis-à-vis* the authorities. Agri-environmental contracts were highly individualized, and differences between regions were common. Hence, the design

of the contracts could more easily accommodate environmental preferences.

The reactions of interest groups in response to the Agenda 2000 decision to introduce modulation are revealing. In the UK, the decision was warmly welcomed by countryside organisations. The Council for Protection of Rural England called the announcement "*terrific news*". However, farming groups expressed disappointment at what some saw as a tax on farmers (Falconer and Ward, 2000).

## **6.9 Subsidiarity Options and International Trade**

Could decentralisation of (some elements of) the CAP create problems in trade negotiations and thus constitute an argument against subsidiarity? As mentioned above, the trade policy components of the CAP cannot be subject to decentralisation. Tariffs, quotas, and export subsidies have to be centralised. Hence, no problems should arise in this area. However, there are WTO rules/commitments on agriculture that go beyond rules for market access or export subsidies and which may complicate things. Elements of the GATT commitments relate to the reduction of domestic support, and to the acceptance of different types of support (green and blue boxes etc.). Since, for example, green box measures are excluded from the commitment to reduce support, the issue whether a particular type of support qualifies as a green box measure could be quite contentious.

International trade negotiations on subsidiarised policies would admittedly become more complicated. Looking more closely at the options advanced in this chapter, the complication would not be that substantial in case of agri-environmental regulations. Broadening the scope and the rules for eligibility is likely to enhance environmental value for support funds, hence making the payments "greener" than is the case at present. Moreover, the Commission would retain a monitoring role as stated below. Hence, the situation would not be much different than at present.

On the other hand, the modulation proposal would raise more issues. (It should be observed that this problem is present already in the existing modulation.) Compensation payments in their present form cannot qual-

ify as green box measures, as convincingly shown by Guyomard *et al.* (1999). If however, a large share of the payments were modulated and transferred to, say, general development assistance available to all kind of activities in rural areas, then those modulated funds would certainly qualify as non-distortionary support, and could thus be exempted from demands for reduction. If different Member States chose different degrees of modulation and different uses of the modulated funds, as is probable, negotiations about the status of compensation may become very complicated.

Could then the Commission negotiate with trading partners on agriculture if policies are decentralised? This partly depends on what elements of policies would be subsidiarised. But the Commission would retain a monitoring and evaluating role, and, as long as this role could be made credible, negotiations with non-EU partners should not represent a problem. Nevertheless, considering that agriculture is so heavily subsidised and a contentious issue between major trading partners, this is potentially a difficult issue that has to be pondered carefully.

# 7

## EU Enlargement and Subsidiarity

### 7.1 Subsidiarity and Previous Enlargements

The policies of the Community and the powers of the Commission, relative to those of individual countries, i.e. questions of subsidiarity, always emerge during enlargements of the EU. This is natural when longstanding national institutions in new Member States are faced with the need to adapt their activities to the requirements of the *acquis communautaire*. Often, the opportunity is taken to extend “common” arrangements to include features special to the new Member State(s). Usually, such arrangements may be considered temporary – by one side or the other – and may require periodic renewal. This section identifies the main developments in the agricultural policies of the EC/EU as it has absorbed more countries since the 1970s.

In 1973, the United Kingdom, Ireland and Denmark joined the Community of Six, constituting its first and arguably most significant enlargement due to the large size and generally free-trading attitude of these countries. As a major food importer, with long historical trade links to the former British Empire, the UK brought a number of problems to the accession negotiations. Some of these issues were resolved by special arrangements peculiar to that country though not all subject to national decision-making. For example, tariff quotas (the exclusive preserve of the Commission as trade negotiator) safeguarded the UK’s traditional imports from New Zealand and a number of former colonies. The beef sector (of major importance to Ireland as well as the UK) was introduced by creating a second and different component to the “common” market organisation for that product.

The accession of Greece in 1981 necessitated the creation (prior to Greek entry) of common market organisation for sheep and goat meat, for which no CAP commodity regime had existed. As with beef, the need to accommodate the different British and French systems of support in this sector resulted in a two-option regime, with deficiency payments (“variable premiums”) in the UK, and market support plus headage payments in France (and Greece). Over the subsequent years, both red meat re-

gimes have slowly moved towards the latter form, in line with the standard CAP commodity format.

In 1986, Spain and Portugal joined the Community of Ten, with long transitional periods. Again, third-country trade problems (e.g. imports of US maize) had to be solved, with the use of Community-level powers and measures. The entry of these two important “Mediterranean” Member States accelerated the reform of the structural policy. The Integrated Mediterranean Programme (IMP) and other measures encouraged the relevant Member States (France, Italy, Greece, Spain, Portugal) to prepare proposals for Commission approval, and paved the way for the programming approach which became the norm throughout the EU in the 1990s.

The most recent EU accessions of Sweden, Finland and Austria, in 1995, took place under rather different conditions than the previous enlargements. The achievement of the EU-12 Single Market by the end of 1992 meant the virtual abolition of border controls and hence the imposition, at last, of common support prices for agricultural products. Thus there was little or no scope for price-related measures such as green rates and deficiency payments, and obvious objections to special rates of area and headage payments in the three new Member States. Although Sweden posed smaller problems of economic adjustment than the other two countries because of its own domestic policy reforms in the early 1990s, certain types of regulations (e.g. milk quotas) had to be re-introduced with CAP adoption. Austria, and in particular Finland, had higher prices and other supports, and had more difficult adjustments; for both countries, a system of degressive national aids was agreed over a period of five years, with additional aids possible in Finland. Transitional periods were also granted for quality standards, e.g. fruit and vegetables (all three), drinking milk (Sweden and Finland) and eggs (Finland).

More significantly, a new set of long-term aids to farming in areas above or adjacent to latitude 62° was created for Sweden and Finland. These aids are *“subject to Commission control and..., in particular, ... may not result in an increase in, or intensification of, agricultural production”* (Commis-

sion, annual 1995). This represents the clear invention of a new element of subsidiarity into the post-1995 CAP.

## **7.2 Background to Eastward Enlargement**

The collapse of the Soviet Union and its empire in 1989/90 posed immediate and major questions for the EU. The first and most urgent of these was the unification of East Germany with the Federal Republic and thus the incorporation of that area into the EU itself. These processes took place with remarkable speed in 1990, and the CAP was applied more or less fully in East Germany at an early stage. Special measures were taken with respect to CAP expenditure control measures such as maximum guarantee quantities (MGQs) and sugar and milk quotas, to encourage agricultural restructuring, to introduce new legislation, and to take account of trade obligations with neighbouring countries (Commission, annual 1990 and 1991), but in general the *acquis communautaire* was applied speedily. All five *Länder* were awarded Objective 1 status within the EU's structural policies, thus enabling 75% reimbursement from the EU budget. Between 1990 and 1995, 17.2 billion DM were spent directly on agriculture in East Germany to overcome financial stress and establish a modern farming sector (BMELF, quoted in Forstner and Isermeyer, 2000, p. 66). Because of the unique nature of this EU "mini-enlargement", most decisions were left to the German authorities, whose amended Agricultural Adjustment Law (*Landwirtschafts Anpassungsgesetz*) of 1991 laid the foundation for a market-oriented farming structure, rather than one of family farms as in the western *Länder*.

Naturally, future EU enlargement to other countries in Central and Eastern Europe poses much larger questions, including the development of their own domestic political preferences (and those of Russia) during a period of renewed national independence and major socio-economic transition. Hartell, Bojnec and Swinnen (1999) have analysed these preference developments, and their influence on agricultural policies, in terms of national economic structure (e.g. share of farm employment), food costs (share in consumer expenditures), net trade position in major food products, and farming structure. The level of protection given to agriculture by governments of Central and Eastern European countries (CEECs) has begun to rise again after sharp and more or less sudden

falls following 1989/90 (OECD, 2000). In other words, the CEECs are actively exercising their newfound national decision-making power. Although CEEC policy-makers sometimes defend this increased support on the grounds of convergence with EU practice (i.e. the CAP), some of its nature and balance, e.g. subsidies for purchased inputs and relatively high protection to the pigmeat sector, are often different from the pattern of the CAP.

The prospect of extending the CAP to the CEECs has given rise to a large number of studies and reports, both official and academic (Csaki and Lerman, 1994 and 1997; Swinnen, 1997; Sarris *et al.*, 1999; Thiele and Brodersen, 1999; Buckwell *et al.*, 1994; Mahé *et al.*, 1994; Tangermann *et al.*, 1994; Tarditi *et al.*, 1994; Commission, 1995b; Tangermann and Banse, 2000; Hartell and Swinnen, 2000). Many of these studies have identified a large number of problems in agricultural accession, notably budget costs (see Section 7.3), but also the non-competitive nature of much of the farm structure and in particular the food processing sector and in rural infrastructure. On the other hand, pressure to accelerate the enlargement timetable is growing within the political leadership of the CEECs, and the EU Commission and Council have been actively searching for ways to make this possible without creating intractable problems of budgetary payments, Single Market competitiveness and Council decision-making.

The Inter-Governmental Conference at Nice in December 2000 has established a new milestone in the current enlargement. Indeed, according to the responsible Commissioner, Günter Verheugen, it marked “the elimination of the last obstacles to enlargement on the EU side” (speech, Brussels, 16.01.01). However, the Commissioner drew attention not only to the “weaknesses in the candidate countries’ preparedness” as regards administrative, judicial and structural economic reforms, but also to the need “to communicate the importance and advantages of enlargement” to the public in those countries. Another Commissioner, Pascal Lamy (speech, Berlin, 8.02.01) has referred explicitly to subsidiarity as a principle of organising the post-Nice EU. These remarks show that issues of governance such as subsidiarity will play as large a part as technical and budgetary matters in the enlargement negotiations and debate.



### 7.3 The Budget Costs of Enlargement

EU accession by the CEECs and their adoption of the CAP including direct payments would certainly result in substantially increased budgetary pressures for the Community – by a total of 12-16 billion Euro according to some estimates (e.g. European Commission, 1995a; Frandsen and Jensen, 2000). Due to their relatively low GDPs, few additional “own resources” for the EU will accrue from these new members, and there are many other purposes (e.g. investment in public infrastructure) for which EU funding will be sought. Moreover, there is the danger that these new members will expand (or distort) agricultural production both before and after entry in order to maximise their claims to CAP subsidies (Bach, Frandsen and Jensen, 2000). Existing members are reluctant to relinquish farm production and subsidies in favour of new members, however great the comparative advantages of the latter in terms of productive efficiency, and their relative poverty in terms of income and assets per head.

The argument for including the standard arable and livestock direct payments in the extension of the CAP into the CEECs is based on both legal and equity grounds. First, the payments were first awarded in 1992 on a permanent basis, and form part of the *acquis communautaire* which the applicant countries are being continually asked to accept without qualification. The term “compensatory” was originally applied to these payments with reference to the fact that they were designed to offset the 1993-96 reduction in CAP support prices. However, this term has now been dropped from official papers (e.g. Agenda 2000). There is thus, it is argued, no legal basis for depriving new Member States from receiving them. Second, it is argued that continuation of direct payments in the EU-15 while banning them in the CEECs would not only be unfair to farmers whose incomes and wealth are generally low, but give an unfair competitive advantage to EU-15 farmers through a regular and reliable source of funds, which may be partly “decoupled” from actual production levels but nevertheless do much to maintain output through periods of low or uncertain prices.

Against this are the arguments that (i) the direct payments were introduced (in 1992) and increased (in 2000) explicitly in compensation for

cuts in support prices which have not directly affected farmers in the CEECs, and (ii) the budgetary cost of these payments would place an unsupportable strain on the EU's budget (see estimates above). The extension of this component of the CAP would also raise protests from third countries in the WTO, since the "blue box" into which the EU-15's payments were placed was not designed to include new Member States. Indeed, as argued above (Chapter 6), even direct payments to EU-15 farmers will come under such attack in future WTO negotiations that they will have to be severely adjusted, e.g. via modulation, or removed.

Despite protestations to the contrary, it is not impossible that the EU would in fact expand its agricultural budget by say 20-25% to cope with new members, particularly if these were relatively small and "cheap" in subsidy terms due to a net trade deficit in farm commodities. In the past, the Community has allowed CAP spending to grow to previously unthinkable levels, and despite strenuous efforts to control its growth. And, if continued, such behaviour could be defended as a relatively inexpensive way of securing the political and economic liberalisation of the CEECs, when compared with the cost of rearmament against unfriendly neighbouring powers, or the costs – financial and social – of border and internal controls against major and unwelcome immigration. Nevertheless, there will be strong resistance amongst many current Member States to agreeing the kind of EU budgetary increase indicated above.

The first enlargement – whether of one CEEC or a "first wave" - will create precedents for all others, and the Commission will undoubtedly be cautious in its approach. Moreover, there is great reluctance on the part of several powerful Member States to increase the EU budget faster than economic growth, and new controls (the Agenda 2000 cash limits, and commodity-specific measures) have so far proved effective in preventing unexpected spending. On the other hand, the EU will not wish to see its first major enlargement into Central Europe blighted by legal challenges within one of its core policies.

It is likely, therefore, that an urgent search for a politically acceptable compromise between full and no award of CAP direct payments will soon be underway. In practice, such a compromise could emerge on both

sides by means of a transitional period during which direct payments are reduced in the EU-15 while increased in the CEECs. Alternatively, the necessary convergence could be achieved by attaching increasingly rigorous environmental and other cross-compliance conditions to EU-15 direct payments so that fewer farmers receive these payments in full or at all, while simultaneously CEEC farmers could become eligible as and when equivalent criteria are applied in the new Member States. Lump-sum payments such as structural funds devoted specifically to agricultural and rural development could be granted on a tapered (degressive) basis to entrant Member States to make up for the initial disadvantage.

A simpler way to achieve a “fair” application of CAP direct payments without budgetary overload would be to apply the same rates (per hectare or livestock unit) in the old and new Member States but at a level which maintains the current expenditure level. The next section elaborates on such a proposal.

#### **7.4 An Enlargement Scenario: “Fair” Direct Payments to Farmers**

In this scenario, the level of EU expenditure on arable payments (the bulk of the direct payment spending) is taken as fixed, and that amount is distributed on the same basis amongst both the old and new Member States. Table 7.1 shows the relevant calculations. Columns (1) to (4) give the reference yields and basic areas on which the current payments (of 63 Euro/ha for cereal and oilseeds, and 71.5 Euro/ha for protein crops) are based. These data result, in column (5), in total payments of 15.8 billion Euro in the EU-15 (the current estimate for the year 2003), and potentially an additional 6.2 billion Euro in the CEEC-12.

If the 15.8 billion Euro budget is not to be increased, and the same direct payments are to be made to all 27 countries, the rates per hectare must be reduced by 28% to 72%<sup>9</sup>. Farmers in the EU-15 would find that their subsidy receipts fall by this percentage, while the entrant states would receive, in total, nearly 4.5 billion Euro (Table 7.1, column 6).

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<sup>9</sup> This is roughly in line with estimates by Frandsen and Jensen (2000), who use a reduction of 33%, to 67%, when the CAP budget in 2010 would be between 52 and 54 billion Euro.

An alternative scenario uses the figure of 3.4 billion Euro which has been allocated in the Agenda 2000 EU budget to market regulation in the six leading CEECs<sup>10</sup>. Extending this on the basis of arable area to the CEEC-12 gives a total of 5.7 billion Euro. In the EU-15, 45% of the corresponding total (about 35 billion Euro) is used for arable payments. Using the same proportion for the CEEC-12 results in available funds of 2.6 billion Euro, which can be added to the EU-15 figure of 15.8 billion Euro to give a total of 18.4 billion Euro. Applying this funding uniformly across all 27 countries requires the arable payment rates to be reduced by 16.5%, and awards a total of 5.2 billion Euro to the CEEC-12 (Table 7.1, column 7).

Naturally, these calculations are crude, partial and speculative. However, they indicate the magnitude of the adjustments that are required if a fully common system of direct payments is to be implemented across an enlarged EU. The falls in EU-15 rates are significant, but not massive. Since beef cattle and sheep numbers in the CEEC-12 have fallen significantly since 1990, the corresponding reductions necessary in direct payments for livestock are likely to be somewhat less. Alternatively, the same reduction in both arable and livestock direct payments could be made, with less adjustment than is represented in Table 7.1. Moreover, application of the same formula to only the "first wave" of applicant countries would clearly reduce the necessary reductions in the EU-15, since the first six account for about 60% of the CEEC-12 arable total.

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<sup>10</sup> The "first wave" has now been abolished in the enlargement negotiations, but the amount is still applicable in financial terms.

Table 7.1: EU Arable Payments Budgets, 2003

	Ref. yields (kg/ha) (1)	Areas ('000 ha)			Payments (billion Euro)		
		Basic area (2)	Basic area utilized (3)	Of which protein crops (4)	Full rate* (100%) (5)	Partial rate** (72%) (6)	Partial rate*** (83.5%), (7)
Belgium	6.24	490	442	2	0.17	0.13	0.15
Denmark	5.22	2018	2002	70	0.66	0.48	0.55
Germany	5.66	10157	9943	208	3.56	2.56	2.97
Greece	3.39	1492	1301	3	0.28	0.20	0.23
Spain	2.9	9220	8812	69	1.61	1.16	1.35
France	6.02	13582	13382	495	5.10	3.67	4.26
Ireland	6.08	346	333	3	0.13	0.09	0.11
Italy	3.9	5801	5078	77	1.25	0.90	1.04
Luxembourg	4.26	43	39	0	0.01	0.01	0.01
Netherlands	6.66	442	400	2	0.17	0.12	0.14
Austria	5.27	1205	1136	48	0.38	0.27	0.32
Portugal	2.9	1022	826	5	0.15	0.11	0.13
Finland	2.82	1591	1579	7	0.28	0.20	0.23
Sweden	4.02	1737	1733	30	0.44	0.32	0.37
United Kingdom	5.83	4461	4372	197	1.62	1.16	1.35
Total EU-15		53607	51378	1216	<b>15.81</b>	11.38	13.20
Bulgaria	4		2700	10	0.68	0.49	0.57
Cyprus	3		10	0	0.00	0.00	0.00
Estonia	2.3		400	10	0.06	0.04	0.05
Latvia	2		650	5	0.08	0.06	0.07
Lithuania	2		1200	10	0.15	0.11	0.13
Malta	3		0.3	0	0.00	0.00	0.00
Poland	3.14		9235	75	1.83	1.32	1.53
Romania	3		7000	15	1.32	0.95	1.11
Slovenia	5		150	2	0.05	0.03	0.04
Slovakia	4.58		1100	30	0.32	0.23	0.27
Czech R.	4.58		1800	45	0.52	0.38	0.44
Hungary	5.19		3628	60	1.19	0.86	0.99
Total CEEC-12					6.20	4.47	5.18
Total EU-27					22.01	<b>15.85</b>	<b>18.38</b>

\* Full payment rates: 63 Euro/ha (71 Euro/ha for protein crops)

\*\* Budget 15.8 bn Euro

\*\*\* Budget 18.4 bn Euro

Source: Own calculations

This scenario are likely to result in a rise in agricultural resource values (primarily land, but also breeding stock, and equipment associated with arable, cattle and sheep enterprises) in the CEECs, since they will attract a secure, long-term (and to some extent unanticipated) flow of funding. In the EU-15, the values of equivalent resources will fall, especially in some of the more specialised farms and farming areas where direct payments have become a major component of farming incomes and borrowings. The effects will be less in more mixed areas, or in mountain areas where the richer governments at least are likely to maintain total support at a level sufficient to ensure continuation of farming and farm population. There may also be an initial period of uncertainty (before and after actual enlargement) as to how the new system will operate, and how far national governments will be willing to mitigate the consequences of spreading the EU budget more thinly over an enlarged Community.

If, politically, the adjustments in Table 7.1 are regarded as sufficiently uncomfortable for existing Member States, application of the principle of subsidiarity might be applied by allowing such countries to replace the "top-sliced" payments with national funding. Thus, for example, Sweden would be authorised to provide up to 0.12 billion Euro (1 billion SEK) in compensation for the "enlargement tax" represented by the main scenario explained above, or 0.07 billion Euro on top of the enlarged EU budget total. Moreover, the criteria for such expenditure could vary from those in the arable Regulation 1251/99, for example simulating those used for modulated funds or those in Rural Development Regulation. If such funding were to be regarded as a serious infringement of common support across the enlarged EU, the scheme could be made transitional, perhaps converting its funding to a full rural development instrument.

So far, the problem has been taken as a simple one of arithmetic extension of CAP direct payments during EU enlargement. Actual use of the funds should, however, seek to reduce the several disadvantages of the present EU-15 system. As argued in previous chapters, the principle of

subsidiarity suggests that Member States should be able to spend this budget in ways which promote rural development and environmental enhancement on a much broader front than the CAP direct payments. It is believed that several if not all EU-15 countries should and would utilise at least some of the direct payment funds in such ways.

In the accession states, the problem is almost the reverse: under pressure from large and powerful agrarian interests in those countries, subsidiarity might well mean a rigid application of per-hectare and per-head payments, possibly in even more distorting ways than at present in the EU-15. Economic arguments suggest that the act and process of accession should be used in such a way as to reduce the chance of continuing existing distortions on a wider scale by modifying the terms of CAP “direct payments” in new Member States towards “aggregate” spending (see Section 7.5 below). This would encourage existing members along the same route, perhaps by introducing degressivity into the standard payment rates while allowing use of the released funds for different purposes. Over time, both sides would end up with smaller or even zero direct payments per hectare or per head of livestock, while receiving funding for rural development and environment purposes that would be of a wider and more sustainable character.

### **7.5 An Alternative Enlargement Scenario for Central Europe: Aggregate Direct Payments**

As an alternative to the sensitive issue of awarding new and “unearned” direct payments to individual farmers in the accession countries, support might be offered in the form of aggregate or “lump-sum” payments to individual countries. The level of the national entitlements to these funds could be agreed as part of the individual accession agreements, or (and preferably) be made on the basis of a formula which would gradually become applicable to existing Member States, as the size of unmodulated direct payments is reduced (degressivity). From the point of view of entrant countries, such a scheme could be regarded as the post-accession version of the SAPARD scheme, under which pre-determined funds are available for Commission-approved programmes for rural development. From the point of view of existing Member States, it could be seen as the growth of the CAP’s “second pillar” in the form of the Rural

Development Regulation 1259/99, while reducing “first pillar” expenditure on direct payments, which are in any case regarded as an unsatisfactory set of measures by non-farmers at least, and constitute a potential EU hostage in future WTO negotiations.

All 10 CEECs have now had their SAPARD applications approved in whole or in part, and although the amount is relatively small – about Euro 500 million per year for all 10 CEECs – the stage has been set for expansion of this channel of support. It is clear that the structural problems facing the CEECs are immense – including a reduction of their agricultural workforce from some 10 million to about half that number – and further calls on this type of support are inevitable. It would be a much better use of available funds in the CEECs – whether large or small – to target them towards the general rehabilitation of rural economies and environments than to allow the somewhat arbitrary criteria of the Mac-Sharry reforms to benefit all farmers regardless of need or the use to which the assistance may be put.

Support policy for preferred farming methods is likely to throw up similar policy dilemmas, or paradoxes. The severe economic squeeze on CEEC farmers over the past ten years has led to major reductions in input use, so that subsidies for maintaining an environmentally friendly operations seem unnecessary. Payments for *not* intensifying and modernising farms appear to repudiate the overriding aim of EU accession, that of simulating the commercial success of a western economy.

Dalton (2000) has claimed that *“sustainability issues are hardly considered in the current EU [agricultural] policy formulation process”*. If this is true for the EU-15, it is even more likely to be true in the context of an enlarged EU. He advocates much more attention to monitoring and forecasting of environmental (as well as market) developments, so that awareness of sustainability (which is otherwise likely to be low in the CEECs) is enhanced and policy making influenced. Further, farmer groups should be encouraged in the pursuit of sustainable agricultural development, despite the widespread suspicion of group actions following years of distortion under socialism.



Aggregate rather than individualised entitlement to “direct payments” draws attention to the public-sector decision-making processes involved. With the fall of communism as an economic and political philosophy, the search for an alternative framework of governance is underway in the countries of Central Europe. Old-fashioned nationalism is one obvious alternative, but suffers from its chequered past (and present, in the case of Former Yugoslavia, and some other areas such as the Hungarian-Romanian border). It also fits badly with the ideal of EU integration and the fact of economic globalisation. Competitive capitalism and a market-oriented economy is another available strategy, but is seen as threatening both in itself and in terms of take-overs from more advanced developed economies in the west.

In parallel with the debate at country level in Central Europe is an argument over more local government, particularly in rural areas. In the absence of strong regional government in most Central European countries, a large number of small local authorities have appeared (or emerged) as semi-autonomous but financially constrained bodies. According to Warner (in Brown and Bandlerova, 2000), “the seeds for rural economic regeneration lie in part in the re-emergence of autonomous local self government”, but “serious problems with mismatch between revenue raising capacity and service provision responsibility still exist” for these units. Warner argues that these rural local governments must establish financial and service autonomy, build capacity and promote integration (with neighbouring municipalities or otherwise), create markets by local privatisation and public-private partnerships, and promote citizen participation.

Such a path may well suit the current and future concepts of “social trust” and “civil society” in Central Europe, as it has done in the counties of the United States and to a lesser extent in Scandinavia. Local leadership, based in many cases on surviving manufacturing or service providers, could then be expected, with a mixed outcome in terms of success or failure in attracting inward investment and support from central-state or private sources. However, in most West European countries, the responsibility for economic development, and often also for service provision, has been given to regional government. Moreover, in Central

Europe, both the fiscal pressures on the central state, plus the urging of external donors such as the EU and World Bank, suggest the build-up of regional authorities rather than a large number of small but locally powerful municipalities.

Thus, rural development in Central Europe with the use of redirected aggregated agricultural funds faces a so-far uncertain structure and balance of national, regional and local government. To the extent that Ministries of Agriculture retain a nation-wide network of offices, data systems and powers, this system offers a suitable vehicle for the suggested funding. However, this runs the danger that the funds will simply be used for direct production-linked support, thus repeating the errors of the CAP. To achieve spending on rural infrastructure and services (e.g. education) that will maximise overall returns, it is probably necessary to utilise non-agricultural networks.

As regards the environment, even in Western Europe, responsibility for land and water management, and for development project approval and funding, is contested between national, regional and local levels. The same arguments can be expected in Central Europe, but with less organised and articulate voices representing environmental specialists, and much less monitoring capacity.

## **7.6 Enlargement Scenarios and Subsidiarity Options**

How do the above two “scenarios” for applying the reformed CAP to the new Member States relate to the two “options” discussed in Chapter 6? These two options were (i) to extend the scope of agri-environmental payments to all natural resources and to non-farmers, and (ii) to extend “modulation” of direct payments to rural development in general. Clearly, it would be short-sighted to undertake further CAP reforms for the EU-15 if the results are agricultural and rural policies which are too strange or difficult for new Member States.

It would be wrong to deny that problems may not arise in the CEECs currently undergoing transition – at variable speeds - to market-oriented economies. The lack of organised and powerful economic interests other than those of the previously (or still) state-controlled production enter-

prises and of new trading and banking companies may make it difficult to encourage the broader and “greener” rural development targeted by the EU-15 options. In the rural areas of many CEECs, the collapse of socialist agriculture and other industries has left behind no obvious social or entrepreneurial structure which can be used to implement the kind of reform options advocated in Chapter 6. Pre-transition, regional and local governments in Central Europe had few independent powers, and their financial resources are now extremely scarce.

On the other hand, no government of a democratic country can operate without a combination of more local public and private organisations which are efficient, resourced, and public-spirited to some degree. In the sectors of primary interest to this paper, the growth of farm producer groups, chambers of commerce, and rural enterprise networks within a stable and fair legal framework is a prime goal of the EU’s efforts to foster progressive socio-economic developments in Central Europe. Such efforts will be enhanced if the funds made available to farmers and others in rural areas can be enlarged through the CAP options suggested in Chapter 6. In particular, the extension of agri-environmental payments to other purposes and recipients should help to protect and enhance the considerable areas of forest and other non-agricultural lands (including abandoned farmland) in the new Member States, and to restore damaged water systems and other rural infrastructure. Eliminating the question of who is a farmer should simplify greatly the distribution of funds to a context of disputed land tenure and unstable land management arrangements.

The extension of “modulation” to rural development in general - and in particular the aggregation of individual entitlements to local and other group recipients - will have the twin benefit of reducing expectations based on current EU-15 levels of direct payments to farmers, and encouraging the growth of collaboration and co-operation between all types of rural entrepreneurs. The continued and perhaps enhanced role of the European Commission in monitoring the disbursement and use of these funds should inhibit their “capture” by powerful interests.

Thus, it can be argued that the kinds of reforms to the current CAP suggested by the options analysed in Chapter 6 will be of positive benefit as and when the countries in Central Europe come to be admitted to an enlarged EU. All sides can see problems in simple continuation and extension to the East of the present arrangements. The suggestions made here should be relatively simple to introduce through parallel developments in the SAPARD and Rural Development Regulations over the accession years of the future decade.

# 8

## Conclusions

### 8.1 Conceptual Conclusions

Subsidiarity is a principle of governance designed to give meaning to the division of power and responsibilities in a multi-tier system. As such, the principle is applicable between any two adjacent tiers in a system stretching from a local to a global level. In the 1980s and 1990s, in the EU, the principle has evolved into a device for curbing the enlargement of competencies of the Community. However, the principle has also been used for justifying movements in the opposite direction. In this report, we have used it to analyse the division of responsibilities between Member States and the Community. The principle could, nevertheless, easily be extended to the sub-national level.

Subsidiarity is often interpreted as a presumption in favour of allocation of power downwards. But, strictly speaking, it is not the same thing as decentralisation or decision-making power to the lower level, rather an imperative to analyse accurately at what level decisions should be taken. A number of somewhat different forms of subsidiarity may be defined and observed, for example *de jure* and *de facto* subsidiarity, and the co-financing of voluntary measures.

The principle has been criticised for being vague and inconclusive. However, evaluation of subsidiarity in the field of agriculture using the criteria of economic efficiency, social equity and political accountability appears to be a useful exercise. In this report, subsidiarity has been analysed mainly from an economic and not a legal perspective. However, the present allocation of competences should not exclude such an assessment exercise for the agricultural sector.

### 8.2 Policy Conclusions for the EU-15

At the time that the European Economic Community was founded, market price systems with the aim of supporting farmers' incomes already existed in most original Member States. Creating a single internal market could be achieved by harmonising these systems. Price support – the main CAP instrument up until the 1990s – gave very little scope for do-

mestic policies, the main exception being the “green” exchange rates, and it enforced a centralised policy. Reforms of the CAP in the 1990s changed the situation considerably, and the justification for letting the entire CAP remain a common responsibility is today considerably weaker. In the new policy areas, such as direct income payments, and much of environmental and rural support, control remains common because those policies originate from the reforms of the old CAP rather than because of the merits of policy centralisation in these areas. Undertaking the assessment of the advantages of centralisation, policy area by policy area, using the above-mentioned criteria, indicates that the case for remaining centralised is weak.

With respect to both the agri-environmental and general rural development, diversity in incomes, preferences and economic conditions between Member States calls for diversity in policy measures. Trans-boundary issues in agri-environmental area are few, and competitive advantage does not flow to states with lax environmental standards or excessive subsidies. Similarly, most rural development policies have limited implications for other Member States. Thus common policies in both these fields are faced with task of implementing EU laws which lack economic rationale or indeed democratic legitimacy. As suggested by Harvey (1998), *“Policies designed to partially compensate previous gainers (of price support) and also regenerate and conserve rural environments and economies are necessarily locally and regionally specific – requiring local or regional political determination, under the principle of subsidiarity”*.

In principle, reform of the CAP could therefore take the form of (close to) full decentralisation. Action at the EU level could be limited to setting an appropriate framework, including the definition of the rules that are needed to preserve the integrity of the single market and to avoid market distortions. Trade policies *vis-à-vis* third countries would also have to be handled at the Community level. Apart from this, Member States could design their own agricultural policies.

But, even if reform does not move that far, efficiency improvements could arguably be achieved if Member States were given a stronger say in several areas of the CAP. The essence of the argument is that, in the

absence of spillovers, joint policies are likely to be inefficient because common decisions may not reflect national preferences.

In such a case, the allowable uses of resources under a common policy may, due to bargaining inefficiency, be different than (some) Member States would have chosen on their own. Consequently, the marginal net benefit is probably lower than is the case for other societal uses of these resources. The more different the preferences, the lower will be the net benefits. Thus, the more restrictions on the use of resources are relaxed, the more could efficiency be expected to increase.

We chose two areas for further analysis, namely, agri-environmental measures and direct payments. In the former case, the suggested option consists of three components, related to the scope of environmental support, provider eligibility, and forms of support evaluation. It is argued that, if projects are compared between different sectors and different providers on the basis of comparisons of cost and benefits, redistribution towards environmental projects with a higher cost-benefit ratio is likely. New agents will have to out-compete the incumbent users of funds, and are hence likely to contribute new ideas and activity designs. Accordingly, a re-allocation from wide and general measures with relatively light obligations (and presumably limited environmental benefits) to projects with higher value for money is likely to follow from the proposed changes in agri-environmental policies.

In the case of direct payments, the option would amount to giving Member States the extended freedom to use the total national “envelope” (budget total) of direct payments completely according to national objectives and criteria. Modulation would thus not be limited to the present 20 per cent, but would be extended to 100 per cent. Moreover, Member States would be given full freedom as long as they promote agricultural and rural objectives. While only farmers are eligible under present rules, other individual and groups could be eligible. However, financing would remain common. The major reason for possible improvements of efficiency stemming from this option relates to the shortcomings in the present use of direct payments.

However, greater subsidiarity should not pave the way for governments to give unlimited national aids. The Commission would have the responsibility to monitor and assess Member States' policies with the view to avoiding distortion of competition. Competition rules have been in operation for many non-farm sectors of the economy, and these could be applied more strongly to the agricultural sector. Any form of national production aid should remain subject to scrutiny and approval according to the procedures laid down in the Rome Treaty. The usual provisions with regard to national aids, as laid down in Articles 92-94, should be applicable.

The CAP has been seen as symbol of EU integration, and was from the inception of the EU the most centralised policy area. Decentralisation of agricultural policies could therefore be seen as a step away from integration. It has been argued that renationalisation of the CAP may signal disintegration of the EU itself (Kjeldahl, in Kjeldahl and Tracy, 1994). However, the creation of the Economic and Monetary Union arguably represents a much more powerful vehicle for further integration than is the CAP. A common monetary policy requires co-operation in fiscal policy (stability pact, etc.) but is also a catalyst for co-operation in other areas of economic policy.

It should be recalled that agriculture now contributes only around 2 per cent of GDP in the EU, and the share is constantly declining. It is hard to see that Europe's integration should so be intimately related to agriculture. Moreover, the CAP is characterised by inefficiency at the same time as it consumes 50 per cent of the EU budget. These resources could be better employed in other areas in order to strengthen integration if this is wanted.

### **8.3 Policy Conclusions for an Enlarged EU**

Nearly all the above conclusions will apply to the countries of Central and Eastern Europe as they become EU members and adopt the CAP. In the interests of economic efficiency, social equity and political accountability, it is to be hoped that the CAP will have been significantly modified by the time this happens. Current problems in the EU-15 will then not be extended to new members, whose presence in the Council will



probably make it harder to secure the relevant reforms. Prior to enlargement, however, both existing and intending Member States have an interest in assessing the arguments in this report.

Direct payments constitute the major difficulty in the present CAP for the enlargement negotiations. Simple extension has strong arguments on grounds of consistency and indeed legal entitlement, as well as fair competition. However, this would pose severe problems for the EU budget. These problems may not be insurmountable, and indeed an obvious option is to apply the same direct payment rates to farmers in both east and west within the current budget for such measures. However, even such modified extension would impose major social inequities and economic distortions in the CEECs themselves. The rural landless and the urban poor would be ignored, and markets for agricultural assets such as arable land would be severely affected after accession (and before, due to anticipation). These problems cannot be avoided.

A more attractive option is to press the case for "aggregate" rather than individual direct payments for the purpose of agricultural and rural development in the CEECs. Given a fixed sum, or a formula for doing so, the new Member States would be able to undertake broad-scale investments in their rural areas, using farmer and social groups as well as local and regional authorities. These payments - which might be co-financed from national sources, but at a low level - would "compensate" CEEC farmers for the lack of EU-15 direct payments through the provision of improved rural infrastructure, better farm and food-processing equipment and training, environmental improvements (e.g. cleaner water), enhanced rural education, etc.

Still more attractive would be the gradual conversion of EU-15 direct payments into such forms, as is already happening to a limited extent in a few Member States, with modulation. If undertaken as a medium-term strategy over say 10 years, convergence could be achieved between the current CAP in the EU-15 and the "new" CAP in Central Europe. Full advance warning, in the form of a timetable for the reduction of individualised farmer payments, and an invitation to suggest and apply for "aggregate" payments, would help to ease the problem of asset value ad-

justment. This course would also make it easier for the EU to reach agreement with its partners in the WTO both over the incorporation of CEECs into the EU customs union, and during the forthcoming "millennium round" of agricultural negotiations.

#### **8.4 Wider Issues**

It is unrealistic to expect that the debate on subsidiarity will ever subside to negligible levels. First, the range and nature of state intervention in the operations of private agents is ever changing. Second, the EU is comprised of a number of ancient nations and nationalities, which can never be expected to surrender all significant powers to a centralised federal union centred in Brussels. Canada provides a simpler but telling example. Even after 400 years (100 since full independence), French Canadians have retained their identity in political as well as cultural terms. Moreover, "first nation" Canadians have increasingly insisted on the exercise of rights which existence and scope are determined through court hearings. Even between the much more homogeneous English-speaking Provinces, there is an on-going process or struggle to define, retain or obtain decision-making powers.

In a European Union of 15 or 25 states, with much greater diversity, a considerably more well defined "subsidiarity process" may be anticipated, particularly as spillover effects between markets, societies and even environments become increasingly important. The lack of a full EU constitution may complicate such a process, and also a slow-moving European Court. However, at Nice in December 2000, limited progress was made towards addressing these issues.

In both existing and applicant countries, there is a stated commitment to equal, or fair, treatment for new entrant, in terms of both the requirements and the benefits of EU membership. A new Member State is to observe in full the *acquis communautaire* and contribute to the EU budget according to the normal rules (see Chapter 3), while gaining immediate full voting rights in the Council and eligibility for all available subsidy schemes. For their part, applicant countries have all stated their willingness to comply with these conditions, but several have requested transition periods and other temporary or permanent derogations from certain

requirements on account of their special situation, including problems of economic and technical (e.g. food standards) transition conditions.

Subsidiarity is likely to play a growing role in the general development of the EU in the 21<sup>st</sup> century, not only in agriculture, but also in fiscal policy, defence and many other areas. However, with the still-fundamental role of food production, the dominance of the CAP in the EU's budget, and the growing interest and concern over the rural and global environment, issues of efficient, equitable and accountable agricultural policy-making are likely to be amongst the more continuous and complicated areas of debate. It is hoped that the discussion and suggestions in this volume will advance that discussion.



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