Environmental and Agricultural Policy: What Roles for the EU and the Member States?

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Harald Grethe, Humboldt University of Berlin (harald.grethe@agrar.hu-berlin.de)[1]

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1 Introduction

The assessment of the role for the EU and the member states in environmental and agricultural policy in this paper is based on the principle of subsidiarity. Applied to the question of centralisation versus decentralisation of policy design and implementation, the subsidiarity principle states that responsibility should be assigned to the smallest viable context at which the objective can efficiently be attained.[2] The economic arguments of the subsidiarity debate build on the literature on fiscal federalism (Musgrave, 1959; Oates, 1972; Weingast, 2005) which explores the optimal level of centralisation for different public policies. The general conclusion from this literature is that the most decentralised policy process which is able to internalise all externalities and to exploit potential economies of scale is preferable. This is because a decentralised process is considered to have various advantages such as a better representation of local preferences, potentially less bureaucracy, and more efficiency because of competition among regional jurisdictions (Tiebout, 1956). In addition, according to the principle of fiscal equivalence, measures should be financed on the same level as they are designed (Olson, 1969).

Subsidiarity does not stand on its own, but in the context of other principles of good governance such as openness, participation, accountability, effectiveness, and coherence. The European Commission sees the application of these good governance principles as reinforcing the principles of proportionality and subsidiarity (European Commission, 2001a: 10). The subsidiarity principle has become part of the EU's legal foundation and according to Ederveen and Pelkmans (2006: 4) it is "widely acknowledged to be the guiding principle for dividing powers in the European Union". The Treaty of the European Community states only for "areas which do not fall within its [the Community's] exclusive competence" that "the Community shall take action, in accordance with the principle of subsidiarity" (Art. 5, para 2). This paper, however, goes beyond this definition and reviews the justification for the assignment of policies independently from the criterion of whether they fall under exclusive responsibility of the EU, such as large parts of the Common Agricultural Policy (CAP).

Ederveen and Pelkmans (2006) develop a functional test for subsidiarity in order to determine the optimal level of centralisation for various policy areas in the EU, which can be considered as a cost benefit analysis of centralisation. Three questions are posed: first, "is policy coordination justified by the existence of economies of scale and/or externalities?" If the answer is affirmative, the second question asks "is credible voluntary coordination possible?" Only if the answer to the first question is "yes" and to the second question "no", the third question arises: "to what degree should the implementation and enforcement be centralised as well?" This paper assesses the role of the EU and the member states in environmental and agricultural policy in sections 2 and 3, respectively, according to the subsidiarity test by Ederveen and Pelkmans.

[2] The definition of the subsidiarity principle is by no means unanimous. For an in depth discussion of its definition and history including its growing relevance in the process of European integration see Fourage (2002) and Döring (1997).

The paper is organized as follows. A short overview of both policy fields is given (sections 2.1 and 3.1), and costs and benefits of centralisation are reviewed (2.2 and 3.2). In addition, the political economy sections for both policies include discussion of why today's policies look different from the ideal from a subsidiarity perspective, which would prevail if the EU were governed by a benevolent central planner with no other interest than to optimize social welfare in the EU (2.3 and 3.3). Finally, in the conclusions for both policy areas some options are explored for how to move closer to the ideal (2.4 and 3.4).

2 Environmental Policy

2.1 Short Overview of EU Environmental Policy

The notion of a common environmental policy of the EU had not evolved before the early 1970s. The European Commission published its first Environmental Action Programme (EAP) in 1973. Much of the early environmental legislation was closely linked to economic motives such as the competitiveness of the EU in international markets and the development of its internal market. With the establishment of the Single European Act in 1986, EU environmental policy got treaty recognition for the first time, and it was further strengthened in the treaties of Maastricht and Amsterdam, when the qualified majority decision principle became the rule for most EU environmental policies.[3]

The European Commission announces its environmental policy strategies in the form of legally non-binding EAPs. The sixth Community environment action plan for the period 2002-2012 is organized along themes rather than environmental media and outlines four priority areas: combating climate change; protecting nature and biodiversity; preserving the environment, health, and quality of life; and preserving natural resources (European Commission, 2001b, 2002a). In order to address these areas the Commission specifies seven thematic strategies on air pollution, reduction of greenhouse gas emissions, prevention and recycling of waste, prevention of damage to and preservation of the marine environment, soil preservation, reasonable use of pesticides, sustainable use of resources, and the urban environment.

EU environmental policy is mainly based on regulation, but to a lesser extent also on budgetary outlays. Alesina et al. (2002) calculate the shares of various policy domains in total EU legislation (Regulations, Directives, and Decisions) for five year periods from 1971 to 2000. EU environmental policies accounted for about 1% of EU legislation in the 1970s and 1980s and their share increased to 2.2% in the period 1996-2000. This alone, however, does not fully reflect the impact of EU environmental regulation, as the cross-sector relevance of the topic has to an increasing extent led to the integration of environmental aspects in regulation not primarily addressing environmental issues, such as Rural Development regulation. Holzinger et al. (2006) analyse the composition of environmental regulation for

[3] See Lenschow (2005) for a history of EU environmental policy.

the period 1967 to 2005. They recognise a relative shift from interventionist regulation to more context-oriented, incentive-based, and cooperative instruments.

The budget explicitly allocated to environmental policy is rather small. In 2005 it was at about € 290 million, and thus, at less than 0.25% of the EU budget (European Communities, 2006). Yet parts of the EU structural, cohesion, and rural development funds also address environmental issues. For example, in 2005, about € 2 billion out of a total of € 5 billion of the European Agricultural Guidance and Guarantee Fund (EAGGF) Guarantee section were spent on agri-environmental measures (European Commission, 2006a). Furthermore, about 50% of the cohesion funds which comprised € 5.1 billion in 2005 are spent on environmental projects (Lenschow, 2005: 314), and the World Wide Fund for Nature (2005) reports estimates of 10% of total structural funds being spent on environmental investments, equivalent to about € 3 billion.

For the future development of EU environmental policy the increasing importance attached to employment and economic growth under the Lisbon strategy as well as the recent and future EU enlargements comprising countries with relatively weak national environmental regulation may limit the prospects for further interventionist environmental regulation in the EU (Lenschow, 2005: 322).

2.2 Costs and Benefits of Centralisation

The basic motivation for a large part of environmental policies is the internalisation of positive as well as negative external effects and the provision of public goods. Many of these external effects and public goods are of a transboundary nature and, therefore, constitute a case for international policy coordination. Also, economies of scale may exist for example in the establishment of transboundary habitats. In addition, the environment is assigned a high value at the European level. The Treaty of Amsterdam establishes the objective of promoting "a high level of protection and improvement of the quality of the environment" (Art. 3). Thus, a minimum degree of environmental protection may be considered an integral part of EU identity and may justify EU regulation raising the level of regulation in laggard states. Furthermore, much of EU environmental policy deals with the establishment and harmonisation of product standards in order to increase the efficiency of the Common Market. Finally, a benefit of centralisation sometimes mentioned is the resulting strong position of the EU in international negotiations addressing environmental problems based on its comparatively high level of environmental protection at home (Vogler, 2005).

On the other hand, disproportional interventionism and centralism may constitute high transaction costs and result in regulation being in conflict with national or regional preferences. A considerable implementation deficit exists in environmental policy which is significantly higher than in other policy fields (Jordan, 2002; Holzinger et al., 2006). This suggests that in many cases national and regional governance levels do not strive for compliance with EU regulation.

The assessment of EU environmental policy in light of the subsidiarity principle is complex and academic literature draws a heterogeneous picture. Early publications which explicitly evaluate EU environmental policy from the subsidiarity perspective are rather critical regarding the strong degree of EU involvement and highlight the regional or local nature of many environmental goods (Golub, 1996; Döring, 1997). Later analyses are more positive about EU involvement (Jordan and Jeppesen, 2000; Flynn, 2000). Flynn (2000) highlights the often poor capability of regional or local governance systems to address environmental problems for reasons such as inadequate administrative, human, and financial resources, and the danger of regulatory capture.

More recent literature on the governance system for EU environmental policy has focused less on the adequate level for the main responsibility for environmental policy. Instead, the focus has moved to the distribution of responsibilities in multilayer governance systems consisting of a regulatory framework at the EU level on the one hand, and flexibility for the member states and regions to address the objectives set at the EU level on the other (Knill and Lenschow, 2003, 2005; Holzinger et al., 2006).

Due to the complexity regarding the assessment of the appropriate level of responsibility resulting from the heterogeneity of environmental problems, it is difficult to draw general conclusions. Some exemplary policies are shortly discussed in the following.

Protection and improvement of air quality was one of the first issues addressed at the Community level and a directive to combat air pollution from motor vehicles was published as early as 1970. Clearly, due to the transboundary effects involved, responsibility at the EU level is justified in order to address various forms of air pollution. However, some forms of air pollution such as airborne particles can be of a rather local nature. A relatively new issue of a clearly transboundary nature is the reduction of greenhouse gas emissions (European Commission, 2005). The assignment of responsibility at the EU level is justified in order to achieve the objectives efficiently for example through incentive-based systems such as the recently established emissions trading system.

Also the protection and improvement of water quality is one of the well established and important fields of EU environmental policy. From the perspective of the spatial extent of externalities, EU involvement must be assessed in a differentiated way. Effects are not always of a transboundary nature: the quality of groundwater and locked surface waters is mainly of local or regional relevance. Contrariwise, pollution of rivers and oceans has often transboundary effects. A relatively new instrument which especially addresses the spatial dimension of water quality is the Water Framework Directive (WFD). The key instrument of the WFD is river basin management, which establishes the river basin as the unit for water management across the EU. Moss (2004) analyses the institutional perspectives for implementing the WFD in Germany. The implementation of the WFD requires the new establishment of horizontal cooperation among administrations in order to overcome the spatial misfit between river basins and administrative structures. Furthermore, it requires the cooperation of administrations with different functional responsibilities. For example "issues of water management, spatial planning, nature conservation and agriculture are administered by distinct organisational units unaccustomed to interacting beyond the scope of formalised planning procedures" (Moss, 2004: 90). EU regulation in this area serves as a catalyst to improve the cooperation among national, regional, and local authorities in order to better address environmental problems in a holistic way.

The protection of nature and biodiversity is another relatively old policy field of the EU with the Wild Birds Directive (79/409/EEC) adopted in 1979, and the Flora-Fauna-Habitats (FFH) Directive (92/43/EEC) of 1992. Together, these two directives aim at the establishment of the so-called Natura 2000 network consisting of protected sites throughout the EU. Arguments which support the assignment of responsibility to the EU include economies of scale in the establishment of transboundary networks of protected sites or the protection of migratory species. Also the EU's international commitments under conventions, such as the 1992 Convention on Biodiversity and the 1979 Pan-European Convention on the Conservation of European Wildlife and Natural Habitats, would favour the role of the EU for the protection of biodiversity. The benefits of biodiversity may accrue predominantly at the local, but also at the transboundary level, depending on the spatial extent of the ecosystems concerned. Kettunen and Brink (2006) provide examples for biodiversity loss affecting national as well as international ecosystems in the EU.

2.3 Political Economy Considerations

Several political economy aspects can contribute to explaining the design of EU environmental policy. First, interests of member states diverge. It is especially the "high regulation countries" such as the Scandinavian members, the Netherlands, and Germany which tend to favour a high level of EU regulation. The objective of reducing competitive disadvantages of home based industries compared to those in "laggard" member states may play an important role (Sbargia, 1996). The empirical evidence, however, for environmental standards determining allocation decisions of industries, is rather weak (van Beers and van den Bergh, 2000).

Second, the European Commission may have an interest in centralising environmental policy because of self-selection of EU officials who are pro-integration, socialisation of its staff during working life, or the administration's interest of expanding or maintaining power (Ederveen and Pelkmans, 2006: 17). One option for the European Commission to pursue the objective of centralisation is the support of environmental NGOs which often favour strong environmental regulation at the EU level.

What can indeed be observed is a lack of economic instruments and voluntary agreements in environmental policy. Holzinger et al. (2006) offer the implied loss of competences and power of the environmental administration as an explanation, among others. In a comparison of different modes of regulation at EU level Knill and Lenschow (2003) conclude: "The dominance of the classical [regulatory standards] approach might partly be the result of institutional inertia preventing most organisations to engage in quick and radical reforms and the structural limits of the EU regulatory state in tying the levels of governance into an effective whole."

2.4 Conclusions on Environmental Policy

Environmental policy is mainly concerned about the provision of public goods and the internalisation of external effects, many of which are of a transboundary nature. Voluntary cooperation among member states may be an option in some cases (such as river basin management), but often this is not likely to happen without a regulatory framework at the EU level. In other policy fields, such as the reduction of greenhouse gas emissions, all EU member states are affected by the external effects. Therefore, assignment of responsibility to the EU level seems justified for many fields of environmental policy.

In general terms, EU environmental policy can thus be considered a successful policy area. However, many authors observe the tendency of overly interventionist and centralist EU regulation (Knill and Lenschow, 2003; Döring, 1997; Golub, 1996). In some cases, regulatory impact assessment, an important element in *ex-ante* evaluation of the potential impact of new regulation, has been poorly done (Pelkmans, 2005). Furthermore, some regulation addresses problems of a predominantly local, regional, or national nature. For example, the suggested inventories for contaminated sites which are proposed as part of the framework directive for the protection of soils (European Commission, 2006b) focus on very local issues, and are questionable from a subsidiarity perspective. Instead, the EU should focus on transboundary environmental problems. In addition, EU regulation may serve as a facilitator for improved governance to address transregional environmental issues, such as new systems of river basin management as described above. After serving that purpose, regulations should be monitored on a regular basis to determine to what extent existing EU regulation is still required and adequate.

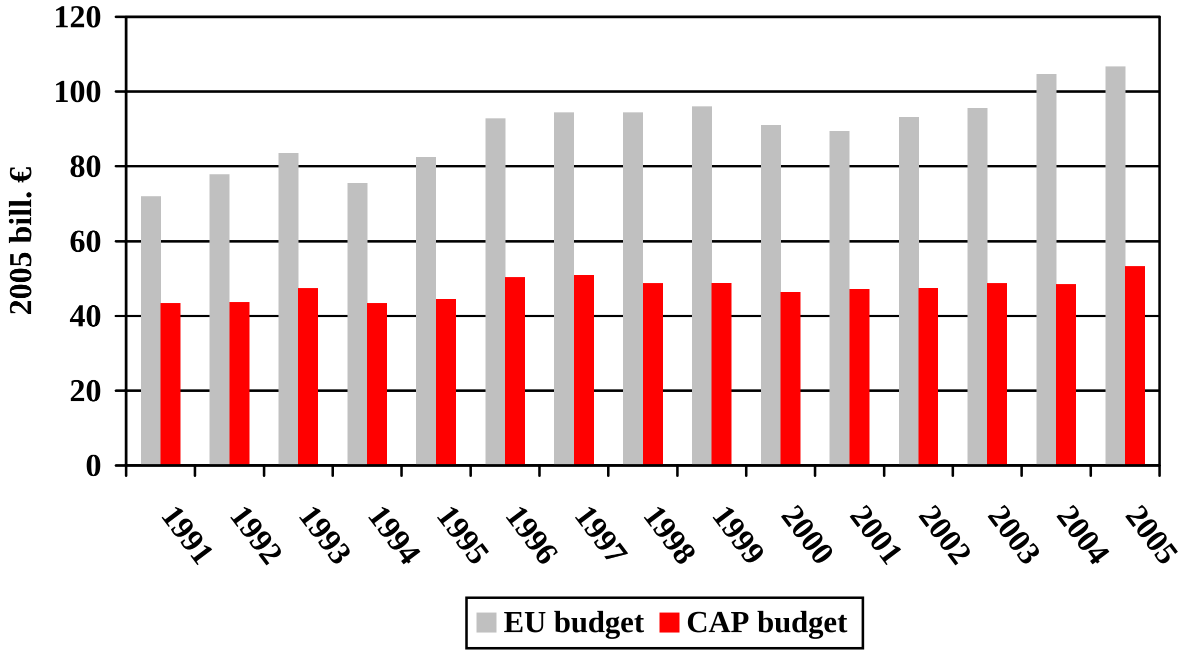
The shift of EU environmental policy from interventionist instruments to more incentive based instruments and to softer, more context oriented regulation (Holzinger et al., 2006) is in accordance with the subsidiarity principle, as it offers more responsibility to the member states and regions with regard to the specific design and implementation of regulation. In contrast to the fast development of these new "regulatory ideas", such as formulated in recent EAPs, "translation" into concrete instruments has lagged behind.

3 Agricultural Policy

3.1 Short Overview of EU Agricultural Policy

The CAP has been a core element of the European Economic Community since its early beginnings (Tracy, 1989, 1997). This is also reflected in the high share of the CAP in the total EU budget as depicted in Graph 3.1.

Graph 3.1: Total and Agricultural EU Budget Expenditure 1991-2005 (in 2005 €)



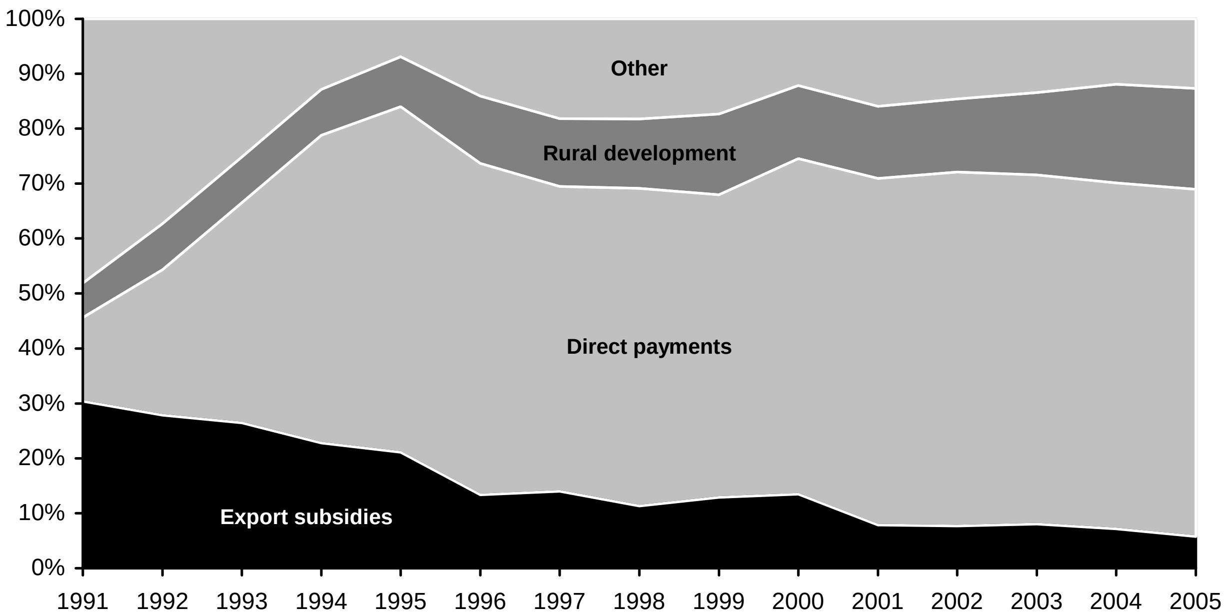
The CAP budget includes expenditures from the Guidance section of the EAGGF for rural development.

Sources: European Commission (2006a), European Communities (2006), Eurostat (2006), own calculations.

The EU budget has increased over the period 1991-2005 by about 50% in real terms. Over the same period, the CAP budget increased by only 23% but still had a share of almost 50% in the EU budget in recent years. Relative to the Gross National Income of the EU the total budget has declined slightly from 1.1 to 1.0% and the CAP budget from 0.7% to 0.5% (European Communities, 2006). This reflects the economic growth of the European Union, including successive enlargements from 12 member states in 1991 to 25 member states in 2005.

Although total agricultural expenditure of the EU is rather stable, its composition has changed tremendously in recent decades. In the first decades of the CAP, its main aims were an increase in production in order to provide food security for a growing population and income support to an agricultural sector which was shrinking in relative terms in the process of economic development. This aim was mainly pursued by a highly protectionist system of price support through high tariffs and domestic measures such as intervention price systems. During the 1980s the Community turned into a net exporter for most agricultural products and increasingly relied on export subsidies which brought growing concerns from trading partners. In the context of increasing external pressure on the CAP during the Uruguay Round of multilateral trade negotiations in the GATT, the EU substantially reformed the CAP by reducing support prices for cereals and beef and introducing a system of compensatory direct payments from 1993 on (McSharry Reform). This principle was continued by further reduction of support prices and the extension of direct payments as part of the Agenda 2000 reforms. Direct payments were increasingly decoupled from actual production and this principle has culminated in the 2003 Reform of the CAP under which currently about 90% of direct payments in the EU-15 are part of the Single Farm Payment (SFP) and, thus, not linked to the production of any specific product. For eight member states out of the EU-10, direct payments are fully decoupled from production under the Simplified Area Payment Scheme (SAPS). Along with the increasing reliance on direct payments since the McSharry reform came an increase of the budget for rural development measures, which include heterogeneous policies, such as agri-environmental programs, investment subsidies, and early retirement programs, and which are co-financed by the EU member states. The main changes in the CAP are reflected in the composition of the CAP budget as shown in Graph 3.2.

Graph 3.2: Composition of the EU CAP Budget 1991-2005



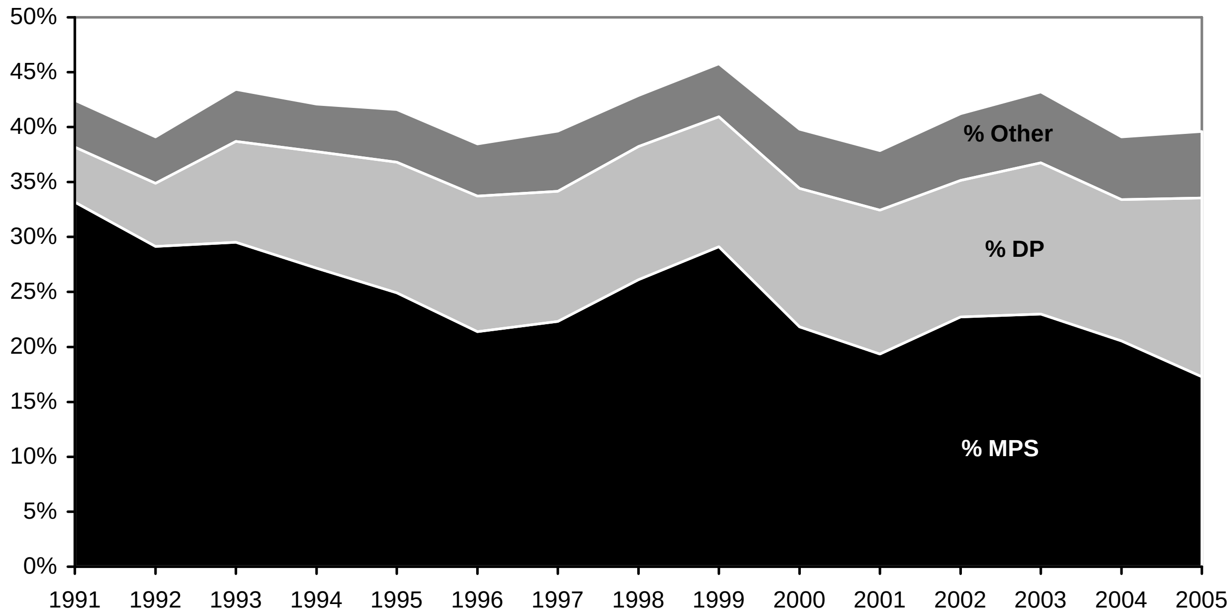
Rural Development includes expenditures from the Guidance as well as the Guarantee section of the EAGGF. Direct payments before 2000 are extracted from OECD (2006) due to a change in the data classification in published EU budget figures.

Sources: European Commission (2006a; various issues), European Communities (2006), OECD (2006), own calculations.

The decreasing relevance of market intervention is reflected in the declining shares of expenditures for export subsidies and the category "other policies", which mainly includes market interventions. Together these policies accounted for almost 80% of the CAP budget in 1991 and declined to less than 20% in 2005. Over the same period the share of expenditures for direct payments increased from about 15 to 63% and for rural development measures from 6% to almost 20%. The increase in the share of rural development funding in the CAP, however, has recently come to a halt when the Council decided to set expenditures substantially below the Commission's proposal for the financial perspective 2007-2013. As a result, future rural development funding will be substantially below the level of 2006 (Agra Informa, 2006a).

Although the share of expenditures for market price support in the CAP budget is rather small, the EU still applies a significant degree of price support through tariff protection. The resulting economic costs of such policies are not born by the public budget but by consumers who have to pay prices above the international level for agricultural products. Graph 3.3 shows the composition of total transfers to agricultural producers in per cent of domestic market revenues and subsidies received by farmers (percentage PSE) as calculated by the OECD.

Graph 3.3: Percentage PSE in the EU 1991-2005



Source: OECD (2006), own calculations.

Graph 3.3 shows that total transfers to the agricultural sector in the EU have been rather constant: the total PSE in the EU was between 38% and 46% of agricultural production value between 1991 and 2005. The market price support (MPS) component has declined significantly over this period but still market price support accounted for about 45% of the total transfers to agricultural producers in 2005.

It is not only in terms of budgetary expenditures that agricultural policy in the EU displays a high degree of EU involvement. Also with respect to the regulatory density the CAP is noteworthy. Alesina et al. (2002) calculate the shares of various policy domains in total EU legislation (Regulations, Directives, and Decisions) for five-year-periods from 1971 to 2000. EU agriculture and fishery policies account for about 37 to 57% of EU legislation during these periods.

The CAP is subject to an ongoing reform process. As part of the initiative to simplify the CAP (European Commission, 2006c) some more technical simplification is envisaged. But the "health check" in 2008 foresees a thorough review of the CAP in general including a view to the CAP design after the period of the financial perspective 2007-2013. In addition, a fundamental review of the composition of the EU budget is envisaged in the "Budget Review" in 2008/2009.

Main drivers for the development of the CAP are budgetary pressures, international trade negotiations, and changing expectations of consumers and taxpayers.

3.2 Costs and Benefits of Centralisation

3.2.1 Market Policies

Market policies are almost exclusively designed and financed at the EU level with their implementation for the most part delegated to the member states. This is the case for the most important policy component, external protection by tariffs, as well as for export subsidies and domestic policies, such as intervention prices (cereals, dairy products), storage subsidies (sugar, dairy products), product subsidies (milk powder for feed use, dairy products), and supply control measures (set aside and production quotas for milk and sugar).

The assignment of the responsibility for market policies to the EU level is the logical implication of the common market. And this common market is not questioned – it allows for gains from trade due to resource allocation according to comparative advantage and positive effects of scale. In a common market, assignment of the responsibility for market policies to member states would in part be technically infeasible (e.g., differing intervention prices among member states), and would partly result in distortion of competition (e.g., product subsidies). On the other hand, implementation at the EU level would result in considerable transaction costs due to the requirement of a parallel administration, which holds in general for the implementation of agricultural policy.

Thus, the current system of responsibilities for policy design and funding at the EU level and implementation at the member state level is adequate. What may be questioned, however, is the high complexity of the policy system which evolved in a period in which market price support was a much more important policy component. Against the background of the declining economic relevance of market price support, simplifications as envisaged under the current EU action plan (European Commission, 2006c) and beyond are desirable. Candidates for simplification are, among others, the import regime for Non-Annex I products, the ever increasing complexity of the EU system of agricultural trade preferences (Grethe, 2005a) as well as the complex but partially redundant EU import system for fruits and vegetables (Götz and Grethe, 2006).

3.2.2 Direct Payments

The historical origins of direct payments are the market policies through which the EU granted support to producers in the past. Direct payments have been granted as a compensation for the reduction of institutional prices. The fact that this compensation was designed and financed at the EU level can be explained by its predecessor, the price support system as well as its dismantling having been designed at EU level, too. There were also good reasons to design and finance direct payments at the EU level from an economic point of view: early direct payments were much more coupled to production than they are today, and, thus, had clear externalities; they were production distorting.

Today, the situation has changed. For the EU-27, on average, direct payments are already decoupled from production to more than 90%. In addition, their full decoupling is currently discussed (Fischer Boel, 2006) and would involve advantages, such as allowing for elimination of the blue box in the WTO and, thus, also obligatory set aside. Furthermore, full decoupling would do away with the production distorting effect of the currently different degrees of decoupling among EU member states.

Thus, the economic nature of direct payments has changed fundamentally: they turned from a product(ion) subsidy to a sectoral and personal income policy.[4] But sectoral and personal income transfer policies, such as income tax systems, social security systems, or sectoral subsidies, e.g., for coal mining, are generally designed and financed at member state level, not at EU level. There are good reasons for this. Preferences with regard to sectoral and personal income distribution differ widely among member states. As there are neither externalities nor economies of scale involved in granting fully decoupled direct payments to farmers, the assignment of responsibility for direct payments and their funding to the EU level is an historical artifact which is in clear conflict with the subsidiarity principle.

3.2.3 Second Pillar Policies

The second pillar of the CAP consists of rural development policies as laid down in EU Regulation 1257/1999. These comprise a heterogeneous menu of policies, such as agri-environmental policies, support for less favoured areas, investment subsidies, training programs, etc. Regions can chose freely from this menu, yet, agri-environmental measures are compulsory. To receive funds, they have to prepare rural development plans which are to be appraised and approved by the European Commission. Rural development policies are financed from the EAGGF Guarantee and Guidance sections and are subject to minimum national co-financing rates of 25% in Objective 1 regions, 20% in the new member states, and 50% in all other regions. On average for the EU-15, the national rate of co-financing was at 55% in 2005 (European Commission, 2006a). Thus, policy design and funding is a shared responsibility of the EU and the member states/regions, whereas the responsibility for implementation is with the regions.

From 2007 on, rural development policies will be governed by the EU Regulation 1698/2005/EC. Funding will be summarised in one instrument, the new European

[4] Sometimes, direct payments are described as a lump sum compensation for the multifunctional non-market outputs of agriculture in the EU which would be implied by the cross-compliance mechanism. This, however, is not convincing as the level of direct payments is in no way linked to the level of output of public goods but rather based on historical production and price support. In case of the historic system being applied for the SFP, and in case of trade of entitlements to the SFP being allowed, payments often wildly differ among farmers providing a similar level of public goods. Furthermore, the level of direct payments seems too high to be justified by the production of public goods and tends to capitalize in land prices to a large extent (Duvivier et al., 2005; Kirwan, 2004; Brümmer and Loy, 2001; Chatzis, 1997).

Agricultural Fund for Rural Development (EAFRD). In addition, the conceptual and administrative linkages between the European Commission, the member states, and the regions will become closer: the Commission has established strategic guidelines which should be the basis for national strategy plans for rural development. Once these national strategy plans are approved by the Commission, regions will, as under the former system, submit their rural development plans that must be in line with the national strategy plans.

Most of the rural development measures are of a rather local nature regarding their effects and the problems they address, and it is difficult to see why the responsibility for design and funding of these measures should be at EU level. This holds, e.g., for the support of less favoured areas, early retirement, young farmer programmes, training and the improvement of rural infrastructure as well as investment subsidies. Further, public funding of many of these measures is questionable. The Advisory Board at the German Ministry of Consumer Protection, Food and Agriculture concludes that rural development policy should exclusively focus on the provision of public goods (Wissenschaftlicher Beirat, 2005). Policies such as investment subsidies, if pursued at all, should be limited to new member states for a transitional period to upgrade their technological level in order to be able to compete in the common market.

For environmental policies which are part of the second pillar of the CAP, the situation is different. They clearly aim at the provision of public goods and have, at least partially, transboundary spillovers. Furthermore, environmental policies are the most important single policy group in the second pillar: agri-environmental measures accounted for 45% of rural development spending in the EU-15 from the EAGGF Guarantee section in the period 2000-2005 (European Commission, 2006a). Because of the heterogeneity of other rural development policies, as well as their generally questionable motivation, the remainder of this section focuses on environmental measures.[5]

Most of the environmental policies under the second pillar of the CAP address predominantly local or regional environmental problems and have by and large local or regional effects. This holds for policies such as those addressing the quality of ground water, the shape of landscape, and soil erosion (Rudloff, 2002: 243; Döring, 1997: 244-257). In addition, local preferences for these public goods as well as the costs of providing them may vary substantially among regions. This would suggest attributing responsibility for their design, funding, and implementation to the member states rather than to the EU. In most cases, regional or local administrations may be even more appropriate (Ewers and Henrichsmeyer, 2000; Niedersächsische Regierungskommission, 2001; Petrick, 2006; Wissenschaftlicher Beirat, 1998). More decentralised and flexible concepts of spatial administration are

[5] Environmental policies discussed here are those which are part of the EU rural development policy. From a farmer's perspective these are voluntary and incentive based policies. In addition, the agricultural sector is subject to a wide range of command and control policies, such as the Flora-Fauna-Habitats Directive 92/43/EEC, the Wild Birds Directive 79/409/EEC, the Water Framework Directive 00/60/EC, and the Nitrate Directive 91/676/EEC. These policies are addressed in Chapter 2 on environmental policy and are discussed here only in case of overlap such as the compensatory payments for areas which are subject to restrictive environmental regulation as foreseen in Article 16 of Regulation 1257/1999/EC.

suggested in order to address the specific spatial extent of the respective public goods, such as Frey's concept of "Functional, Overlapping and Competing Jurisdictions" (Frey and Eichenberger, 1999). Specific proposals for agri-environmental policies are made by Urfei (1999), Zeddies et al. (2000), and Hampicke et al. (2000). Petrick (2006) reviews arguments as to why central governments should not directly finance and provide public goods. Arguments include the potential ineffectiveness of central governments in meeting residents' preferences: sorting and voting of residents may result in the provision of public goods which is closer to their true preferences (Tiebout, 1956; Dowding et al., 1994). Furthermore, central governments may be less effective than community governance due to information problems, rent-seeking, and lack of accountability (Baland and Platteau, 1996; Westholm et al., 1999; on agriculture: OECD, 1998). Finally, private initiative may be crowded out by public measures (Andreoni, 1993, 2006). Other recent work also highlights the potential for local and private co-ordination mechanisms, such as environmental co-operatives, to address the provision of public goods in rural areas (Hagedorn et al., 2002; Moseley, 2003). In contrast, other authors point to the often poor capability of regional or local governance systems to address environmental problems for reasons, such as inadequate administrative, human and financial resources, and the danger of regulatory capture (Flynn, 2000).

To sum up, empirical evidence suggests that the current system of agri-environmental policies is too centralised. Therefore, the responsibility for design as well as funding of a large part of today's agri-environmental policies should be assigned to the member states, or lower administrative levels (Ewers and Henrichsmeyer, 2000; Wissenschaftlicher Beirat, 1998; Petrick, 2006; Niedersächsische Regierungskommission, 2001). For policy design, a large share of responsibility is already with the regions and member states which prepare rural development programmes. For funding, however, the EU is heavily involved through substantial co-financing which hurts the principle of fiscal equivalence.

In contrast to the measures above which predominantly address local and regional environmental goods, some agri-environmental measures address environmental goods which have a transboundary character. These may be measures which address biodiversity, global warming, and the pollution of surface waters which flow into transboundary rivers. In addition, some agri-environmental policies may involve economies of scale, such as the establishment of transboundary habitats, e.g., through the Flora-Fauna-Habitats Directive and complementary compensation payments as part of the rural development package, or the provision of resting areas for migratory birds.

In such cases, EU coordination of policies, or policy design and funding can be justified. When voluntary cooperation is impractical or inefficient because of economies of scale, responsibility should be assigned to the EU level. The decisive criterion for the EU to distribute available funds should be where to get most of environmental goods for the same money. This could be realized, for example, in a tender system under which local or regional institutions could apply. The rates of co-financing, however, should not be fixed *a priori*: a region may have an urgent agri-environmental problem and be able to address this at relatively low costs, but have very limited means for co-financing.

Unfortunately, it is not always possible to assign a clearly defined spatial effect to a specific agri-environmental measure. Many measures affect local as well as regional and cross-border or even global environmental goods. Take the example of planting and maintaining a hedgerow. This will have a predominantly local effect on the landscape. If the region's local recreation or tourism is connected with the hedgerowed landscape, this may have regional or even national or international spillovers. Furthermore, the hedgerow may prevent soil erosion, which could result in reduced nutrient loads reaching surface waters, which may be transboundary, before finally flowing into the sea. Also, the hedgerow may become a habitat for endangered species and therefore contribute to global biodiversity.

The current system of co-financing agri-environmental policies seems to address this complexity as both member states and the EU contribute to finance measures which aim at local as well as transboundary public goods. This link, however, is weak, as there is no link between the rate of co-financing and the degree to which measures have transboundary spillovers. Instead, the current system of co-finance has various significant disadvantages. First, it results in policy design which is often more determined by the intention to generate budgetary flow-back from the EU than by preferences of the local or regional residents – a problem often described as the "shared lunch" or "common pool budgeting" problem (Weingast et al., 1981: 651; Inman and Rubinveld, 2002: 9).

Second, funds are not concentrated on spots with the most urgent agri-environmental problems. Instead, funds are distributed among member states according to the size of their agricultural sectors, their historical negotiating power, and their capacity and willingness to co-finance EU funds. Within member states, funds are distributed among various measures according to regional preferences and the influence of lobby groups.

No clear criteria exist for the distribution of rural development funds in general, yet, the EU has established agricultural area, employment in agriculture, and GDP_{PPS} per capita as criteria for the allocation of modulation funds, which is "new second pillar money".[6] The same criteria were used by the European Commission for the allocation of SAPARD funds to the Central European accession candidates, and for the allocation of rural development funds for the EU-10 as well as Bulgaria and Romania (European Commission, 2002b: 5). Summarizing these criteria in order to reach a weighting scheme for the distribution of second pillar funds among member states could happen according to (1), a formula which has successfully predicted the allocation of second pillar funds envisaged by the European Commission for Turkey (Grethe, 2005b):

$$(1)\quad \text{Weight}_c = \frac{(0.65 \bullet \text{area ratio}_{c/EU\text{-}15}) + (0.35 \bullet \text{employment ratio}_{c/EU\text{-}15})}{(1 + \text{GDP}_{PPS}\ \text{ratio}_{c/EU\text{-}15})/2}$$

and the resulting share in rural development funds for each country being

6 EC Directive 1782/2003, Official Journal of the European Communities (OJ) L 270, 21.10.2003.

(2) $$\text{Share}_c = \frac{\text{Weight}_c}{\sum_c \text{Weight}_c}.$$

Table 3.1 compares the current distribution of expenditures for rural development from the EAGGF sections Guidance and Guarantee among the EU-15 countries for the period 2000-2005 compared to a distribution which would result from applying formulas (1) and (2).

Table 3.1: Current Distribution of Rural Development Funds in the EU-15 (2000-2005) and Distribution According to the Measures Promoted by the European Commission

Member state	Current share (%)	Share as defined by (2)	Deviation (in perc. points)	Criteria for distribution		
				Share UAA (%)	Share ag. empl. (%)	Relative GDP_{PPS}/capita
Belgium	0.7%	1.0%	-0.3%	1.1%	1.1%	108.2%
Denmark	0.7%	1.7%	-1.0%	2.0%	1.4%	112.4%
Germany	18.2%	13.0%	5.2%	13.1%	13.4%	99.1%
Greece	4.8%	6.2%	-1.4%	3.0%	10.1%	74.2%
Spain	17.1%	18.3%	-1.2%	19.4%	14.4%	89.7%
France	12.4%	19.8%	-7.5%	22.6%	16.1%	101.7%
Ireland	5.6%	2.5%	3.1%	3.4%	1.7%	121.5%
Italy	14.4%	13.1%	1.3%	11.6%	16.0%	97.9%
Luxemburg	0.2%	0.1%	0.1%	0.1%	0.1%	197.0%
Netherlands	1.1%	2.0%	-0.9%	1.5%	3.4%	110.7%
Austria	7.3%	2.6%	4.7%	2.6%	3.1%	112.0%
Portugal	6.2%	6.3%	-0.2%	2.9%	10.1%	68.2%
Finland	5.5%	1.7%	3.7%	1.7%	1.9%	103.4%
Sweden	2.8%	2.1%	0.7%	2.4%	1.7%	105.6%
UK	3.2%	9.5%	-6.4%	12.6%	5.5%	108.6%
EU-15	100.0%	100.0%		100.0%	100.0%	100.0%

Sources: European Commission (2006a, various issues), own calculations.

Table 1 shows that formulas (1) and (2) serve quite well to explain the distribution of rural development funds; the coefficient of correlation between actual and predicted expenditures is 84%. Notable differences exist, however, such as Austria which received almost three times as much funding as predicted whereas the UK received only about one third of predicted funds.

Looking at the distribution of funds over different measures, the picture is extremely heterogeneous. For example, Spain, which accounts for almost 20% of the total agricultural area in the EU, received only 6% of EU wide funding for agri-environmental measures, whereas Austria that accounts for only 2.6% of the EU agricultural area, received more than 15%. This, of course, does not reflect differences in agri-environmental problems among member states from an EU perspective, but rather a difference in national preferences and the success of Austrian negotiators to attract a disproportional amount of second pillar funds. If, however, the distribution of agri-environmental funding throughout the Union is to such a large extent determined by local preferences, it is unclear why it should be EU co-financed by 50% or more.

Another drawback of the co-finance system is the resulting ambiguity of the European Commission's motivation in the surveillance of competition distorting effects of rural development measures. On the one hand, the Commission wants the money attributed to the second pillar to be spent. On the other hand, the Commission has to monitor undue competition distorting effects. Agri-environmental measures explicitly allow for compensation payments exceeding the costs or income foregone involved by a maximum of 20% in order to provide an incentive.[7] Empirical studies, however, suggest that these are often exceeded and considerable windfall gains for producers exist (Zeddies and Doluschitz, 1996; Ahrens et al., 2000; for an overview of the discussion see Osterburg and Stratmann, 2002). If a large part of rural development policies were to be overseen exclusively by the member states/regions, the European Commission could better concentrate on monitoring competition distorting effects.

As a result, the current system of co-financing is not adequate for most of the rural development policies. Instead, the clear attribution of responsibility for a large part of these policies to the member state level and below, with only some responsibilities exclusively to the EU, as suggested above, is more in accordance with the subsidiarity principle. Such a change, however, may require the development of new institutions and mechanisms at local, regional, and national levels to take over design as well as funding of policies. In addition, financial flows would need to be adjusted, too, in order to enable local administrations to finance the provision of public goods within their jurisdictions which were financed previously by the EU (for suggestions in the German context, see Ewrigmann and Bergmann, 2000).

3.3 Why is the CAP not in Accordance with the Subsidiarity Principle? Political Economy Considerations and Dynamics

3.3.1 Basic Considerations

Today's CAP looks different from the model which would result from the subsidiarity based perspective discussed above. Specifically, it seems to be overly centralised. Obviously, economic efficiency arguments do not support the current allocation of responsibilities. Political economy arguments, however, as well as the historical origin of the CAP can contribute to explain its current design.

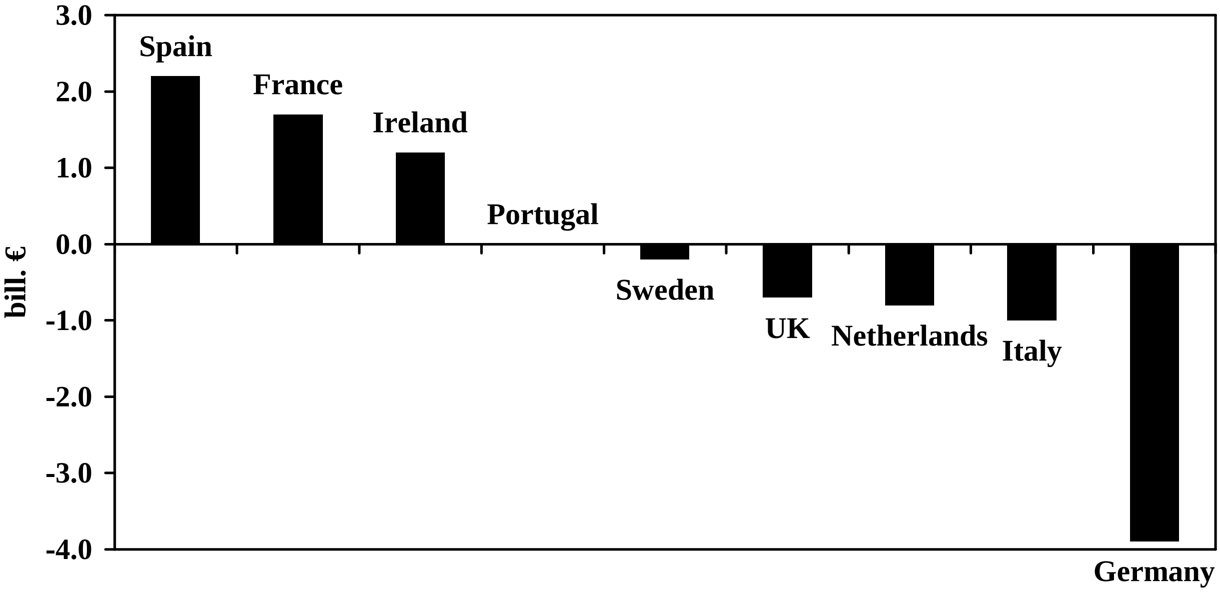
3.3.2 Different Interests of Member States

Interests of EU member states concerning the size of the CAP budget and its composition differ widely. These differences result from different endowments and from different national preferences regarding the role of agriculture in the society. Differences in preferences

[7] Under the New Rural Development Regulation this provision has been removed and replaced by a reference to allowance for transaction costs, motivated by bringing agri-environmental measures in line with the WTO Green Box provisions (Matthews, 2006).

comprise aspects such as the interest to keep agricultural activity in marginal regions and the motivation to move towards efficient farm structures. With respect to endowments, it is mainly the share of the agricultural sector in the economy which determines the position towards the CAP, because it is this share which determines the resulting net budgetary flows. This is because the national contributions to the EU budget are largely determined by the size of the economy as a whole whereas the receipts resulting from the CAP are related to the size of the agricultural sector. Graph 3.4 displays the average annual net budgetary flow resulting from the CAP for selected member states over the period 2000 to 2005.

Graph 3.4: Average Annual Net Budgetary Flow Resulting from the CAP for Selected Member States over the Period 2000 to 2005

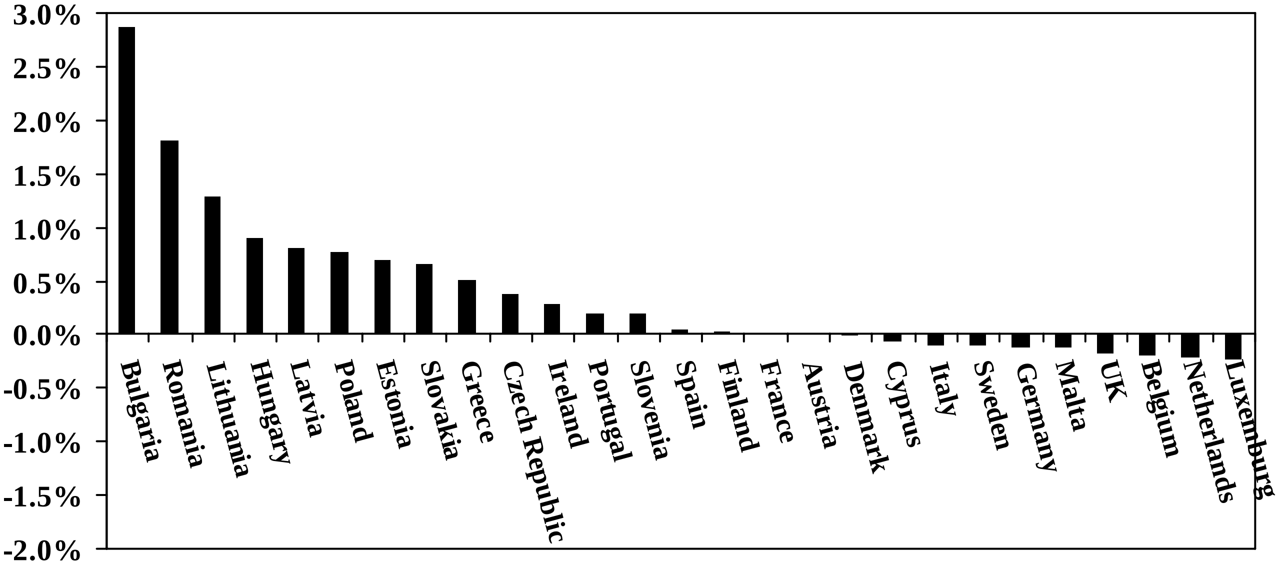


Sources: Grams (2006), own modifications.

Graph 3.4 shows that Spain, France and Ireland were substantial net beneficiaries of the CAP, whereas the UK, the Netherlands, Italy and Germany were net contributors. Graph 3.4 also shows that the CAP is not in conformity with the cohesion objective. Part of the net flows go from countries with a relatively low GNI per capita such as Italy to wealthier countries such as France and Ireland. Distributional aspects of the CAP have always played a role in reform discussions, an example being that of France's general opposition to the reduction or nationalisation of direct payments due in part to its strong net beneficiary position resulting from direct payments.

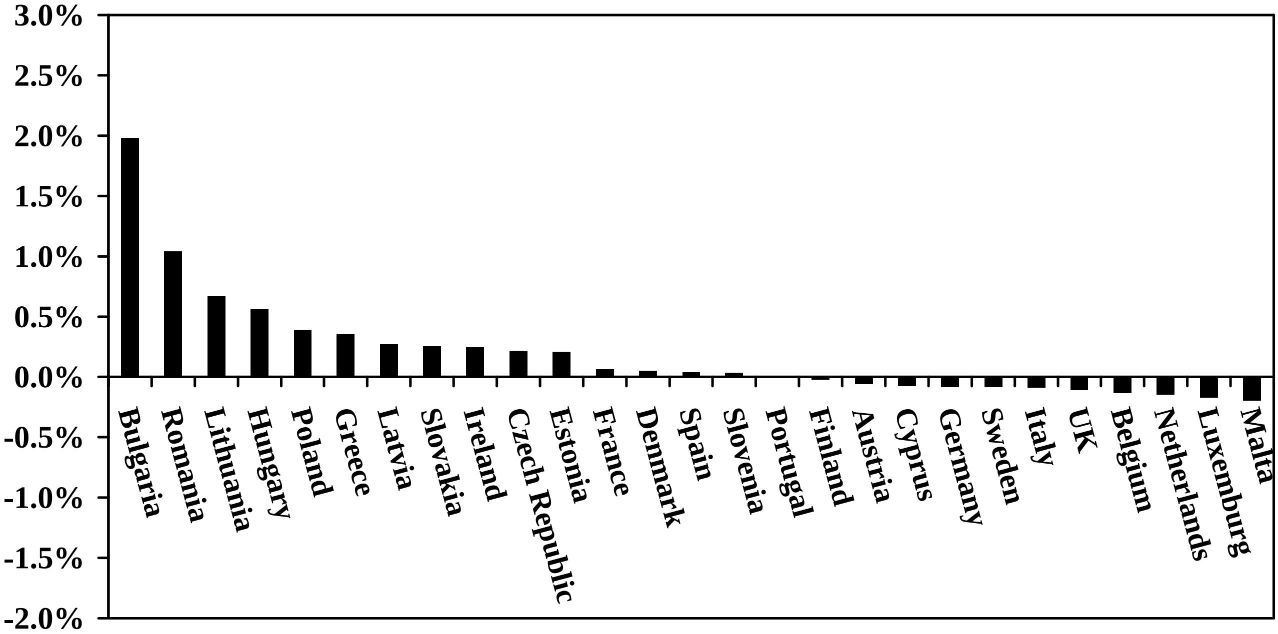
In order to assess likely coalitions for a reform of the CAP in the future, Graphs 3.5 to 3.7 present the net budgetary flows projected to result from the CAP in 2013 as a percentage of the GDP per member state should the British rebate be eliminated.

Graph 3.5: Net Financial Flow Resulting from Direct Payments and Rural Development Measures in 2013 (% of GDP)



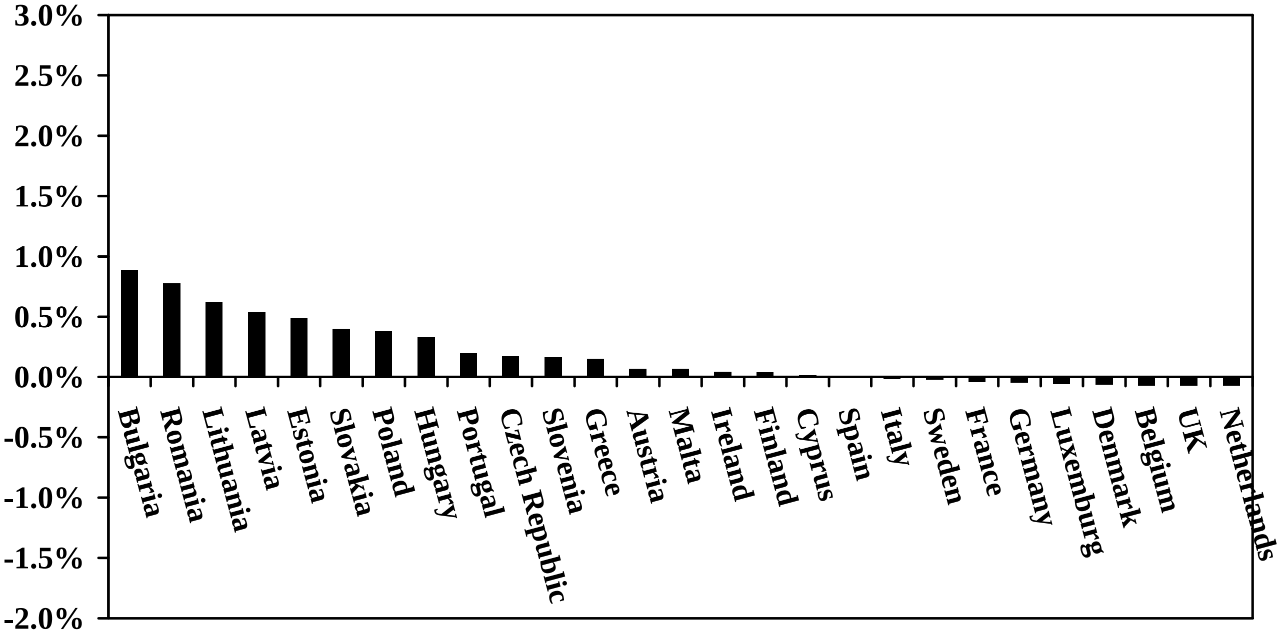
Sources: Direct payments based on national envelopes in EC Regulation 864/2004 (OJ L206/20-36, 09.06.2004) minus 5% modulation and adjusted in order meet commitment appropriations as in European Commission (2006d). Rural development spending according to European Commission (2006e). Contribution to the EU budget calculated based on projected shares in GDP (Eurostat, 2006; growth rates according to European Commission (2006d: 3), without British rebate).

Graph 3.6: Net Financial Flow Resulting from Direct Payments in 2013 (% of GDP)



Sources: Direct payments based on national envelopes in EC Regulation 864/2004 (OJ L206/20-36, 09.06.2004) minus 5% modulation and adjusted in order meet commitment appropriations as in European Commission (2006d). Contribution to the EU budget calculated based on projected shares in GDP (Eurostat, 2006; growth rates according to European Commission (2006d: 3), without British rebate).

Graph 3.6: Net Financial Flow Resulting from Rural Development Measures in 2013 (%7of GDP)



Sources: Rural development spending according to European Commission (2006e). Contribution to the EU budget calculated based on projected shares in GDP (Eurostat, 2006; growth rates according to European Commission (2006d: 3), without British rebate).

Graph 3.5 shows that the net budgetary flows resulting from direct payments and rural development measures will be different in 2013 compared with today. Traditional net recipients such as France and Spain will no longer belong to this group but will end up in a balanced situation where receipts from the CAP are similar to their respective contributions. Instead, the new member states, except Malta and Cyprus, will become significant net beneficiaries of the CAP in 2013 when direct payments are fully phased in for the EU-10 and by 70% for Bulgaria and Romania. Among the EU-15 members, only Greece, Ireland, and Portugal will still be substantial net recipients by 0.2% to 0.5% of their domestic GDP. Among the net payers, the UK (in the absence of the rebate), Germany, Italy, and the Netherlands would account for about 90% of net payments.

The picture for the redistributive effects of direct payments (Graph 3.6) and rural development policies (Graph 3.7) alone display a similar pattern in general, although some notable differences exist. France and Denmark, being in a neutral position for the CAP as a whole, are clear net beneficiaries from direct payments but net payers for rural development measures. For Austria and Finland the situation is the opposite: they are net beneficiaries from rural development measures but net payers for direct payments.

3.3.3 Common Pool Budgeting

Political economy models show that common pool budgeting, which is financed from a highly dispersed tax base but provides public goods with a higher geographical or personal concentration than the tax base, usually leads to overspending (e.g. Weingast et al., 1981) in the form of "locally beneficial but centrally inefficient government policies" (Inman and Rubinfeld, 2002: 7). For legislators, a tendency for an "I'll-scratch-your-back-if-you-scratch-mine" decision rule may result (Inman and Rubinfeld, 2002: 9). Indeed, decisions in the Council of Agricultural Ministers, which may be described as a "repeated game" setting, involve many examples of such a behaviour. In addition to overspending, overly detailed systems of co-ordination which may be at odds with the proportionality principle may result (Ederveen and Pelkmans, 2006: 15), and the details with regard to individual measures contained in the rural development regulations may serve as an example.

3.3.4 Leviathan and Lobby

Departing from the assumption of benevolent governments, Pelkmans (2006) distinguishes two cases of government failure: Leviathan and lobby. One may therefore ask whether the overly centralised process of the CAP allows governments to act more "Leviathan" in pursuing their own rather than the public interest compared to a more decentralised setting mainly because of weaker public control. There is little evidence for such a systematic bias. The decision making process in the Council of Ministers is probably under more public scrutiny than many of the national decisions. In contrast, some authors highlight the relevance of the European co-ordination process for transparency of the resulting policies, for example, in case of rural development programs (Osterburg and Stratmann, 2002: 276).

One may also ask whether the agricultural policy process at the EU level is more vulnerable to hidden lobbying than national governments. There is also little evidence for this bias. In contrast, the fact that the European Commission is not subject to the usual election cycle and election cycles of national governments are not synchronized makes lobbying more difficult and seems to result in a rather stable development of agricultural policy. It is especially the gradual and unbroken transition process from price support policies in the early 1990s towards increasingly decoupled direct payments which may be attributed to the centralised policy process. It is doubtful that agricultural policy would be more liberalized today if member states had been fully responsible. The EU process often allows agricultural ministers to return home blaming the reforms decided on the EU as a scapegoat, which makes them more immune to lobbying. The instability of US agricultural policy over the same period may be an example of a process more prone to the influence of lobby groups.

3.3.5 Role of the EU Commission

The potential tendency of the European Commission to overly centralise has already been discussed above. Indeed, it is interesting to note that, in contrast to the trailblazing role of the Commission in shifting from price support to decoupled direct payments and rural development funding, there is silence about any kind of nationalisation of core policy fields. One may ask why there is no analysis from the Commission on the adequate level of centralisation of the second pillar while many researchers argue for more decentralisation. Further, why is there no discussion from the European Commission about fully decoupled payments being nationalised?

Pollack (2003: 51) provides a list of criteria in order to test whether there is any discretion of the European Commission to promote overly centralist policies. Three of these criteria support a strong potential for the Commission to influence the degree of centralism in agricultural policy:

- Information is imperfect, as it is mainly at the EU level where information from all member states is collected and evaluated systematically.
- The uncertainty about future developments is high. The CAP is subject to continuous reform and there is constant external pressure from international trade integration.
- Transaction costs of negotiating alternative policies are high, because the policy system is complex and national positions are highly divergent.

On the other hand, many potential changes in the CAP have strong distributional consequences among member states which contradicts high discretionary power of the Commission because the distribution of power and preferences among member states dominates the decision process.[8] The Commission, however, has been very successful in dealing with this problem in several ways:

- The establishment of compensatory payments in case of significant changes in market policies mainly in order to avoid redistribution of benefits.
- The maintenance of financial benefits within member states in case of reforms through policies such as modulation or decoupled payments still being based on historical endowments.
- Balanced packages of benefits and costs for reforms.
- Balancing with other policy fields.

3.3.6 Dynamics

During the early decades of the EU the dominant element of the CAP was "market policy" – for which a centralised policy design is appropriate. A centralised policy design has also worked very well in transforming market policies into decoupled direct payments and rural development. For the further design of a large part of these policies and for their funding, however, the EU seems to be the wrong administrative level. The evolution of the CAP has resulted in an historical artifact and the CAP now faces the challenge of shrinking its responsibilities, administration, and budget.

[8] A detailed literature review on the relationship between the member states and the European Commission can be found in Kassim and Menon (2004) who oberserve a strengthening of the member states since the 1990s.

3.4 Conclusions on Agricultural Policy – How to Get Closer to the Ideal?

The strong involvement of the EU in agricultural policy design and funding can be explained historically, but is misplaced today. EU involvement should be limited to market policies and agri-environmental policies which address cross border externalities. For other policies competition rules need to be monitored on the EU level. Only for market policies should the principle of full centralisation be maintained. Furthermore, a uniform implementation of product and product related process standards should be strengthened.

How do we get there? Most of the conclusions drawn here are not new (Sapir et al., 2003; Wissenschaftlicher Beirat, 1998; Niedersächsische Regierungskommission, 2001; Padoa-Schioppa et al., 1987). To quote only two sources, Sapir et al. conclude that "there is…a solid argument for decentralising to Member States the distributive function of the Common Agricultural Policy" (2003: 164). Padoa-Schioppa et al. state that the distributive character of the CAP "represents a systematic anomaly, since the Community … is not well suited to executing distributive policies at the level of individual persons or small enterprises. Efficient income distribution requires detailed administration at the level of the individual, and coherence with features of income tax and social security systems, and the Community cannot assure this. The Community has thus switched role with the Member States, counter to the basic principles of subsidiarity and comparative advantage" (1987: 102-103). The policy process, however, shows different dynamics. Three aspects seem especially important when envisaging a fundamental redistribution of responsibilities in designing and financing the CAP. First, changes can only be established gradually. It may be more important to establish principles which point in the right direction than to get results quickly. Second, it must be accepted that trade-offs have to be sought in order to limit the redistributive effects and get buy-in from potential losers. Temporary compensation as well as trade-offs with policies other than the CAP may help. Third, the self maintaining mechanism of centralistic institutions needs to be taken into account when looking at the potential drivers for reform. It is unlikely that the European Commission would initiate a reduction of the scope of the CAP and its budget. In the remainder of this section, potential tracks for reform are explored for the policy areas of direct payments and second pillar policies keeping these aspects in mind.

For direct payments, full decoupling, which is currently discussed in the European Commission (Fischer Boel, 2006) would be helpful for starting to think about nationalisation for two reasons. First, full decoupling allows for different levels of direct payments from a competition point of view as they have (almost) no effect on production. Second, full decoupling adds to the transparency of the largely missing justification of these payments – and thus adds to the public and political pressure to reduce them.

As direct payments tend to be successively reduced, this also helps open discussion of options for their nationalisation. After all, the less their volume, the less the redistributive effects of their nationalisation. As direct payments are fixed in nominal terms, inflation leads to an annual reduction in real terms of about 1.9%. In addition, chances are that the budget ceiling for the first pillar of the CAP will require the reduction of direct payments from 2008 onwards. Current estimates hint at a reduction by 5% in 2008 and an additional 8% by 2013

(Agra Informa, 2006b). Together with an increase of obligatory modulation from 5% to 10%, which is also discussed by the European Commission (Agra Informa, 2006c), the real value of direct payments could be reduced by more than 28% in 2013. The pace of future reduction, however, is subject to many uncertainties. A more reliable and transparent phasing out process would be much better and enable producers to adjust to a future environment without such payments.

In fact, there is a strong interdependency between nationalisation and reduction of direct payments. From both, an efficiency as well as an equity point of view, it would be the first best option to completely phase out direct payments in their current form. They capitalise into land prices and thus inhibit structural change. Furthermore they contribute strongly to income inequality in the agricultural sector, as they mainly accrue to large and wealthy farmers (von Witzke and Noleppa, 2006). If it were possible to phase out direct payments at the EU level over a reasonable period, say 10 years, there would be no need for nationalisation. If this turns out to be infeasible, nationalisation may be an option to at least increase the pace of phasing out in many member states due to budgetary rivalry at the member state level.

Searching for a potential majority in the Council for a reduction or nationalisation of direct payments, it is clear that this especially contradicts the distributional interests of the new member states, except Malta and Cyprus (see Graph 3.6 above). They, however, will also be the main recipients of structural and cohesion funds and potential trade offs could be sought in this area. Also, some trade-off would potentially have to been sought with Ireland and Greece, which would be negatively affected from a distributional point of view.

Turning towards the second pillar of the CAP, the justification of responsibility at the EU level for rural development instruments should be critically reviewed. Except for transitional measures to increase the competitiveness of newly acceding members it is difficult to see any justification except for environmental measures. But also for those, responsibilities and especially funding should be disentangled to a large extent and assigned to the member states or the EU along the lines proposed above. Potentially it is a relatively small share of today's rural development spending, for which a fixed rate of co-financing would be the adequate instrument, for example, because costs at member state level can be clearly linked to EU regulation and benefits are to a significant extent transboundary and local in nature (e.g., costs or revenue foregone resulting from restrictions at Natura 2000 sites or from implementation of the Water Framework Directive).

How can we begin to dismantle the system of co-financing? A modified modulation system may be an option to do so. Modulation in its current form is a problematic instrument. The fixed link between the reduction of direct payments and the increase of rural development funds is artificial and only motivated by avoiding distributional effects. Furthermore, the resulting increase of the total volume of agricultural support because of the additional co-finance funds from the member states is questionable. Instead, a modified modulation mechanism would offer the opportunity to establish a first step out of a fully co-financed rural development policy. Money could be saved in the first pillar of the CAP and, instead of shifting it to the traditional co-financed funds, part of the money could be transferred to the exclusive responsibility of the European Union for agri-environmental policies described above which would address issues of a transnational character and would not necessarily require co-funding from the member states. The other part of savings could be directly transferred to the member states (or converted to a reduction of the EU budget, or used for alternative spending) and it would be in the member states' responsibility if this money should be spent on rural development, and for which measures.

For the funding which is currently allocated to the second pillar of the CAP, such a new type of modulation could in the long term be an example for the split of funds into those under exclusive EU-responsibility and those under exclusive member state responsibility. Funds which would be co-financed by the EU and member states could be limited to some agri-environmental measures, which can be clearly linked to EU regulation.

What should be sought, in addition, are mechanisms which would allow reducing the current budget for co-financed rural development funding. Such an initiative, however, would realistically need to come from the member states rather than from the European Commission. One supporting element could be a clearly defined, transparent, and objectively rural development motivated key for the distribution of funds among member states. Such a key could reduce the potential for hidden trade offs which are predominantly motivated by distributional motives rather than rural development considerations. In addition, current rural development funding could be shifted to a larger extent to newly acceding member states with technological and structural gaps, e.g., by increasing the weight of the per capita GDP factor in the formula presented above, and part of funding could be limited to a transition period and would be phased out over a period of, say, 10 years. This would also serve as an incentive for national policy makers in the new member states to concentrate money on measures which make their agricultural sectors independent from such support instead of distributing rents. In addition, this would create a large and powerful coalition of old member states that would be net payers for such a policy and would, thus, support the limitation of its time horizon. The money thus saved could then shift to newly acceding countries, or, alternatively, could move into the splitting mechanism discussed above.

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