

FINANCIAL FRAMEWORK FOR SUSTAINABLE DEVELOPMENT OF THE EU RURAL AREAS: TOWARDS THE NEW PRIORITIES

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Abstract

Economic activity stimulation in rural areas is among the major spatial development directions in the EU countries. In its context, the Common Agricultural Policy (CAP) is implemented at the supranational level. Its goals receive substantial financial resources both from the EU budget and national budgets. The paper aims to research the mechanism of the EU CAP development and implementation and its impact on rural economic development and agriculture, and outline advantages and problems to be addressed in the context of the policy implementation. The mechanism of the EU CAP development and implementation is examined, economic development stimulation in rural areas is analyzed across the CAP pillars, and directions of financial support to farmers, agriculture as a whole, and rural areas are emphasized. The analysis of the EU CAP has revealed that public policy should be based on a dual approach to rural areas – in the first place, as national wealth and source of historical-cultural identity of a state, and in the second place, as a driving force on the way to transition to the care economy and environmentally oriented entrepreneurship.

Keywords: *agriculture, economic activity, European Union’s Common Agricultural Policy, funding, rural areas, sustainable development.*

JEL Codes: *F33, O13, R58.*

Introduction

Economic activity stimulation in rural areas has been among the major spatial development directions in the EU Member States in the last 50 years. The second half of the XX century was clearly characterized by depopulation and marginalization trends in rural areas of the EU countries, while population decrease has become a common trend for most rural areas. The population of predominantly urban areas in the EU is projected to have increased by 24.1 million persons by 2050, while the population in

predominantly rural areas is projected to decline by 7.9 million persons (ESPON, 2017).

Depopulation of rural areas stems from the impact of demographic and economic factors and, according to European researchers, ‘becomes indicative of a broader structural crisis of economic and labour market decline, peripheralisation and a deepening urban-rural divide – intensifying the inherent disadvantages of rural areas’ (ESPON, 2017). Unlike urban areas, rural ones lag behind by many parameters, and income per capita is much lower here (72% of the EU average rate)

than in urban areas (121% of the EU average rate). Other problems include the lack of attractive employment offers, deficit of professional workforce, low investment in infrastructural projects, low coverage with high-speed Internet, lower level of coverage with social services, ageing of the population, and youth outflow.

To overcome these problems and stimulate spatial development of rural areas, the Common Agricultural Policy (CAP) has been implemented in the EU countries on the supranational level since 1962, which nowadays is the largest subsidizing system and is implemented in areas defined as rural based on the share of rural population, according to the methodology of typology of EU regions (Eurostat, 2018). For example, in 2017, 38 % of the EU budget was spent on agriculture and rural development (European Parliament, 2019), which is three times above financial resources directed by the Community at job creation and overcoming unemployment (Parrock J., Huet N., 2020).

The EU CAP is currently based on the three-pillar sustainable development concept, which provides that rural areas should be stimulated with the view to protect the environment, improve the social domain, and secure balanced technological and economic growth. The CAP is clearly in line with the 2030 Agenda for Sustainable Development and aims to address 13 of the 17 sustainable development goals (SDG) in the long run. Today, it is characterized by significant performance in achieving the 1st SDG (poverty reduction) and the 2nd SDG (overcoming hunger, achieving food security, improving nutrition and promoting sustainable agricultural development) (Pe'er G., 2019; Matthews A., 2020).

Obviously, the CAP has undergone a long process of changes and reforming. In the 1960s, it was launched to secure access of EU citizens to food and respective living standards for farmers. Since 2003, the CAP aim has been to secure integrated rural development and develop an agricultural model based on family farming. Meanwhile, the CAP makes farmers responsible for not only food production but also rural development and protection of

biodiversity and natural resources. 'The farmers reinvest in the environment they inhabit, thus securing the prosperity of rural area', ensuring their long-term future (Borodina, 2016).

Meanwhile, the theories of local development (underlying place-based policy) have been getting more relevant in the context of spatial development stimulation in the EU rural areas. Being based on the principles of innovations generation and capacity for adaptation and regulation (Bouvet F., 2001; Bassand M., Hainard F., Pedrazzini Y., Perrinjaquet R., 1986), they stipulate involvement of local stakeholders in the development and implementation of strategies, decision-making, and resources distribution (community-led local development approach), as well as growing responsibility of local governments for resource management and opportunity for interterritorial cooperation in the context of addressing the common development challenges (Storonyanska I., Patytska K., Hrynchyshyn I., Chemerys V., 2020).

In addition, strengthening the participation of states and regions in the CAP has another "effect", as it aims to ensure "regional targeting" of financial resources and more efficient and equitable distribution of funds, which will stimulate spatial development of rural areas by increasing local initiatives. scientists, NGOs, and administrators work together to create repetitive, scalable success stories "(Scown M. W., Brady M. V., Nicholas K. A., 2020).

On the other hand, 'the increasing multidimensionality of agriculture, linking the domain with environmental, trade and food safety concerns, has mobilized new policy actors' and generated new priorities in the discussion on rural development policy in the EU and the place the environmental component takes in it (Alons G., 2017; Thomas F., Midler E., Lefebvre M., Engel S., 2019). Given the dependence of agricultural performance on climate conditions, it is clear to define sustainable management of natural resources and climate change as one of the key areas of CAP (EURactiv, 2019). However, a study of the impact of the CAP on climate

change and greenhouse gas emissions conducted by the European Commission in 2019 revealed insufficient effectiveness of CAP action to address climate change threats and the inconsistency of agricultural measures with EU climate goals (European Commission, 2019). The solution to this problem lies in the development of CAP in the context of the European Green Deal and the Farm to Fork strategy, which provides a framework for the transition to a sustainable food system, strengthening the role and responsibility of farmers for the environment (European Commission, 2019).

To maximize the impact of CAP in the environmental field, it is increasingly focused on nature-based solutions (NBS) in addressing societal challenges such as climate change, food security and biodiversity loss, effectively combining place-based policy principles and people-based policy priorities (Bechauf R., 2021). After all, the formation and implementation of CAP on the basis of a comprehensive concept of the NBS involves solving social problems, while improving human well-being and supporting biodiversity.

The research of the EU CAP is important not only in the context of supporting agriculture and spatial development of the territories of the Member States but also from the viewpoint of integration processes in the EU because since 2014, the CAP reform has been securing the growing impact of countries and regions on the distribution of financial resources to take into account national needs (Henke R., Benos T., Filippis F., Pierangeli F., 2017). Various 'output conditions', development features and goals of Member States contribute to the role of these changes (Feher A., Stanciu S., Popescu G., Adamov T., 2020), which can be traced for the countries of the Western and Eastern Europe. For the Eastern European EU Member States (namely, Bulgaria, Romania, Slovakia, Slovenia), inconsistencies between the needs of rural residents and defined conditions and priorities of the policy are the major problem of projects implementation on rural development in the framework of the CAP. They focus on the

primary need for investment in the basic infrastructure of rural communities (sewerage, roads, water supply) (Ravera D., Gaudron M., 2021) without rejecting the basic CAP principles (Man M., Ciurea M., 2017).

Taking into account significant financial resources allocated to the support of rural areas in the EU under the CAP and a long period of policy implementation, the paper **aims to** research the mechanism of the EU CAP development and implementation and its impact on spatial development of rural areas and agriculture and outline advantages and problems to be addressed in the context of the policy implementation.

Results and discussion

Despite continuous transformation and inability to overcome all negative trends in rural development, two facts confirm the CAP efficiency: firstly, the share of people residing in predominantly rural areas of the EU has not decreased in the last 50 years, having remained consistent for a long period (Fig. 1); secondly, in 1961-2011, the share of predominantly rural areas facing depopulation reduced substantially (ESPON, 2017).

Having undergone a long reforming period, currently (2014-2020, 2021-2027), the CAP is directed at achieving goals in three directions (European Parliament, 2021): *economic* – securing food safety and promoting smart, sustainable, and diversified agriculture; *environmental* – securing sustainable natural resources management, combating climate change; *territorial* – boosting social and economic resilience of rural areas.

The CAP is developed and implemented by two individual pillars. Therefore, the funding is also divided and is secured by different funds: the I pillar – by the **European Agricultural Guarantee Fund (EAGF)**; the II pillar – by co-funding of EU member States and the **European Agricultural Fund for Rural Development (EAFRD)** (Fig. 1 shows the mechanism of the CAP development and implementation in 2014-2020). Meanwhile,

the EU CAP funding system provides an opportunity to adjust resources among pillars to fund more important goals.

I EU CAP PILLAR aims to support and develop agriculture in the EU countries and has two directions: common organization of the markets in agricultural products carried out through market measures and financial support of farmers secured by providing direct payments to farmers.

Allocation of substantial financial resources to support and stimulate agriculture is designated to maintain food security for the EU population. It had five goals for 2014-2020: to increase agriculture productivity by using technological and innovative tools and ensuring the optimum use of the factors of production and labor; to ensure a fair standard of living for farmers; to stabilize markets; to secure availability of supplies; to provide consumers with food at reasonable prices.

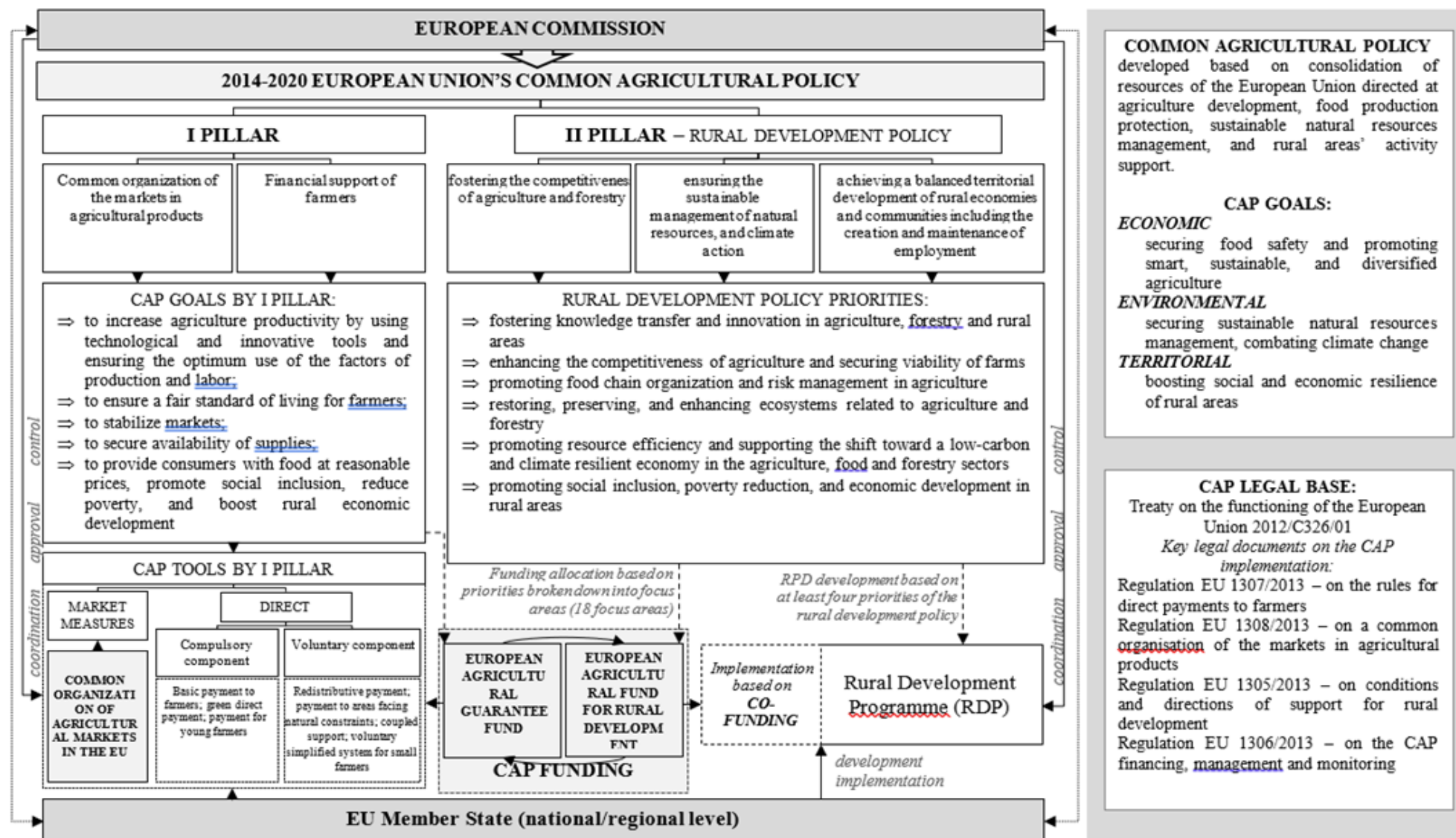


Figure 1. The mechanism of the 2014-2020 EU CAP development and implementation

*Source: developed based on (European Parliament, 2021).

EU agricultural market intervention measures (market measures) are conducted under the common organization of the markets in agricultural products to achieve goals in the following directions: protection and stabilization of agricultural markets, prevention of crises, adaptation of agricultural entities to changes in market infrastructure, exceptional measures, and sector-specific aid schemes; encouraging cooperation between agricultural producers through various forms of organizations and agricultural producer representative bodies, stimulation of cross-sectoral interactions; establishment and compliance with quality requirements, trade standards, and competition policy.

Financial support to farmers as the second direction of the CAP implementation by the I pillar provides direct payments to farmers and aims to achieve the goals beyond the farmer support, indirectly including rural development and achievement of farmers' self-identification with the area they reside and work in. It provides farmers development as the guarantees of food security in Europe, stimulation of agricultural production, farmers encouragement to produce safe, healthy, and affordable goods, and rewarding of farmers for taking care of rural areas and environment.

The system of direct payments in the EU is formed in such a way that it includes compulsory and voluntary components and consists of seven direct payments granted to farms to support their activities and, in some cases, on condition of compliance with defined terms. Therefore, farmers receive financial assistance in exchange for the commitment to manage their businesses, focusing on preserving biodiversity, preventing soil erosion, and contributing to carbon sequestration, etc. As a result, in the last

decade, the fourth part of the EU's agricultural area was covered by agri-environmental management commitments (Matthews A., 2019).

II EU CAP PILLAR is designated to help sustainable rural development by strengthening social, environmental, and economic resilience. For the matter, the European Commission defines three long-term goals of rural development policy: fostering the competitiveness of agriculture and forestry; ensuring the sustainable management of natural resources, and climate action; achieving a balanced territorial development of rural economies and communities including the creation and maintenance of employment. These goals are the basis of six EU rural development policy priorities. At least four out of six EU rural development policy priorities are the basis for Rural Development Programmes elaborated and implemented by each Member State or its regions and approved and monitored by the European Commission.

Obviously, the system of the EU CAP funding has undergone substantial changes in the half-century development period. The goals set when the CAP was launched have not changed but have been expanded. Nowadays, they constitute ensuring economic entities' competitiveness, environmental sustainability, and territorial balance. Yet, the system of financial tools used for policy implementation has faced the most essential transformations. The analysis of the structure of the 1990-2027 EU CAP expenditures (Fig. 2) shows the decline in the share of market measures expenditures from 90% down to 5% and the growing role of direct payments to farmers (accounting for $\frac{3}{4}$ of the EU CAP expenditures).

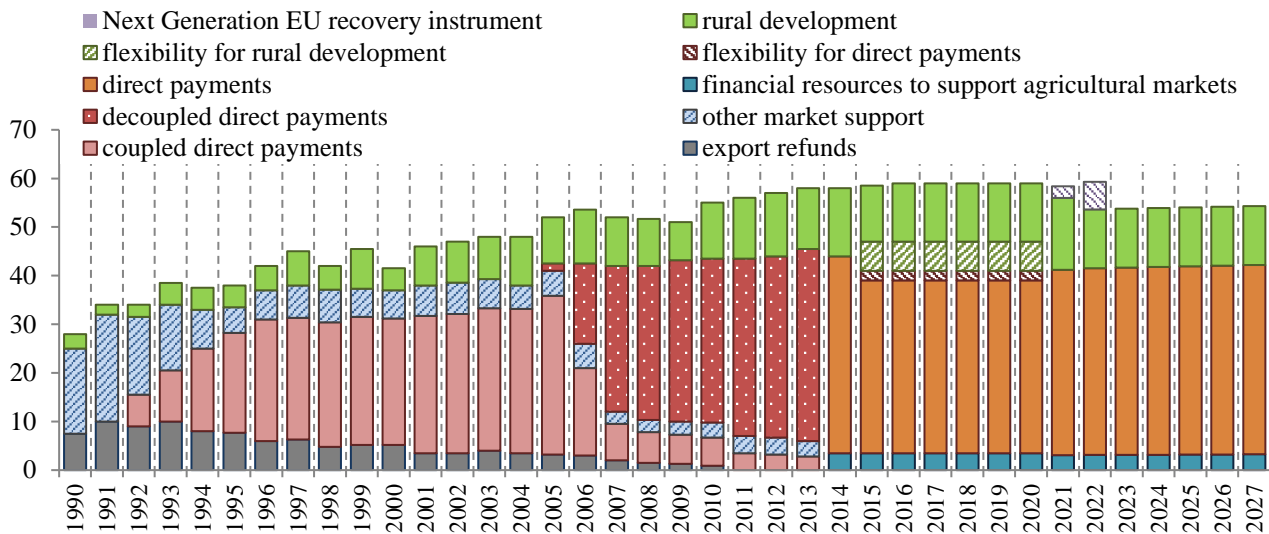


Figure 2. Dynamics of the EU CAP expenditures by the stages of reforming, € billion

*Source: developed based on (European Parliament, 2016; European Parliament, 2021)

In the period under research, financial resources were consistently directed at the implementation of rural development policy (about 1/4), in particular in competitiveness of SMEs support (28.9% of all funds by the II CAP EU pillar), environment protection and resource efficiency (25.6%), and climate change adaptation (21.3%) (Fig. 3).

The major *EU CAP advantages* include food security of the EU countries, support of rural development, protection of agricultural producers, high quality and diversity of food products, environmental protection, etc. Total factor productivity (TFP) is among the key indicators showing the EU CAP efficiency.

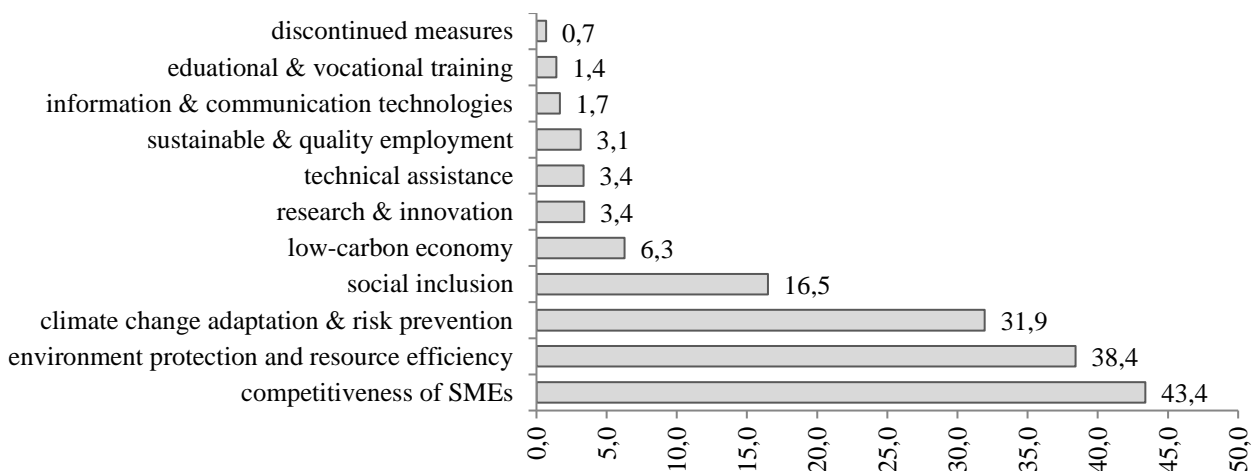


Figure 3. The 2014-2020 EU CAP expenditures by pillar II across rural development directions, € million

*Source: developed based on (European Parliament, 2016; European Parliament, 2021)

It indicates the residual growth in total output in an industry that cannot be explained by the accumulation of traditional inputs like labor and capital. The rate increased by 10 p.p.

in the EU countries in 2005-2018 (Fig. 4), showing the growing efficiency and introduction of new technologies at agricultural enterprises and farms.

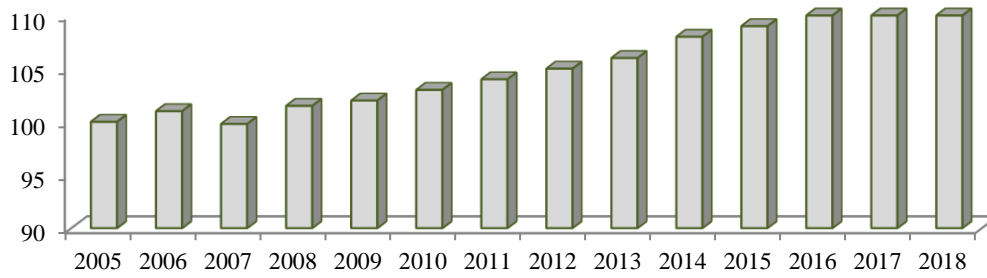


Figure 4. Dynamics of total factor productivity in agriculture in the EU, % (2005 rate = 100%)

*Source: developed based on (European Union (2020))

On the other hand, examining the CAP efficiency, one can assume that financial assistance to agriculture by the I CAP pillar in the EU countries should be accompanied by the relevant indicators of Gross Value Added (GVA) per capita created in the industry. The analysis of these interrelations in the EU countries in 2014-2020 confirms our hypothesis and shows a correlation between the GVA created in agriculture and amounts of funding in the industry by the CAP (coefficient of correlation $R=0.4294$) (Fig. 5). Notably, the countries with less agricultural lands and therefore – small amounts of financial resources allocated by the CAP (the Netherlands, Greece, Ireland, Denmark, Lithuania, Romania, etc.) are characterized by high GVA per capita rates, which is related to the peculiarities of agriculture. Meanwhile, the

calculations show a group of the EU Member States with a higher level of funding (France, Spain, Germany, Italy, and Poland), which accounted for 63.6% of financial resources by the I EU CAP pillar in 2014-2020. The efficiency of the EU agricultural policy in these countries is confirmed by high GVA per capita rates (Spain (€ 4002.7), Italy (€ 3810.2)), and high GVA growth paces in Poland in 2020 against 2014 – 134.9%. On the other hand, significant growth of organic farmland areas was peculiar to the countries with the highest CAP financial assistance (France (+97.3%), Italy (+67.7%), Spain (+27.9%), Germany (+27.2%) (Agriculture, forestry and fishery statistics, 2020)), which shows the CAP efficiency in environmentally-friendly agriculture.

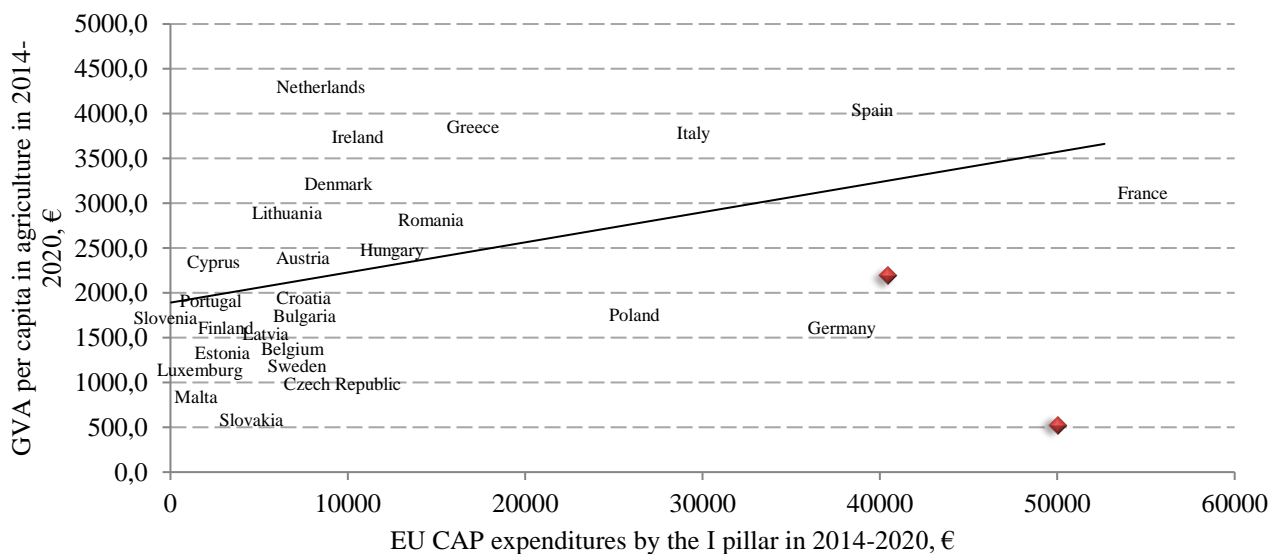


Figure 5. Dependence between financial support to agriculture by the I CAP pillar in the EU Member States and GVA per capita in the industry in 2014-2020

*Source: developed based on (European Commission, 2021)

The EU CAP bottlenecks include agricultural overproduction, inefficient allocation of financial resources (farmers account for 3% of the EU population and generate about 6% of the GDP, while receiving 30% of the CAP total budget through various EU CAP instruments (Debating Europe, 2021)), restricting impact on agriculture through the system of market measures and agriculture protection from healthy competition on agricultural markets.

Unbalanced financial assistance to farms through direct payments by the 1 EU CAP pillar is among the CAP bottlenecks much addressed in political debates and economic discussions in various EU countries. The following problems are the most essential in this context.

1. *Unequal financial assistance to small and large farms.* According to the EU statistical factsheet (European Union, 2020), 6.5 million farmers were entitled to direct payments by the I EU CAP pillar in 2018. In total, they were paid € 41 billion. Yet, the CAP funding system is formed based on the

agricultural area (i.e. the funds are allocated per 1 ha). Therefore, there is a situation when 20% of the largest farms receive 80% of payments.

Therefore, it can be said that the system of direct payments to farmers is developed in such a way that the main weight of financial assistance accounts for large farms rather than small agricultural producers. Despite the voluntary simplified system of income support for small farms available to small farmers, it is rather incommensurable by allocated amounts.

Such situation has been observed for a long time, affecting the development of small farms. The comparison of the farm structure in the EU countries by area in 2013 and 2005 (Fig. 6) shows two trends: decreasing number of farms of less than 5 ha for over 1/3 and growing number of large farms of over 100 ha by 12.8 p.p.

For 2021-2027 European Commission urged consultations to set maximum subsidy limits per farm, but the suggestion met significant resistance from certain countries, where agriculture is organized around large farms (Czech Republic, Germany, Sweden).

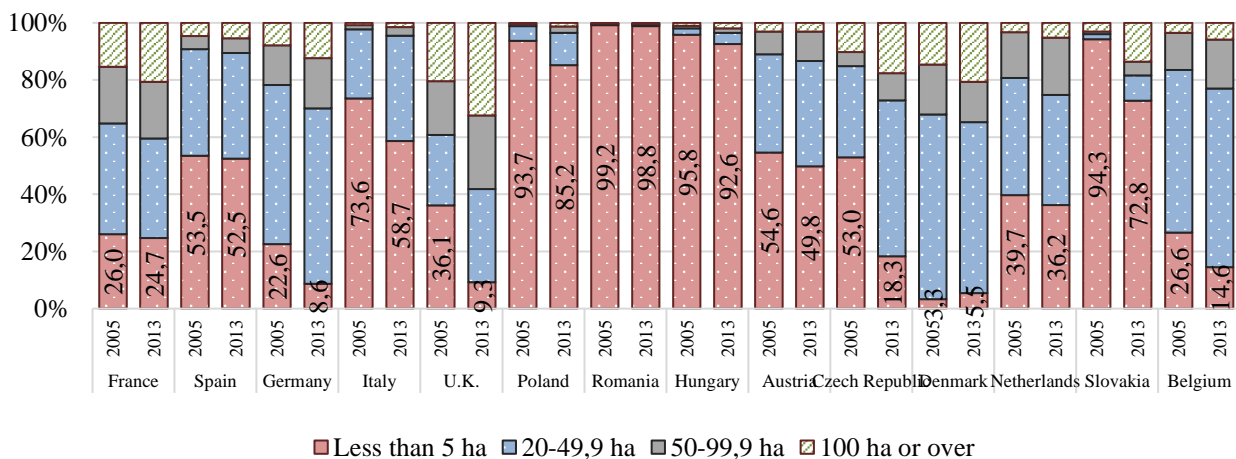


Figure 6. Comparison of farm structure in the EU countries by area in 2005 and 2013, %

*Source: developed based on (CEMA, 2019).

2. *Misbalances in direct payments allocation to farms in the EU countries.* Unequal distribution of direct payments is related to different practices and traditions of farming in the EU countries. Therefore, in addition to substantial misbalances in funds

distribution between large and small farms, there is also a substantial differentiation of payments among the countries.

3. *Incompatibility of the role of direct payments for farms depending on the type of activity.* Direct payments are allocated

depending on the agricultural area, but the type of activity is not taken into account. Therefore, payments are higher for farms in arable farming and grazing, and often they can significantly exceed the income from agricultural activity. Meanwhile, direct payments have a limited role in the income of a farm where the farm area is not essential (namely, in animal husbandry) or the output per hectare is very high (winegrowing, gardening).

In general, it is worth emphasizing that nowadays three main foundations specify the direct payments to farmers in the EU: the need to increase the low income of farmers, stabilization of their income under risk, and as compensation for high standards to be met by farms and their products in the EU. Yet, none of the factors is taken into account when developing the mechanism of these payments: firstly, as it was demonstrated above, the payments mostly go to large farms, secondly, they are allocated regardless of high or low income of a farmer, thirdly, the algorithm of payments does not include consideration of additional expenditures on maintenance of the high quality of production or proper labor conditions for employed on the farm. Therefore, the system of direct payments to farmers in the EU cannot be considered optimal and efficient because it is developed based on the farm area but is not linked to specific results of activity and performance and even profitability.

The solution to this and other problems is envisaged in the context of reforming the EU CAP in 2021-2027. In the first place, it is worth mentioning that the application of the EU CAP rules designated for 2014-2020 continues for the 2021-2022 period defined as transitional under the impact of the COVID-19 pandemic according to Regulations EU 2020/531 and 2020/2220. It helps to secure the consistency of financial assistance to farmers and stipulates additional funds for their support under crisis.

Yet, overall, European Commission substantially changes the EU CAP management model for the 2021-2027 period, focusing on its simplification and performance improvement. In the process of developing the suggestions on the CAP modernization, the

main attention is paid to solution of problems in three directions: development of smart, sustainable, and diversified agriculture that maintains the EU food security; fostering the measures on environmental protection and climate change combating, contributing to the achievement of EU goals on environmental protection and climate; and strengthening of socio-economic structure of rural areas.

The main advantage of the 2021-2027 EU CAP consists in the transition from the approach oriented on compliance with requirements to the approach directed at the result. Moreover, the goals to be achieved in the context of the CAP implementation are considerably expanded: in addition to traditional tasks (securing fair income, farms competitiveness, climate change adaptation, and generation renewal), there are the new ones (value chains, ecosystem services, employment, bioeconomy, digitalization, securing of high food quality and health), which are mostly related to environmental, social, and spatial aspects of rural development and linked to a broader concept of agriculture and its sustainability.

Conclusions

The half-century practice of comprehensive systemic consistent support to rural development in the EU can be useful for developing countries in the context of setting the priorities of regional development policy and directions to foster rural economic growth overall and, in particular, rural settlements in unfavorable conditions. It is obvious that the approach to rural development focusing on agriculture and increasing agricultural raw materials exports is outdated and fails to meet the requirements of present days and global trends.

Public policy should be based on the dual approach to rural areas – firstly, as national wealth and source of historical-cultural identity of a state, and secondly, as a driving force on the way to transition to the care economy and environmentally oriented entrepreneurship. In this context, rural development should be focused on achievement of economic, social, and

environmental goals both in the framework of agriculture stimulation and national food security maintenance as well as rural endogenous development based on economic

activity diversification, support to small and medium entrepreneurship, social inclusion, and preservation of local human resources.

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