Northern Region Agriculture & Rural Development: What Futures?

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Abstract

The countryside and its supposed bedrock, farming, are commonly supposed to be under threat. What might the future hold? This article explores the major pressures and apparent opportunities facing agriculture and rural development in the Northern Region. It begins (section I) with a brief review of the recent economic history of the agricultural sector in Britain, drawing out the implications for the North. It then outlines the major policy directions apparent in both European and British policy (Section II), including a critique of the Agenda 2000 proposals. Section III outlines an alternative policy strategy, without which any policy critique is largely rhetorical. The last major section (IV) explores the implications of these policy directions, in conjunction with market trends, for the future of farming and rural development in the North. Section V offers some conclusions for both future practice and research.

I. Recent Economic History of Farming in the UK

The agricultural sector is in decline - its share of national economic activity and incomes is falling and will go on falling. This is an inevitable fact of socio-economic life - as people become richer, they spend a smaller fraction of their total income on food (though greater fractions on services, entertainment, and on meals outside the home). As they do, so the falling share of total spending generates a smaller share of total earnings accruing to the producers of food. On the other hand, as economies grow, so demands for other goods and services grows, and opportunities expand for those previously earning their livings from farming. Farmers, their families and their employees leave the industry over time (or find part-time occupations and income sources other than farming) to take advantage of these opportunities. Typically, such adjustments happen as generations change - farmers heirs and offspring do not follow their parents into the business but find other occupations, so the adjustments are not necessarily either traumatic or dramatic.

Typically, the first to leave are those who have better opportunities elsewhere, or who are less implacably wedded to the career and lifestyle of farming. Those remaining in the industry tend to be content (or are able) to earn rather less than those who leave, so farm incomes tend to lag behind those elsewhere in the economy. In the past, this apparent income lag or gap has been sufficient to persuade politicians to favour the farm sector with support and subsidies. This tendency has, from time to time, been re-inforced with arguments in favour of: import saving; countervailing action against monopolistic food manufacturers, processors and distributors; supporting rural (agriculturally-dependent) local economies and so forth.

However, both economic logic and the history of farm returns clearly show that supporting farm product prices and receipts does not increase farm incomes (Figure 1). Why not? Increasing farm receipts encourages more people to stay in farming than otherwise and encourages more use of inputs than otherwise. Both these effects tend to increase costs, leaving farm incomes (as the difference between receipts and costs) no higher than before. Since people will only remain in farming so long as their incomes (and lifestyles) are expected to be more attractive than those elsewhere, farm incomes are more determined by what people can earn elsewhere than by the receipts from farming. The post war history of British agricultural returns clearly illustrates this logic.

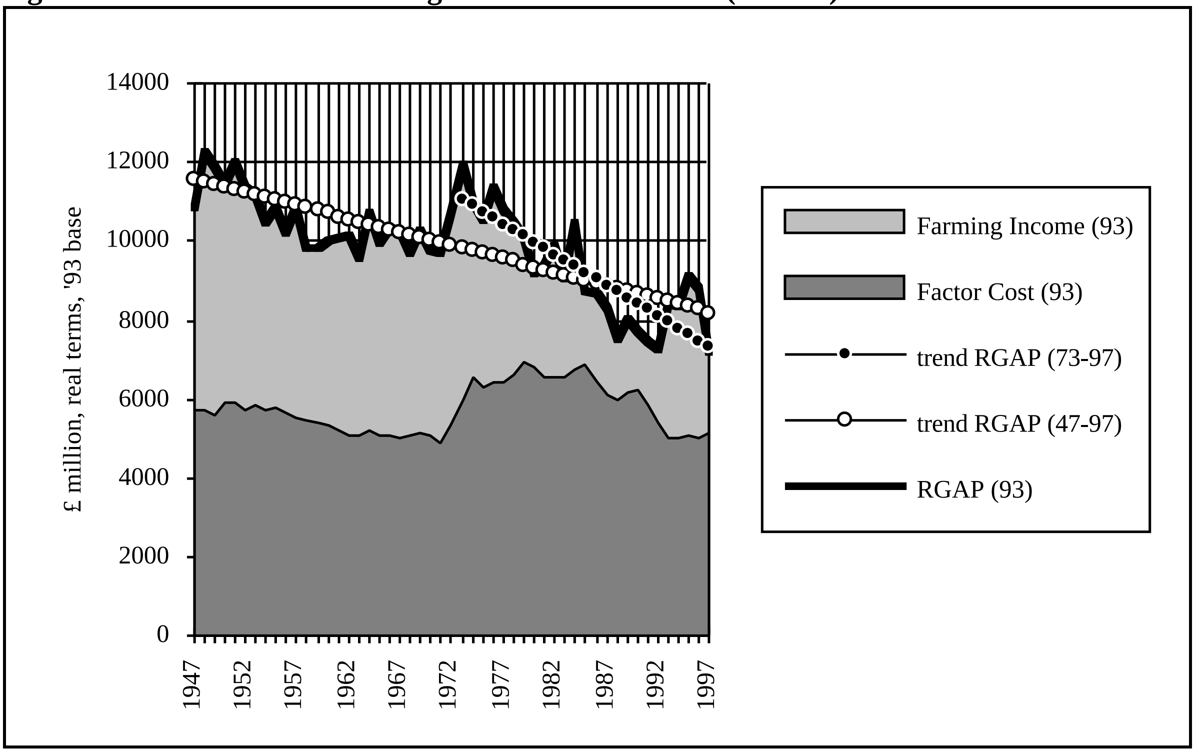
Figure 1 shows the post war history of the UK's real gross agricultural product (RGAP (93)). This measure is the difference between gross receipts from farm output sales (cereals, livestock products etc.) and gross expenses on farm inputs (fertilisers, feedstuffs, power and fuel etc.), with the result being deflated by the national Gross Domestic Product deflator (base 1993), as the most comprehensive indicator of inflation, to produce a measure of total farm returns in real purchasing power terms. The pattern of cost change is closely similar to that of changes in gross output receipts - changes in real spending on inputs closely follows changes in gross receipts (output), which

[1] This article (especially section IV) draws heavily on ideas and arguments developed during the preparation of a report on the present situation and future prospects of the "Northern Uplands Red Meat Chain" (NURMC), coordinated by the Northern Development Company (NDC), with substantive inputs from ADAS, MLC and the Department of Agricultural Economics and Food Marketing, the University of Newcastle upon Tyne. A shortened version is forthcoming in the Northern Economic Review, early 1999.

reflects the substantial fraction of farm costs made up by feed and seed. These changes are shown in more detail in Box 1, though only for the period 1973 - 1997.

This industry gross product is the national equivalent of the farm gross margins at the farm business level, and it is from this gross income that the industry and its farmers pays for its land, labour, capital and management - in other words, it is this gross product which pays those people trying to make a living from farming. Two trend lines are shown for this gross income from farming, both showing substantial declines: one taken over the whole post-war period (1947 - 1997), the second, steeper, trend beginning from 1973 (the year of formal entry to the European Union (Community as was) and the start of the UK accession to the EU's Common Agricultural Policy (CAP). The rather few occurrences of counter-trend fluctuations in the industry's gross income are typically consequences of rapid (and shortlived) increases in world farm commodity prices (48 - 52; 73 - 75) or of substantial declines in the international value of sterling (depreciating exchange rates (64, 71 - 75; 84, 92-93), through which international prices (and EU support payments) are reflected to British farmers.

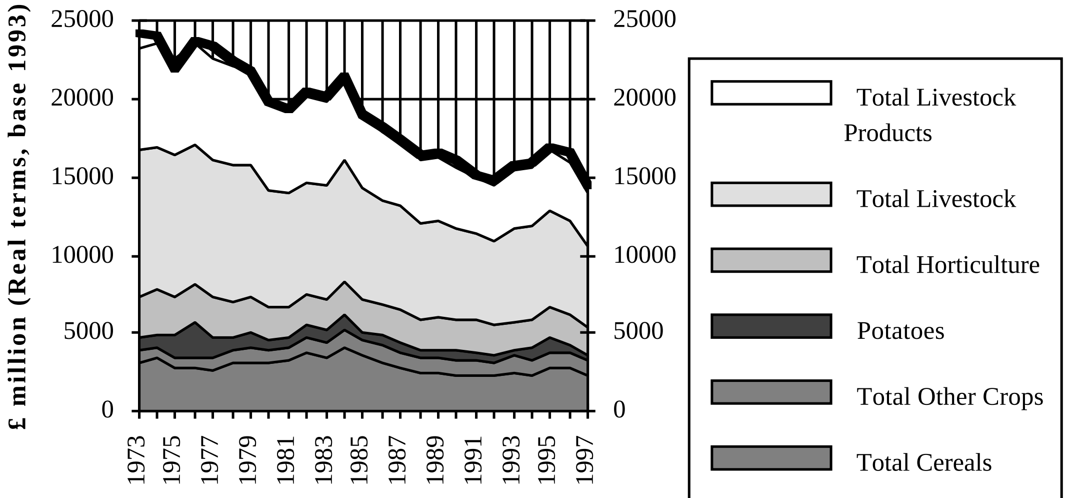
Figure 1 UK Real Gross Agricultural Product (RGAP)



Source: This, and related figures below, are derived from MAFF, Farming Incomes in the UK, various issues.

Figure 1 also shows a major breakdown of this gross product, into "*factor cost*" and "*farming income*". The factor cost measure shows the total of: *interest payments* actually made on farming's debts to its various lenders; an estimated allowance to cover the *depreciation* of agricultural capital plant, machinery and equipment; wages and salaries paid to hired labour and managers; an estimated allowance to pay family labour (excluding that of the farmer); net rents paid by sitting tenants to their landlords. The balance left after all these payments represents the return to the farmer for his or her own labour, management, equity capital and land ownership, and is termed farming income. The clear implication of this figure is that while farmers may not be doing less, they are certainly earning less.

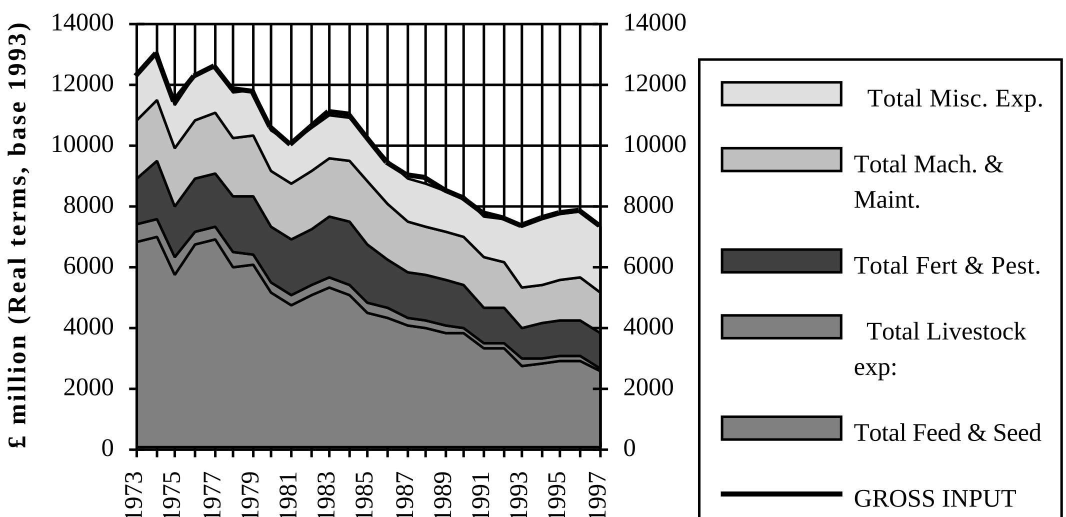
Box 1: B.1: UK Agricultural Output Value in real terms.



Note: 'gap' between Gross Output and sum of named products is accounted for by: direct payments; stock adjustments; intermediate output (feed & seed)

Output values fluctuate around a downward trend, frequently reflecting changes in the value of sterling (which translates European support prices into sterling) and also indicating local price changes (e.g. potatoes in 1976/7). However, the real value of livestock (beef, sheep, pork and poultry) has fallen faster than that for other (especially cereal) outputs.

B.2. UK Agricultural Input Spending in real terms.



Note: Difference between Gross Input and component parts is input stock adjustments

That input spending closely tracks output receipts comes as no surprise, as feed and seed comprise a substantial, though falling, fraction of total input costs. Fertiliser and pesticide spending has been falling in real terms, reflecting some technological improvements as well as increasing economy in use. Miscellaneous spending has been increasing in real terms (this category includes vet. and medicines, non-machinery specific power, containers and sundries - possibly reflecting increased attention to marketing in the industry).

Over the post-war period, there have been relatively extensive systems of farm support. First, under the UK 1947 Agriculture Act, deficiency payments were made from the national exchequer, making good the difference between market prices and government set guaranteed prices (see, e.g. Tracy, 1989, p 277ff). More recently (post 1973/8), under the European Union's Common Agricultural Policy (CAP), domestic market prices have been supported through systems of import taxes (levies), export subsidies and internal intervention buying, and more recently still (since the McSharry reforms of 1992) through systems of direct payments (the cereal area and livestock headage payments) - see, Ritson and Harvey, 1997, part 1. However, this government and public support, through both taxpayer transfers and through artificially high food prices, has not prevented the inevitable decline in earnings in the industry[2]. If anything, the substitution of a generally higher level of protection and support under the CAP than under the 1947 Agriculture Act has precipitated a faster rate of decline in farm incomes (albeit from an apparently higher starting point (1973).

As Figure 1 indicates, 1972 - 77 was an exceptionally prosperous time for British agriculture, stemming from the consequences of devaluation in 1971 and the dramatic escalation in world market prices in this period, which were still strongly reflected in British market prices, since the latter had not adjusted to the CAP support prices at this time. This extraordinary period generated expectations within the farming sector of continued prosperity, hoped for as a consequence of CAP accession, and driving the increase in the real costs of factors employed in the industry (especially labour and capital). By the end of the 70's, it became apparent that the CAP was not going to produce these anticipated returns, while real interest rate increases re-inforced the resulting incentives to reduce the fixed (factor) costs in the industry. 1984 saw both the European Union moving into surplus (and growing export subsidies) for cereals, and the introduction of milk quotas. These events provided a clear signal to the farming industry that unlimited and open ended support for the sector was at an end. Some form of supply control (like quotas) or support price reductions were now seen as inevitable eventually in other commodities as well, as the only alternatives available to the old CAP for limiting the growing budgetary expenditure on export subsidies.

As a consequence, the farming industry began to reduce labour and capital costs, as Figure 1 shows, and effectively release these factors to other occupations and uses. However, 1992 saw a reversal of this emerging trend. Although the McSharry reforms (substituting direct area and headage payments for market price support - see, e.g. Hubbard and Ritson, 1997) had been widely forecast to lead to significant reductions in farm returns, strong world market prices (and thus, effectively, European prices) coupled with a major depreciation in sterling (for the UK) masked these forecast effects, and apparently convinced many in the farming industry that the reforms would lead to better returns. In fact, a combination of high world prices (for cereals especially) and a weak pound produced the best period in terms of farming income the industry has known since the halcyon days of the mid 1970s. It was clear to those who understood the fundamentals that this situation could not be sustained, and this understanding was widely reported.

The eventual (and rather dramatic) collapse in real gross margins resulted as sterling appreciated and world market prices fell to their trends, exacerbated, especially in the beef market, by the catastrophe of BSE. In addition, the milk market saw the competition between milk processors for limited supplies of milk (following the privatisation of the Milk Marketing Boards in 1993) leading at first to rather high producer prices as processors sought to ensure their supplies. Once again, it was widely commented that these high prices were commercially unsustainable and would have to fall, as has proved correct. Yet the coincident falls in real margins across all the major agricultural commodities seems to have caught the industry as a whole by surprise. This dramatic fall finds the industry as a whole in an extremely difficult but historically typical position - too many people are trying to earn a respectable living from agriculture. Although the 1997 gross income figure is widely seen as disastrous for the British farming industry, is very close to the 25 year trend line, albeit substantially below the 60 year trend. The signals are clear - people and capital can be expected to leave the industry, or become more part-time, and farm rents (and hence agricultural land values) can be expected to fall in real terms in the future.

Figure 2 shows (for the EU phase of British farming history) how this margin has been distributed amongst these production factors and their owners - the banks and creditors, the depreciation

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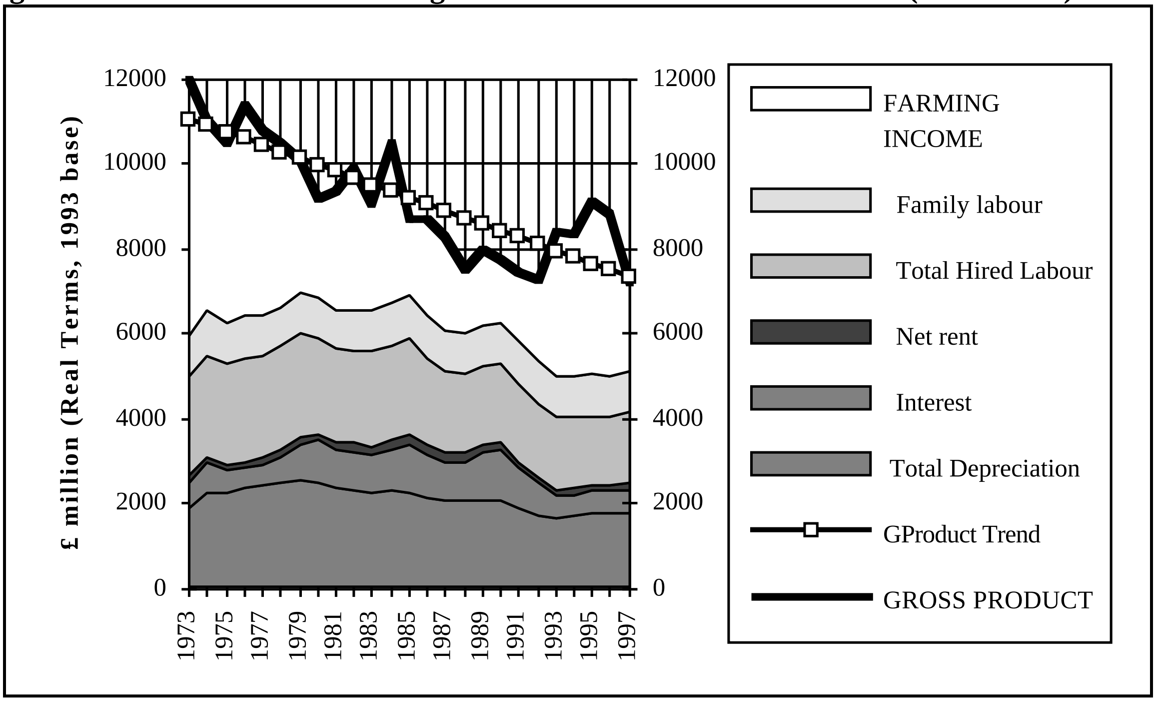
2 According to the OECD, the level of support amounted to between 35 and 50% of total farm receipts in the European Union between 1989 and 1994, and showed a general upward trend between these dates. See, OECD, 1997.

accounts, the landlords, the hired workforce, and farm families. In this figure, as implicit in figure 1, interest charges are those actually paid by the farms on borrowed capital, while the depreciation charge is calculated on the basis of the capital plant, equipment, buildings etc. employed in the sector. The rent figure is rents paid by sitting tenants to landlords (and does not include owner occupiers' returns). The hired labour bill is returns to full and part-time and paid casual labour, while the family labour bill is an estimate of the (possibly notional) wages paid to families, but excluding any returns to the farmer[3].

Figure 2. Distribution of UK Agriculture's Real Gross Product (1973 - '97)



The underlying prosperity of the industry, however, has remained under very substantial pressure throughout this period. To get a picture of the underlying profitability of the sector, it is necessary to take account of the opportunity costs of farmers' land, labour, capital and management employed in the industry, as the earnings these factors could be expected to realise in other activities than farming[4].

Figure 3 illustrates the effects of taking account of these opportunity costs. Here, farmers' own labour is charged to the gross product at the average hired labour wage rate - thus assuming that farmers could generally earn at least the hired farmworker's wage doing something else. The average rent paid on tenanted land is applied to the whole farm acreage, thus assuming that the capital tied up in land could earn at least the agricultural rent in other uses. The opportunity cost of capital includes the depreciation charges and interest paid on borrowed funds already illustrated in the previous figure (2), but excluding long term loans for land purchase, since the opportunity cost of land is already included as rent. To this cost of borrowed funds is added an estimate of the market rate of return on non-land equity capital in the industry (here set at 2 points below the average borrowing rate on long-term loans to the industry). The resulting estimates of the actual and opportunity costs of the factors of production (land, labour, management and capital) employed in

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3 These figures are subject to considerable *caveat.* In particular, the estimates of the numbers of farmers employed in the industry seems likely to be suspect (the marked increase in farmers' labour/management costs since 1990 is largely driven by a reported increase in total numbers). Nevertheless, the overall picture can be taken as reliably indicative of the state and history of the industry.

4 Of course, realising these potential opportunities may be easier said than done. Typically, career farmers do not find it easy to get alternative employment (especially as they have a house and car and other 'perks' associated with farming which would be lost in other occupations), so changes in occupation tend to happen only at changes in generations. Here, however, release of capital invested in the business tends to attract capital gains and/or inheritance tax unless retained in the industry - further slowing the response to falling returns and tending to 'capture' otherwise un-economic capital and own labour in the industry.

the industry can then be compared directly with the actual earnings of these factors - represented by the declining real value of the gross product. The result indicates whether the industry as a whole is profitable or not. The answer will come as no surprise to farmers, though may concern and surprise some others.

Figure 3 Profitability of UK Agriculture in real terms.

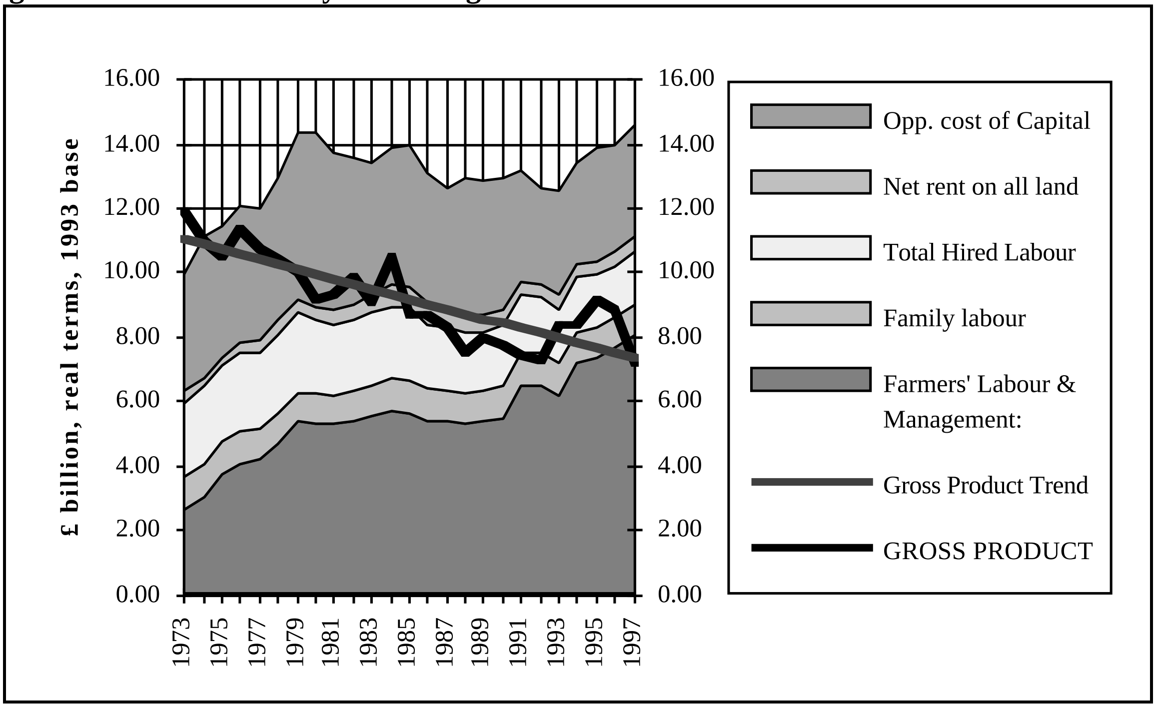


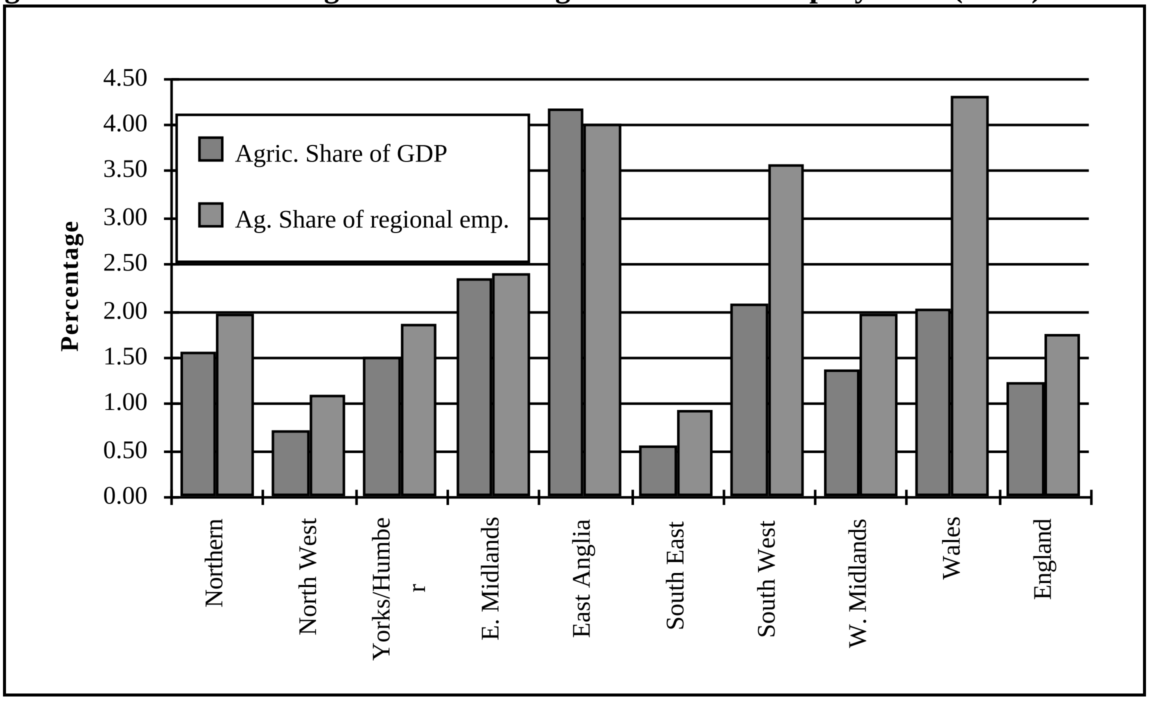
Figure 3 strongly suggests that the UK agricultural sector has not made an economic profit since 1974, and that the economic losses being made by the industry have been growing rather than declining. The implication is very clear - if people wish to earn comparable returns on their labour and capital to those obtainable elsewhere in the economy, they will have to find something else to do other than, or as well as, farming. In fact, people are already doing so, in a variety of different ways. Apart from leaving the industry all together, many farmers are taking on part-time jobs and other employment; developing redundant buildings into workshops, offices and homes; adding value to their raw farm products by improved marketing and processing; providing recreational facilities and services; developing mineral or woodland resources and so forth. Since none of these activities show up in Figure 3 as providing returns, while it is distinctly possible that the factor costs do include at least some labour and capital costs associated with these secondary (and in some cases, primary) activities, it is possible that this picture is overly pessimistic.

Nevertheless, the picture remains one of a declining agricultural sector. It is unrealistic and unsustainable to expect this situation to be reversed, either by national or European policy, or by domestic or international market forces. What does this mean, specifically, for the Northern Region?

The Implications of Agricultural decline for the Northern Region

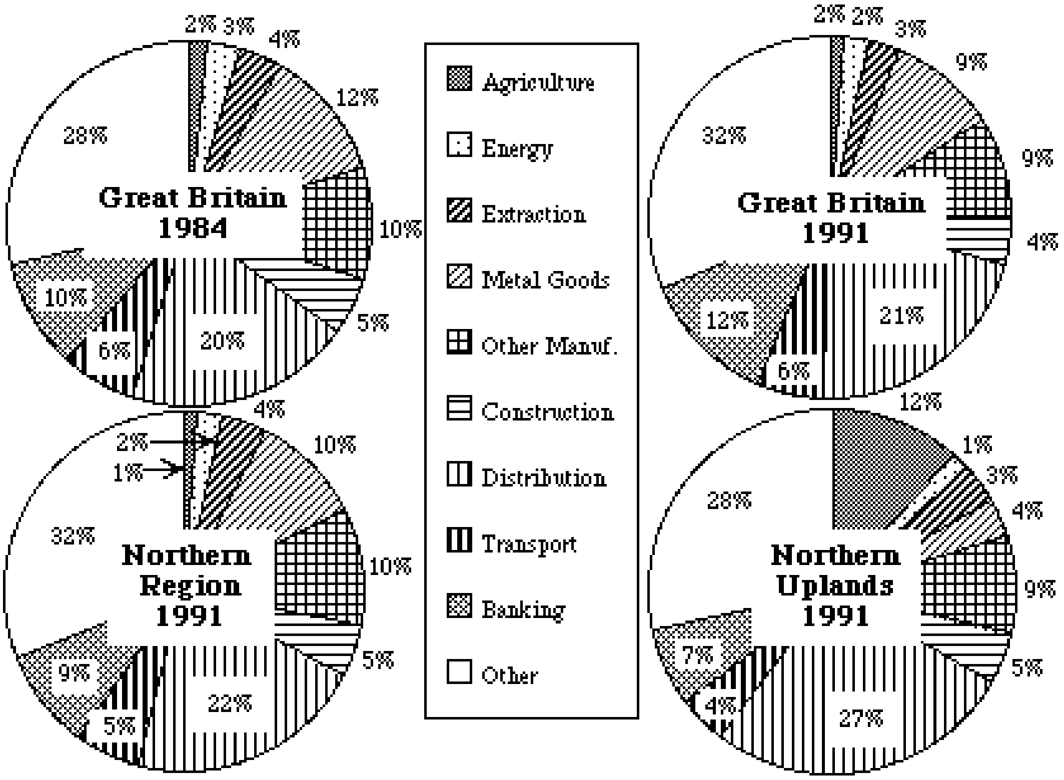
The overall position of Northern agriculture within this national picture is illustrated in Figure 4. Contrary to popular belief, this figure indicates that agriculture is not especially important to the regional economy of the Northern Region (defined here as Northumberland, Durham, Cleveland and Cumbria). Nor is it in the adjacent regions of Yorkshire and Humberside and the North West (including Lancashire and Cheshire). The same chart for 1996 data shows even smaller contributions to regional Gross Domestic Product (the measure of regional output and income). However, these figures are to be expected given the predominance of major concentrated conurbations in these regions. They can be expected to mask a much larger contribution of agriculture to the output and incomes of the predominantly rural areas in these regions <u>outside</u> the major conurbations.

Figure 4 Shares of Agriculture in Regional GDP & employment (1994)



Source: Farm Incomes in the UK, 1994/5, The Stationary Office.

Figure 5 Employment Distributions between sectors and regions



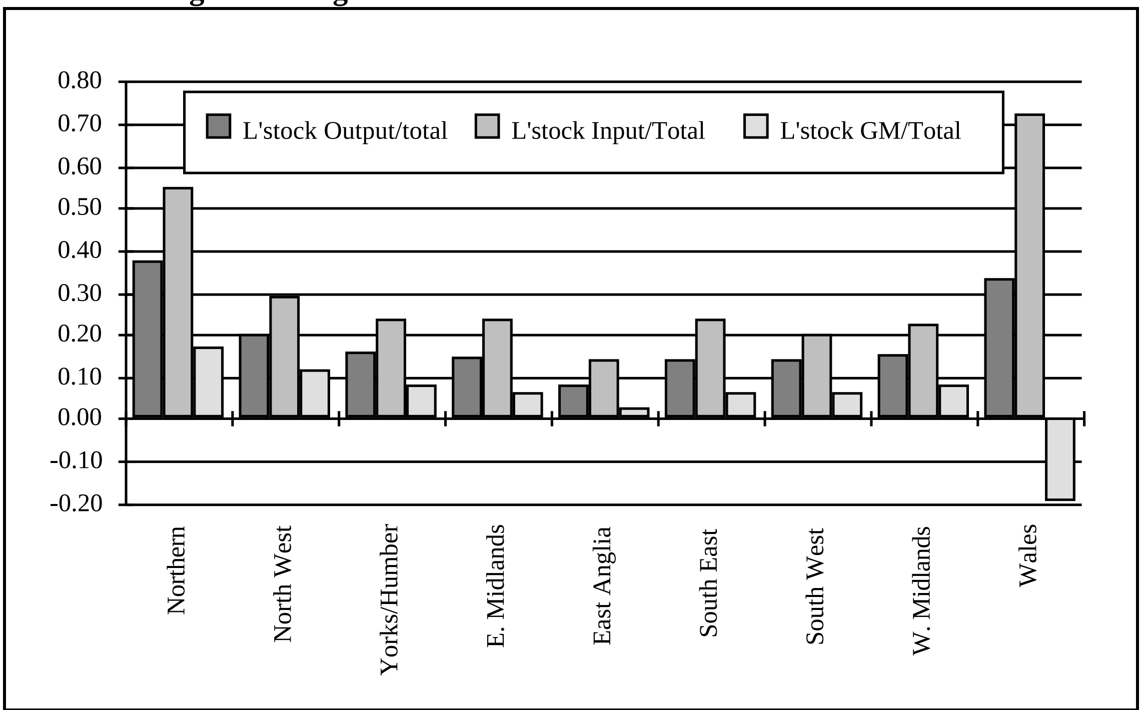
Source: Derived from Appendix A, Northern Uplands Objective 5b Single Programming Document, Dec. 1995

In fact, at least according to the employment statistics, the Northern Region is remarkably similar to Great Britain as a whole in terms of the distribution of activities across the major sectors of the economy (Figure 5). This figure shows that the primary production (Agriculture, Energy, Extraction, Metal Goods) sector of the economy has been shrinking as a proportion of total employment (as is widely known), falling from 21% to 16% of total employment for the country as a whole between 1984 and 1991. The Northern Region, with 17% in primary production in 1991, is practically indistinguishable from the rest of the country (and an even smaller share accounted for by agriculture). Even in the Northern Uplands (the European Union's Objective 5b area), the primary production share is only 16%, although here, of course, agriculture dominates. Otherwise, the distribution of employment within the 5b area is remarkably similar to the rest of the country.

As pointed out above (Box 1), livestock farming (especially beef and sheep) have tended to show more rapidly declining real gross margins than other sectors of the UK industry. This relative decline would be expected to show in the Northern Uplands agricultural sector, although it would be offset to some extent by the special public assistance these areas have received (especially Hill Livestock Compensatory Allowances). Unfortunately, data on this are also difficult to estimate and derive on a regional basis. However, some indication of the state of livestock (beef and sheep) relative to the rest of agriculture can be gained from Figure 6.

This figure strongly illustrates two features of agriculture relevant to review of the future of rural areas and farming in the North. Firstly, beef and sheep production is considerably more important to the Northern region's agriculture than it is to any other region except Wales, accounting for almost 40% of the region's total farm output and well over 50% of the input use. This leads to the second point. Beef and Sheep production is considerably less profitable than other sectors of agriculture in England and Wales, since the proportion of gross product earned from these enterprises is substantially lower than their share of output (also reflected in the fact that beef and sheep inputs are a greater proportion of total farm inputs in all regions than is output - to the extent in Wales that beef and sheep are estimated here to be running at a negative gross margin, in effect being subsidised by other farm enterprises for their continued existence).

Figure 6 Regional proportions of Beef & Sheep outputs, inputs and gross margins in England & Wales totals



Source: derived from the Land Use Allocation Model, Centre for Agricultural Strategy, Reading[5]

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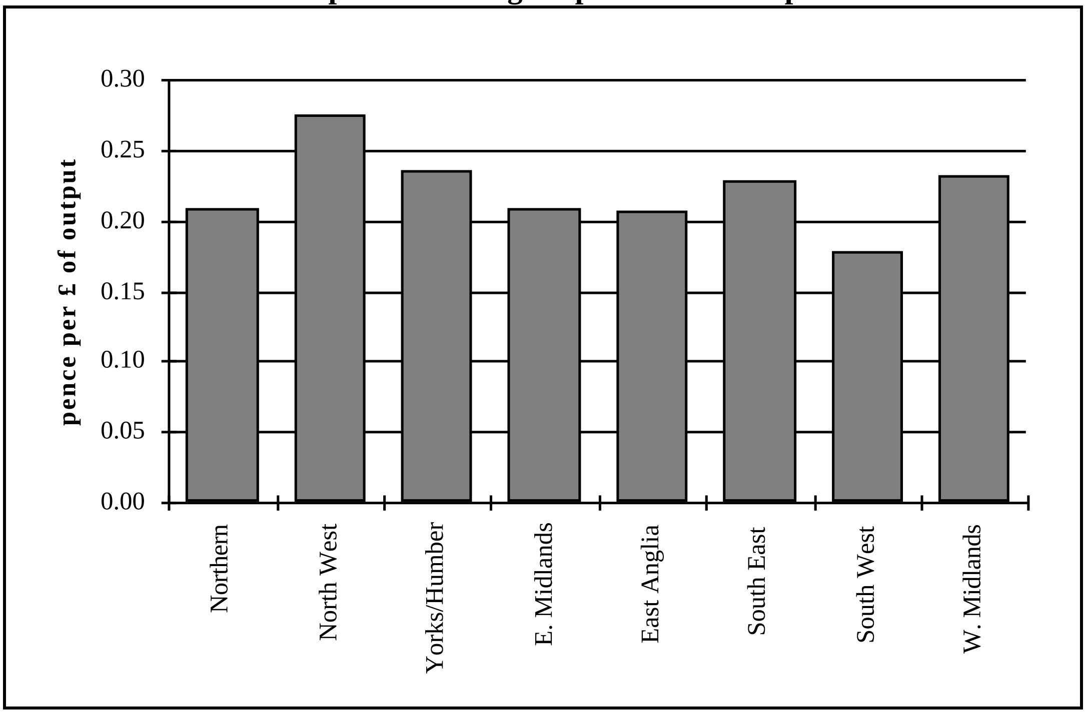
5 The basis of the estimates shown in figure 6 is a model of land use in England & Wales developed at the Centre for Agricultural Strategy, Reading University - the Land Use Allocation Model (LUAM). Among other things, this model allocates the national (England and Wales) agricultural output, input and gross product data used earlier in this section to regions of the country, based on the Institute of Terrestrial Ecology's land classification of each part of the country. The allocation is achieved through farm level relationships between inputs and outputs derived from the MAFF Farm Business Survey and separately estimated for different types of land. The allocation is constrained to be consistent with the geographical distribution of crops and grass areas and livestock numbers, as reported annually in the June Agricultural Census. Hence, although model results rather than direct

This is emphasised in the next chart, Figure 7. The implication of Figure 7 is that beef and sheep production in the Northern region is somewhat less profitable (and thus less competitive) than elsewhere (except, according to these estimates, their South Western and Welsh counterparts which are not shown here). When adjusted for the quality of land and capital employed, these differences may be marginal. However, there is no indication here that the Northern Region is currently showing a significant comparative advantage in, particularly, red meat production over other regions of the country. Nevertheless, the region's share of the total and declining agricultural gross product is, as a consequence, rather smaller than its share of the people trying to make living from agriculture. Farming in the northern region is poor relative to its counterparts elsewhere in the country, reflecting both the poorer quality land, especially in the relatively large upland areas, and the relatively poor performance of grazing livestock in generating incomes and returns.

Figure 7 Beef and Sheep Gross margins per unit of output

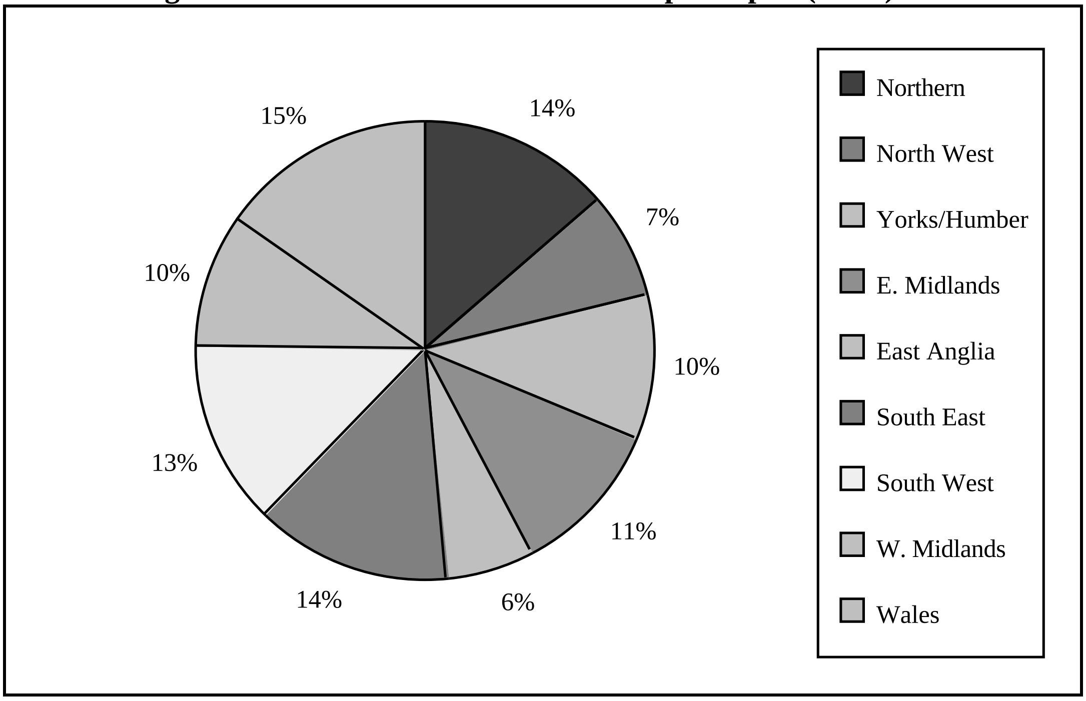


Source: LUAM, Centre for Agricultural Strategy, Reading University.

However, the Northern Region, and especially the Northern Uplands are capable of producing high quality stock, and have traditionally been regarded as the suppliers of top class breeding sheep for lowland flocks and of quality store cattle for finishing on traditional grass-fed systems in the northern lowlands. Furthermore, the region does not command a major share of the British market (Figure 8). Thus, an industry strategy which seeks to develop and promote the quality aspect of the northern red meats products, especially directed towards the upper segments of the market (see below), may make more sense than one devoted to competing in the mass commodity markets. This may be particularly important for those seeking to preserve and enhance the particular and special characteristics of the northern countryside, rural communities and landscape.

observation, the estimates are defined as consistent with all available data on farm input/output relationships and land use.

Figure 8 Regional Distribution of Beef & Sheep Output (1990)



Source: LUAM, Centre for Agricultural Strategy, Reading University.

II. Agricultural and Rural Development Policy Directions

The general policy directions for both agriculture and rural development are set through the European Union. Both have been subject to considerable change in the last decade, triggered by a major change in agricultural policy strategy. But neither are yet firmly established in their new strategic trajectories. In brief, the European Union's Common Agricultural Policy is in the process of change from a regime of supported market prices to one of direct exchequer payments, which are likely to become increasingly targeted towards rural development and environmental objectives, both at the European and at the national and regional levels (see, for example, House of Commons, 1998; House of Lords, 1998; Buckwell, 1998; Ritson and Harvey, 1997).

The latest reforms have been proposed by the European Commission (1997, 1998) under the title "Agenda 2000", aimed at reconciling European union policy with the requirements of expansion of the Union to include the Central and Eastern European countries (CEECs). As the House of Commons Select Committee remarked (HoC, 1998): "though the Commission does have a vision for transforming the CAP into a more integrated rural policy, they appear to have judged that the Agriculture Council would not share or accept that vision at this stage of the reform process. A more positive lead from the Commission would have forced the Agriculture Council to confront these issues directly, and it is regrettable that the Commission has not felt able or willing to provide such a lead in Agenda 2000."

BOX 1: THE (NEW) EUROPEAN MODEL OF AGRICULTURE. [Agenda 2000]

"The CAP's future policy objectives:

* to improve the Union's competitiveness through lower prices;
* to guarantee the safety and quality of food to consumers;
* to ensure stable incomes and a fair standard of living for the agricultural community;
* to make its production methods environmentally friendly and respect animal welfare;
* to integrate environmental goals into its instruments;
* to seek to create alternative income and employment opportunities for farmers and their families."

Source: European Commission, Agenda 2000: For a Stronger and Wider Union. "An historic opportunity" - Overview, 1997.

"All these proposals together have the aim of giving concrete form to a European model for agriculture in the years ahead. It is worth listing here what the main lines of this model should be:

- a competitive agriculture sector which can gradually face up to the world market without being over-subsidised, since this is becoming less and less acceptable internationally;
- production methods which are sound and environmentally friendly, able to supply quality products of the kind the public wants;
- diverse forms of agriculture, rich in tradition, which are not just output-oriented but seek to maintain the visual amenity of our countrysides as well as vibrant and active rural communities, generating and maintaining employment;
- a simpler, more understandable agricultural policy which establishes a clear dividing line between the decisions that have to be taken jointly and those which should stay in the hands of the Member States;
- an agricultural policy which makes clear that the expenditure it involves is justified by the services which society at large expects farmers to provide."

Source: European Commission, Explanatory Memorandum, The future for European Agriculture Agenda 2000 Agricultural Proposals, June, 1998

The logic of the Agenda 2000 proposals can be summarised as two "pillars". The first, comprising farm support price reductions and compensation payments, based on crop areas and livestock numbers, can be labelled the "Competitive Commercial Agriculture Pillar" which seeks to turn the CAP into a "HAT" - **Healthy Agricultural Trade**, where 'healthy' refers not only to the health and safety of the products, and the health of the environment (see, e.g. Whitby, 1996) and animals used to produce them, but also to the health of farm markets and of international competition, especially under the auspices of the World Trade Organisation and the Uruguay Round Agreement on Agriculture (see, e.g. Harvey, 1997b). These international commitments have recently been re-inforced by declarations of intent through the OECD (OECD, 1998 a, b and c).

The second pillar comprises the enclosure of existing 'accompanying measures' from the 1992 reforms, with rural development assistance, market assistance and agricultural structural assistance into a single Rural Agricultural Development 'box' (see, e.g. Lowe and Ward, 1998). This pillar seeks to provide necessary and justified public support and payment for **"Re-Creational" agriculture** - the parts of farming which, by virtue of their means and structure of production rather than their end products, provide for: environmental maintenance and re-creation; amenity and recreation; cultural integrity, re-creation of rural values and a creative foundation for rural development.

These two pillars support quite different objectives. The Competitive Pillar is aimed at establishing and promoting a world class competitive and sustainable agricultural sector. This pillar needs to meet two major objectives: first, to transform a previously protected industry to one capable of survival and prosperity in an unprotected world market; second, to provide legitimate and justified assistance and regulation to ensure that the resulting free-market is healthy - properly competitive, safe and efficient, and sustainable. The Re-Creation Pillar is aimed at conserving and enhancing the social or public goods of landscape, managed natural environments, rural cultures and communities - the Conservation, Amenity, Recreation and Environment (CARE) goods.

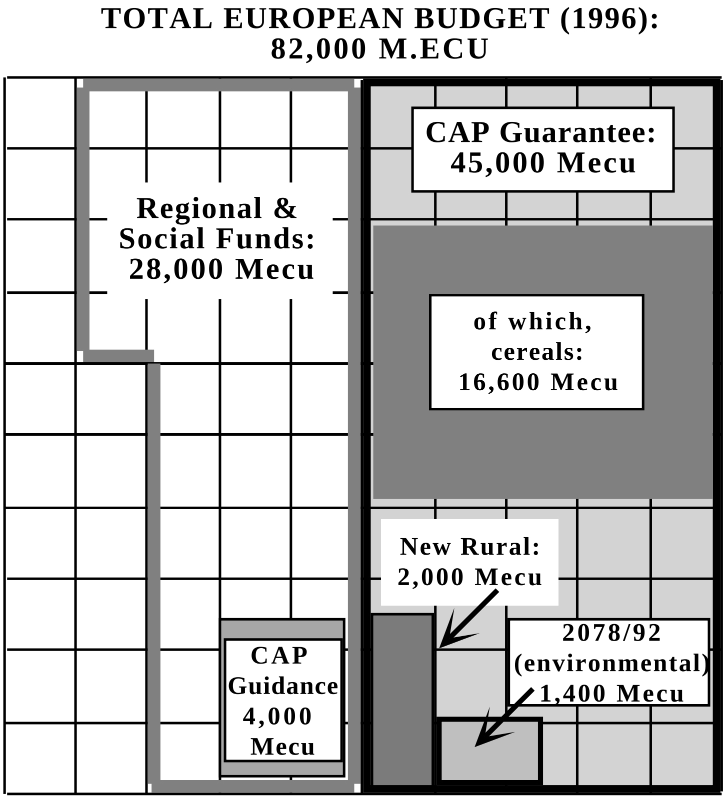
Between these two pillars, however, lies a potential bridge or beam - the contribution of the agricultural sector to rural development. Such a contribution can come from three major sources: (a) activities of a world-competitive farming through its supply and marketing chains; (b) activities of Re-Creational farming through its land and rural resources management, supporting the delivery of CARE goods and the associated tourism, lifestyle and living/working space demands; (c) release of capital and labour presently associated with uncompetitive farming to the local economy for other more productive and socially desirable uses.

The Commission presents the Agenda 2000 proposals as being entirely consistent with the Agricultural Guideline for European budgetary spending, which limits European Union spending on agricultural support. In fact, because the substitution of direct payments for market-related support means substituting fixed payments (depending only on historic crop areas and livestock numbers) for variable payments depending on world market and present European production conditions, the forecasts are for a substantial 'underspend' on agriculture by 2006. The 'gap' is estimated to be some 9.7 Bio ECU for the EU 15, (16% of the 2006 Guideline estimate). Including the Central European Countries expected to be members by 2006, the gap falls to 6.4 Bio ECU (10% of the relevant guideline).

However, these estimates make no allowance for further market policy reforms other than those identified in Agenda 2000, especially for milk and sugar, which are largely untouched by the 2000 proposals. The OECD estimate of the Producers' Subsidy Equivalent (PSE) for the European dairy sector is of the order of 21 Bio ECU (basis 1994), of which the current policy regime results in a liability to the European budget of only 7.5 Bio. ECU. The balance comes from the fact that European consumers pay substantially more than the world market price for dairy products as a result of the import levies and export subsidies of the CAP (which still apply to milk). Complete compensation for reform of the dairy regime (eliminating dairy quotas as well as removing import levies, export subsidies and intervention buying of butter and skim milk powder) would more than eliminate the so-called 'gap' in budgetary guidelines, potentially costing an additional 13.5 Bio. ECU for the EU15 (rather than the relatively paltry 1.9 Bio ECU in the present estimates), and much more for the EU 21. Reform of the sugar regime would add to these liabilities. Nor do these estimates make any serious allowance for increases in the environmental (CARE) payments or rural development assistance ('only' some 2.1 Bio ECU additional funds in the estimates).

The general picture of the present European budget (as of 1996) is illustrated in Figure 9. The total budget (82 billion ecu) is restricted to be no more than 1.3% of the European Gross Domestic Product, which can be contrasted with the general level of national budgets at around 40% of GDP. In spite of propaganda to the contrary, the European Union plays an extremely modest part in the financial affairs of the Community. Nevertheless, of this modest total, the CAP currently accounts for more than half the total budget, with the market support measures (the guarantee section of the CAP) accounting for 50%. The so-called second pillar of the CAP is a tiny 4.5% of the total EU budget, although the "new" Agenda 2000 rural development budget and the environmental regulation budget (both now within the guarantee section) nearly double the size of this 'pillar'.

Figure 9. The European Budget in Perspective



The farm population in Europe is now rather less than half the unemployed population, while present forms of farm spending are increasingly regarded as being less than helpful towards the environment in particular. They are also embarrassing the Union in the World Trade Organisation and giving rise to considerable potential problems with the forthcoming enlargement of the Union to include the Central European countries (see, e.g., Ritson and Harvey, 1997). As a result of all these factors, the imbalance of the European Budget is becoming increasingly difficult to defend.

The logic of policy reform to meet the new objectives of HAT and CAREful Rural Development, however, has quite different implications for the European Budget (or at least for public spending on agriculture, the environment and rural development). First, full compensation for product price support reduction (elimination) requires an increase in current CAP spending over the finite lifetime of this compensation. This is necessarily so since the bulk of product price support has been borne by the consumers in Europe, not the taxpayers. Any attempt to pretend otherwise is simply disguising either the extent of the reform and/or the extent of the compensation being paid. Second, the laudable objectives of paying properly for CARE goods, and providing effective assistance for rural development, logically imply additional increases in public spending, if not from the European budget then from national exchequers.

Against these logical demands for increases in public spending on "things rural" are the twin arguments familiar to government: a) the willingness of the taxpayer to finance increased spending is held to be extremely limited; b) there are other things which have a strong claim on the limited public purse. Hence, there is a legitimate ceiling on the spending which can be reasonably contemplated for things rural, notwithstanding the apparent logic that we should, at least in the short-term, be spending more, not less, than this already established 'guideline'.

How can this contradiction be reconciled? There are two important avenues. First, while full compensation implies an increase in current product-related support spending (the guarantee section), there are grounds for considering less than full compensation (at least as financed from the EU budget). The simple fact is that only some 20% of farmers account for 80% or more of farm production, and thus receive 80% or more of the product related support. It may be a legitimate political judgement that these 20% do not need or deserve full compensation. Justification for such limited compensation is re-inforced by the fact that a considerable fraction of the price support and market protection cost (the PSE) is 'wasted' in the sense that it either raises marketing costs or, more importantly, depresses world prices, and hence does not actually raise farm revenues over and above what they would otherwise be (see Harvey, 1991). However, such political judgements on the legitimate extent of compensation have to be made at the national (or even regional) level, at least in substantial part, rather than at the European level. Hence, it would be legitimate for the European Council to decide that it could only afford to pay, say, 70% compensation rather than 100%. This 70% compensation sum could then be distributed to member states on the basis of historic (fixed) production shares, who in turn would decide the basis of distribution of this compensation. Member states could even be permitted to 'top-up' this EU compensation package to some or all farmers from national resources - subject to strict limitations on the ways in which such compensation could be paid - strictly unrelated to present products and production levels, and strictly finite and limited.

The second avenue arises from the present uncertainty about the need for environmental payments and rural development assistance to accompany the reform of the agricultural sector to a HAT sector. It is quite possible that a restructured agricultural sector, coupled with rapidly emerging private 'markets' in CARE goods, will provide a considerable improvement in CARE provision without additional public support. Similarly, restructuring agriculture may also generate substantial and sustainable rural development from a wider base. In any event, the need for additional public assistance is likely to be highly locationally specific (though not at all easily locationally defined). This strongly suggests, a) that additional spending on CARE and rural development might be delayed until the end of the asset-compensation programme (say 2006); b) that such additional spending should be co-financed by national exchequers (as indeed, most of the Social and Regional funds already are). In the interim, therefore, national decisions on necessary spending could supplement the limited spending currently provided by the EU budget for CARE and rural development.

No doubt such suggestions will raise the twin 'problems' of renationalising the CAP (see, e.g., Wilkinson, 1994) and of necessary/legitimate cohesion/convergence redistributions of EU resources from the richer to the poorer member states. Against such arguments are the twin logical imperatives. a) Policies designed to partially compensate previous gainers and also to regenerate and conserve rural environments and economies are necessarily locally and regionally specific and political - requiring local or regional political determination, under the principle of subsidiarity. b) Cohesion and convergence require some form of redistribution between the 'haves' and the 'have nots' in any event. However, the extent to which the EU is presently constituted and politically willing to contemplate such redistribution is currently extremely limited. The debates over specific policy reform (CAP in this instance) can be and obviously will be used to advance arguments that the EU should or should not be more proactive in this redistribution. But these arguments cannot and should not be allowed to divert attention from the need to redesign and re-target existing policies.

Agricultural and Rural Policy Futures

Agenda 2000's focus on the agricultural expenditure guideline is symptomatic of the classical tendency of bureaucracies towards incrementalism, complication and compromise. It takes an antiquated but ongoing ceiling on agricultural spending - the guideline - fixed to put a limit on open-ended product-related support - and applies this to the fundamentally different policy of direct compensation payments. It then seeks to compromise and complicate this limited spending so as to achieve a number of widely different objectives simultaneously. The end result is not only a substantially incoherent and incomplete policy, but more importantly is generating ongoing confusion and increased uncertainty.

This confusion and uncertainty is generated at several different levels in the European agricultural/rural complex. For convenience, these levels (communities) are here identified as: commercial farming; active farming; less favoured farming; environmental interests; rural communities. In addition, there are two important international communities with an interest in the future of the CAP: the Central European Countries (CECs); the World Trade Organisation and the major agricultural exporters (the US and the Cairns Group). These confusions and uncertainties are further complicated by the bureaucracies at both the national and European Commission levels.

Consider the **commercial farming community** first. This community is rapidly recognising three major facts - first that it <u>can and should</u> be competitive at free and fair world trade prices, given appropriate compensation for policy change; second, that it cannot achieve competitiveness so long as it is bound by quota, set-aside and other limitations and restrictions; third, that the present compensation payments (and those envisaged under the Agenda 2000 proposals) cannot be relied upon indefinitely - the public will not put up with payments for nothing in return, especially not to obviously rather well-endowed businesses which are popularly seen as being antipathetic rather than sympathetic to environmental and other public interests.

The inescapable logic of these realities is that the present policy of indefinite compensation payments is unsustainable and needs to be changed. Furthermore, the change, when it comes, will involve market prices close to world prices and virtually no continuing protection and support for commercial farming as such. Business and family plans and strategies need to be made on this basis. However, these strategies are inconsistent with the commercial necessity of retaining past crop and livestock levels, since it is these levels which provide the licence to compensation payments. Thus there is a serious inconsistency between the policy and the proposals with the necessities of business strategy. There is also major uncertainty about when (or even if) the logic of the present policy situation will materialise into a more coherent and sensible policy system.

Of course, this community is presently rather small in number. Much larger is the **active farming community**. This is much less convinced of either its ability to survive and prosper in an unprotected market and/or of whether such an unprotected market would be sufficiently secure and stable to allow survival and prosperity. However, it is equally well aware of the precarious nature of the present indefinite compensation payments without some form of return contract with the public about what is provided in return. The present proposals, however, do not make this situation at all clearer. These people are entitled to infer from the proposals and the associated rhetoric that support will be continued indefinitely in some form or other, but that this support will be increasingly tied to the provision of CARE goods and/or contributions to rural development (cross compliance, national envelopes etc.). Otherwise, their conventional farming activities will be constrained by regulation and required to be competitive with much more favoured agricultures elsewhere in the world, not least in the CECs. This is a dismal prospect for many conventional farmers, and they are understandably dismayed by these prospects, their dismay being echoed by their representatives in the farm unions and in the Ministries of agriculture.

How are these farmers to plan for the future? They are understandably nervous about their ability to compete in a free world market, yet their alternatives - to farm for the countryside and rural development - are not yet at all well specified and do not appear to provide for anything like the returns of the past support. Hence the ‘compensation’ payments are their only lifeline, and they can be expected to fight for the retention and general unrestricted application of these as long as is possible, especially since they have taken business and investment decisions on the basis that they will be continued. Their expectations are re-inforced by the rhetoric of the Commission, which still promises to “ensure stable incomes and a fair standard of living for the agricultural community” with the proposed reforms “*designed to safeguard the earnings of farmers, above all keeping them stable, using the machinery of the market organisations and compensatory payments*.”

But these farmers are not stupid. They well recognise the pressures for change, both within the EU and from outside (especially from the CECs and the WTO). They can read that the US and the Cairns Group are determined to question and challenge the EU’s compensation payments in the forthcoming Millennium Round of international negotiations. They can hear other groups (the environmental lobbies, the consumer groups, the unemployed) in Europe complaining that farming takes far too much of the European budget. In other words, the ‘machinery of market organisations (intervention boards, import levies and export subsidies) and compensation payments’ is obviously and widely regarded as being too expensive, too anti-social and too obsolete to continue running.

However, these farmers can be expected to strongly resist further change unless that change is spelled out and underpinned with market and income stabilisation measures which make obvious sense. If the present machinery is unworkable, what does the alternative look like? Without any machinery, how can these farmers survive? In many cases, the answer will turn out to be that they cannot - their successors will not follow them into farming but will chose to do other things, they and their spouses and family members will find other things to do as well as farming, which will safeguard the family income. Yet the policy rhetoric promises to sustain them in farming. This is obvious nonsense, and is increasingly recognised as such. But recognition is not the same thing as acceptance - for the present, it makes good sense to take the Commission at its word - that it intends to secure the future of their farms - and to support all the arguments of their leaders and Ministers to minimise the changes and maximise the support levels.

At the other extreme of the farming sector lie the **less favoured farmers** - those in remote and agriculturally poor areas, with small family resources and farms. This community is not just unsure about its ability to survive in the free market - it is convinced that it cannot. Part of it, however, is also convinced that it is owed a living by the general public, either through increased food prices or through direct payments, for their 'obvious' contributions to the natural landscape and the remote rural communities. These obvious contributions are now being called into question - requiring specification to legitimise future payments, and being opened up to potential competition, since perhaps other people can provide these contributions more cheaply and more effectively than the traditional small farmer.

This community, as the others, is not static or homogeneous. Many of its members are already earning substantial fractions, if not most of their family incomes from off-farm or non-farm sources. Some are content (or resigned) to live on modest incomes in return for a valued life-style. Others are determined to either get out or get bigger at the earliest opportunity. Many are resigned to the fact that their heirs do not want to be their successors, and will choose other occupations, if not also locations. Some are new arrivals, lured by the life-style and willing and able to sacrifice monetary reward for it, farming as a hobby. The contributions of these very different 'communes' within this community to the countryside and rural cultures are different, while their needs and desserts for public support are also very different. Tailoring and targeting support to this heterogeneous community for the delivery of presently ill-specified and badly understood public goods of rural and environmental culture - through re-creational 'agriculture' (better, land use and management) - is obviously and self-evidently difficult. But it is also abundantly clear that uniform production-related 'compensation' payments are not the answer.

All of these **farming communities** (constituencies) are faced, in their own very different ways, with the certainty that things are changing and have to change, but are uncertain and confused about what these changes will be and how they will affect their future plans and strategies. Faced with the twin prospects of novelty and uncertainty, people generally exhibit their inherited animal responses: fight; flight; submit. Fighting, in these contexts, means organised action and pressure to resist change and retain the old certainties - hence the Council of Ministers' understandable reluctance to accept the Agenda 2000 proposals. Flight is exhibited through a variety of avenues, from outright exit to other locations and occupations, to diversification and generation of new and different ways of making a living while continuing to enjoy living in traditional landscapes, cultures and locations. Submission typically involves keeping one's head down and trying to ignore the outside world.

But people are blessed with human, as opposed to animal responses - namely to imagine: invent new futures and restructure existing conditions. This response materialises as new and different ways of organising the households and (typically family) businesses, otherwise categorised as 'flight'. It might also be exhibited as a fighting response, but this requires collective action and public leadership. *The key problem with the present Agenda 2000 proposals is that they provide little if any leadership or framework for collective discussion or action.*

There is virtually no invention or re-structuring in these proposals - they do not provide a framework for the satisfaction of the differing private and public aspirations or the reconciliation of the conflicts within the primary political constituency still driving CAP reform. As a consequence, it can be confidently predicted that the proposals will fail. Either they will not be agreed, though some alternative proposals will have to be, or they will be agreed but will not work, requiring a succession of new Agendas (2005, 2010 ...). Above all, these proposals conspicuously fail to provide the basis of stability and security promised in the objectives and aspired to by the principle constituents.

These failings are repeated amongst the other important constituencies and communities with an interest in the future of EU farm and rural policy. The **environmental** community remains unconvinced either that free markets will generate ecological diversity and sustainable environments, or that the governments are willing to spend or regulate sufficiently to provide for these ambitions. Nor are they convinced that farmers are necessarily the right people to provide these CARE goods and services. In many cases, their own private, voluntary, charitable and collective activities are already seeking tailored and participatory solutions to these issues, yet these activities are patently ignored in the reform proposals and implicit strategy.

Similarly, the **rural development** community cannot see the logic of providing rural development assistance primarily through payment of indefinite compensation for the operation of existing crop areas and livestock numbers. How is this supposed to generate sustainable and competitive growth and the associated security?

Meanwhile, the **Central European Countries** are similarly confused and disappointed. The CECs had (in part) anticipated application of the generous EU CAP to their ailing but potentially extremely productive agricultures, but now find that the policy is changing and that the new 'direct' support payments will not apply to them. Here we have economies and agricultural systems and conditions similar in many ways to those afflicting the European Community at the formation of the old CAP. Yet they are being required to forego the public support that these conditions so evidently generated in the European Community in favour of a 'modern' package of *acquis communitaire* regulations and a requirement to develop (from scratch) 'integrated rural development programmes', which so far have proved beyond the wit of their western counterparts. This, in return for a strictly limited and highly tied flow of transfers from the richer west - to 4% of GDP, when other 'poor' countries in the west have enjoyed and seem destined to continue to enjoy substantially larger flows. The countervail, of course, is that the presently poorer members of the western club are anxious that their deserving status is not undermined by eastward expansion of the club's membership. Again, Agenda 2000 conspicuously fails to provide a coherent framework for resolution or even discussion of these basic issues.

The **WTO, US and Cairns Group** communities are dismayed by the timidity of the proposals. The re-opening of the Uruguay Round Agreement on Agriculture (URAA) is scheduled to begin in 1999, while the 'peace clause' (Article 13, 'due restraint', suspending the countervail and challenge of domestic farm policies deemed incommensurate with free and fair trade) terminates in 2003. There is a commitment to freer and fairer trade, and thus to world market signals and incentives enshrined in the URAA and strongly echoed and amplified in the recent OECD ministerial resolutions. "Ministers stressed that agro-food policies should seek to strengthen the intrinsic complimentarities between the shared goals, thereby allowing agriculture to manifest its multifunctional character in a *transparent, targeted and efficient* manner. The challenge in pursuing the shared goals is to use a range of well-targeted policy measures and approaches which can ensure that the growing concerns regarding *food safety, food security, environmental protection and the viability of rural areas* are met in ways that maximise benefits, are most cost-efficient, and *avoid distortion of production and trade*."[6]

Aside from the doubt as to whether existing EU policy is consistent in the longer term with existing commitments and legal bindings on export subsidies and import tariffs under the URAA, and the near certainty that the Millennium round will eventually agree to substantial strengthening of these commitments, the continued and indefinite payment of production-related 'compensation' payments is bound to come under substantial pressure in the Millennium Round. Expiry of the peace clause may well trigger challenge and countervail in the absence of clear reform of these 'blue box' measures. As the House of Commons Select Committee (June 1998) said (and as has been accepted by the UK Government): "We would much prefer to see the EU entering the next WTO Round sharing the moral high ground with the USA and the Cairns Group countries, and we have serious doubts as to whether the CAP reform proposals will allow the EU to do more than establish a base-camp in the moral foothills." (par. 30).

The crucible in which these conflicting pressures are amalgamated into a national 'position' and negotiating stance is the **national Ministry** and associated bureaucracy communities. Crudely, those countries with less agricultural pressure (e.g. the UK) and with greater philosophical, economic and cultural interest in freer trade can be expected to argue for greater liberalisation of the CAP. These countries are assisted in this argument by the possibilities of shifting the blame for such policy reform (and its apparent problems) onto international pressures. They can also afford to be radically *laissez faire* in the knowledge that such a dramatic reform is rather unlikely to be

[6] OECD News Release, SG/COM/NEWS (98) 22, 6.3.98. See, also, OECD Discussion Papers: Agricultural Policy: the need for further reform; Agricultural Policy Reform: Stocktaking of achievements; prepared for the Ministerial Committee, March 5/6th., 1998.

adopted. Those with greater farm interests and with lower cultural and economic predispositions to free trade (Spain, Portugal, Italy, Greece) can be expected to argue for the *status quo*. However, the *status quo* is only credible as a holding position - it is not credible or sustainable as a strategic option, since there are too many internal and external pressures for change. Arguments in favour of the *status quo* are bedevilled by the fundamental difficulty of defining and articulating a credible alternative to the reform proposals.

Failing a credible sustainable alternative, opposing national positions will degenerate into argument over detail and defence of established perceived national interests rather than interest in development of a sustainable reform strategy. In short, this is the current and expected immediate future of negotiations over the Agenda 2000 proposals. Underlying this defensive and essentially counter-productive posturing is a more fundamental conflict between the conventional and established power of the farm ministries and the emerging force of the environmental, consumer, trade, industry and rural development bureaucracies and ministers, and the constituencies which they both represent and from which they derive their support and legitimacy.

This situation embodies substantial dangers. It runs the major risk of alienating the legitimising constituencies - the now fragmented and divided farm communities. Since the 1992 reforms, themselves reflecting the major changes in socio-economic pressures on farm policy, the bedrock of previous EU agricultural policy has suffered major fissure. Once the system of protected markets and supported prices is eliminated, the interests of the commercial farm sector become quite different from those of the re-creational sector. New situations and conditions require new visions and new policies. These are not provided by the established organisations without major revision of their arguments and positions. Such revision needs leadership.

The **European Commission** is responsible for this leadership. It has the authority to make proposals, which cannot be made formally by the member states. As far as Agenda 2000 is concerned, however, the leadership is timid. “Though the Commission does have a vision for transforming the CAP into a more integrated rural policy, they appear to have judged that the Agriculture Council would not share or accept that vision at this stage of the reform process. A more positive lead from the Commission would have forced the Agriculture Council to confront these issues directly, and it is regrettable that the Commission has not felt able or willing to provide such a lead in Agenda 2000.” (HoC Select Committee report, June 1998).

Such criticism is well justified. However, it is largely academic without providing a coherent outline of what such a vision would mean for reformed policies. As the Commission is entitled to complain - if the Agenda 2000 proposals are unacceptable, what would the alternative look like?

III. Some Suggestions for Improvement and Development[7]

III.1 A HAT to replace the CAP

As argued above, the key requirement for the development of a competitive agriculture is that farm prices (the signals for commercially competitive production practices and levels) should be the free trade world prices. Such price signals are also necessary (but not sufficient) to ensure that agriculture is careful (see next section). However, there are two key problems with this prescription: first, how can the industry be best assisted to become competitive from its historic condition of heavy protection? Second, how can the condition of free trade be ensured and assured sufficiently to warrant the commitment, investment and invention necessary to produce genuinely competitive farming? The framework advanced here, in conjunction with the suggestions in section IV below, seek to answer these questions.

This framework - Box 1 - assumes that maintenance of farm incomes can no longer either be regarded as an appropriate objective or can be achieved through commodity support programmes. It also ignores for the present the issue of stabilising farm returns or incomes, which is returned to below, Box 2. However, it incorporates the notion of limited and production/product neutral compensation for removal of previous support, both on theoretical and practical political grounds - that changes in government policy cannot be regarded as socially optimal or politically practical

7 This section is taken from Harvey, 1997c, p 426 - 30.

unless the losers are at least partially compensated. It also retains some limited defence against 'predatory' policies of foreign suppliers or their policy-makers through import tariffs to defend a 'free-trade' market price, hence also retaining a negotiating 'weapon' for the Millennium Round and any successive negotiations about farm trade.

The essential elements of this framework represent a relatively minor evolution from the present EU policy for cereals (though not as yet for other products, especially milk and sugar). The key differences are: a) that compensation payments should be explicitly limited both in total and per farm; b) that compensation should be independent of all product/production, including areas and livestock numbers; c) that more flexibility is included in the ways in which this compensation can be made to a widely heterogeneous farming sector and population within Europe. Within these parameters, producers should be given the option of choosing the form in which they would prefer to receive their compensation entitlements, within nationally and regionally defined constraints reflecting the social justification for continued support.

Under this alternative, dairy quotas and sugar quotas would also be eliminated. In both cases, the values of these quotas, as reflected in the prices and rents they command on change of ownership, already provide good indications of the value of the support they provide. Hence, compensation payments can be explicitly related to the present quota allocations - in effect simply buying in the quota.

The framework implies a considerable element of 'renationalisation' of the CAP, in the sense that socio-political decisions on the appropriate levels and mechanisms for the delivery of farm sector compensation should be devolved from Brussels to the member states and regionally differentiated within member states. However, as Wilkinson, 1994, points out, "the type of renationalisation we are discussing should better be called 'targeting'" and " a fine line has to be drawn between *renationalisation* and *subsidiarity*" (p 31)

Box 1 An Agricultural Policy Framework for the EU for the next century

Eliminate all internal support prices, intervention activities, export subsidies and import levies and substitute:

1 Common import tariffs such that the internal price is, on average, within the boundaries of best estimates of a free trade world price (unless this proves above currently bound tariff levels under GATT, in which case the latter should apply) - hence meeting the requirement for simplification and extending the spirit of the URAA on tariffication and access;

2 provide finite and limited compensation to existing producers for this policy change on the following conditions:
i compensation payments to be limited in aggregate to an agreed fraction of base European Union production levels;
ii total (EU funded) compensation payment be agreed at EU level within absolute upper limit already committed in GATT;
iii distribution of EU total between member states to be determined on basis of base production shares;
iv distribution of compensation to farmers to be determined by member states;
v whatever the form of compensation payments, all should be independent of either current production or current products (including planted areas and stocking levels);
vi producers to elect to take compensation payments from within following options, subject to nationally and regionally determined constraints reflecting the justification for support (see below):
- fixed annual payment of explicitly limited duration (*a la* US FAIR Payments);
- lump sum "CAP bond";
- 'down payment' for farm-level income stabilisation account - see Box 2 below.

3 Within these provisions, member states to be free to decide:
i the farm-level distribution of compensation;
ii the choices of compensation option (2.vi above)
iii the extent to which national 'top-loading' shall be applied, subject to EU agreed upper limits

Stabilisation and Market Security

Provision of a market safety net has long been provided in the US through the loan-rate system. Though this has been restricted to programme crops in the US, there is no reason why the general principle should not be extended to cover the major livestock products as well. Under this programme, producers are able to get cash advances on their production at pre-specified rates (the loan rate) per unit of production, with entitlements to these advances being established on the basis of the farm crop area (or livestock number). These advances are loans - to be re-paid as and when the products are sold on the private markets. Thus, farmers are assured of immediate cash returns, through the loans, for their production, but are encouraged to market these products for their best possible returns. However, if the market prices are depressed below the loan rates, then the loan authority takes possession of the products in lieu of loan repayment. Thus, the loan rate provides a safety-net under the local market price. Hence, the setting of the loan rate is critical. The US has provided that the loan rates are to be set automatically at 85% of the "olympic" five year moving average of market prices, thus ensuring that the loan rate does not support market prices over the longer-term. (The "olympic" moving average excludes the highest and lowest price from the relevant five-year period.) A similar procedure could well be adopted by the EU, with the present Intervention agencies responsible for the administration of the loan rate scheme.

This safety-net support might not be of substantial assistance in the well-developed markets of the EU, though even here it would lend substantial credibility to the market system amongst those farmers not yet convinced of the reliability of markets. However, in the CECs, farmers are currently faced with ill-developed markets, frequently subject to local monopolies and market imperfections. Here, such loan rate schemes provide considerable assurance for market developments, while encouraging their development and performance. At present, these countries are being encouraged to ape and imitate the present CAP institutions and procedures, which are already obsolete. Substitution of the loan rate schemes for the present intervention systems would be both a sensible and an attractive development and re-orientation of the institutions already being established in the CECs.

Over and above such market safety-net provision, there may also be a case for provision of stabilisation schemes which promote longer term planning and resource allocation at the farm level, thus contributing to competitive supplies. A European 'stabilisation' programme can be outlined (Box 2), in an essentially similar fashion to those suggested by Harrington and Doering, 1993, for the US.

Box 2 Framework for Production and Revenue Insurance Programmes.

Voluntary farm-level yield insurance and revenue insurance plans as follows:

("tbd" in the following signifies 'to be determined' through negotiation. Moving averages could be considered shorthand for any reasonable and reliable trend estimate)

1 Production Insurance Plan - PIP:

Registered farmers pay actuarially-sound annual premia insuring a critical production level set at not more than 75% (tbd) of a 10 year (tbd) moving average of farm annual "yields" (appropriately defined for livestock). Payments to be made on shortfalls below this level at registered market prices, subject to an upper limit per farm business (tbd). Farm 'PIP accounts' to be closed only on condition that notional balances are 'accounts owing'.

2 Revenue Insurance Plan - RIP:

Registered farmers pay a fraction (tbd) of actuarially-sound annual premia insuring a critical indexed gross revenue level, set at not more than 80% (tbd) of a 10 year (tbd) moving average of market prices indexed by cash costs of production. Payments to be made on the basis of moving average farm 'yields', subject to an upper limit per farm business (tbd), unless premia financing payouts above this ceiling are entirely paid by the farmer. Balance of annual premia necessary to ensure actuarial integrity of programmes to be contributed by EU and member states according to an agreed formula (tbd). Farm 'accounts' to be closed only on condition that notional balances are 'accounts owing'.

The essential features of these plans are:
a) that they are voluntary, and require contributions from participating farmers;
b) that they are limited to 'stop-loss' or 'fail-safe' levels of revenue protection;
c) that they should be actuarially sound, with the premia covering the payouts;
d) that provision is made for farmers to withdraw from the programmes.

Moral hazard and adverse selection problems[8] are minimised in these plans through the incorporation of observable farm-determined performance (yield levels) in the definition of the contracts. The plans do not conflict with the purposes and functions of legitimate and generally efficient futures and options markets, which would still be expected to operate for short-term market price risk spreading. Fixing the 'stop-loss' price as a fraction longer-term moving average market prices (which are otherwise unsupported) minimises the danger of such programmes being used as a stalking horse by farm lobbies for increased farm support, while explicit farm business level limits ensure that 'rent capture' by farmers themselves is limited, whilst also bolstering the argument that they can be considered production neutral.

The plans contain sufficient flexibility to be tailored at the national level to suit particular farm types or regions, including the possibility for the RIP that different types of farm with different circumstances might enjoy different rates of farmer contribution to the plan. Although there may seem to be some advantage in 'rolling up' such programmes over the farm level mix of commodities to make the programmes farm based rather than commodity based, this would reduce flexibility as far as farmers are concerned if they wished to adjust their production mix.
The danger that these stop-loss price floors might distort production and marketing decisions is greater the closer the floor is set to current moving average (or other trend) price levels. A key question for such a proposal is how it might be introduced in the present EU system, where historic market prices contain a large element of support, and where farmers are totally un-used to such a proposition. As far as market prices are concerned, it is suggested that the appropriate 'market' prices to use for the present (until world market liberalisation is much more complete) would be the OECD annually computed reference price (the world price) plus the agreed 'world price defence tariff' outlined in Box 1 above. If necessary, this EU wide price could be adjusted to national or regional levels through the application of annually revised estimates of EU spatial price relationships. To encourage farmers to take advantage of these plans, it is suggested that farmers be offered the opportunity to substitute limited annual compensation payments for a specified 'premium holiday' for these plans, which could be phased out over time rather than suddenly closed off. This may well provide an important and valuable political rational for compensation, especially for the larger commercial farmers, and would warrant a discount on the arithmetic entitlement to compensation for these larger farmers. Determination of an appropriate discount might be achieved through a 'tender' system, whereby farmers are invited to 'bid' current entitlements to (indefinite and insecure) compensation payments for specific premium holiday provisions (or to lump sum payouts).

III.2 Horizontal Measures: Payments for CARE and Rural Development.

While the internal consistency and external legitimacy of the European Union's agricultural policy is, perhaps, the major focus of current debate on the Agenda 2000 proposals, the development of effective policy for rural development is more fundamental to the future of, especially, the remoter rural areas. The logic of providing rural development assistance primarily through payment of indefinite compensation for the operation of existing crop areas and livestock numbers is being increasingly questioned. However, it is clear, both in logic and from the evidence of history, that farm incomes are largely determined by the opportunities available for income generation off the farm. The higher and wider these are (the more developed the local and regional economy) the more likely it is that incomes earned from farming are relatively competitive with elsewhere in the economy.

Economic development happens through integration and interaction of markets and policies. It depends on: i) capital accumulation - more and/or better plant, equipment and infrastructure; ii) people - more or better skilled and educated people participating in economic activity; iii) technical progress - better people, better capital and better management and organisation; iv) " 'x' efficiency" - the interactions between markets, policies and the contributors to economic development which produce more growth in incomes and productivity than can be accounted for by the sum of the parts. Evolution of economies depends on self-organisation of open, complex and dynamic systems which exhibit 'emergent' properties - those which are a consequence of the specific interactions between contributing parts rather than inherent in the parts themselves (see, e.g. Allanson, 1996).

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[8] Moral hazard relates to the possibility that insurance schemes encourage more risky behaviour than otherwise would be followed; adverse selection relates to the possibility that only those most at risk choose to join the insurance scheme, thus making the risks to high and concentrated to be spread effectively.

Rural development depends on these things happening in rural areas. When they don't, the reasons are typically the consequence of two rather separate though related causes. First, labour, management (people) and capital tends not to remain in rural areas, preferring to seek their fortunes and livelihoods elsewhere (the 'desertification' problem). Second, the 'critical mass' of related markets and interconnecting physical and social infrastructure (transport, communications, services etc.) is insufficient to support a growing local economy, which also tends to encourage exodus of the better equipped and skilled resources (people and capital) to other sectors of the national and international economy.

The natural inclination to associate rural development with agricultural development is not necessarily helpful here. Although historic rural development trajectories seem to reflect the prosperity of farming, with rural areas booming as agriculture booms and *vice versa*, the co-evolution of the national and international economies towards increased services and increased demands for pleasant and uncongested environments leads to a rapidly diversifying demand for rural locations both for living and working (see, e.g. Harvey, 1997a). In any event, premising rural development on an unsustainable (insupportable) artificial enhancement of agricultural earnings and returns can only lead to any resulting rural development being also unsustainable and insupportable.

Rural development, therefore, must be considered as a far wider and deeper process than simply agricultural development. The contribution of agriculture to rural development depends on the agricultural sector being both healthy and CAREful. Beyond that, it will depend on the encouragement of capital and people to remain in and invest in the rural areas, requiring encouragement of the general economic and social infrastructure, as well as capitalising on the apparent aesthetic and lifestyle advantages of the rural areas themselves. The only possible direct link between agricultural and rural development policies then concerns the constraints (if any) placed on public compensation for asset revaluation associated with reductions in product-based farm support. It might be regarded as sensible and justified to require such compensation to be retained within (less favoured) rural areas, to encourage other inward investment. However, such restraints will simply generate behaviours which get around the restrictions or subvert them unless the rural area is genuinely seen as an attractive place to live, work and invest. In other words, forcing present agricultural support payments to be retained in rural areas will not work unless the rural areas themselves are already regarded as attractive growth areas. If they are, then forcing agricultural payments to be related to rural development will be unnecessary.

a. Rural Development and Prevention of Desertification

The new policy environment has highlighted rural development as a major rationale for 'farm' policy. This has potential implications both for the geographical and individual distribution and for the method of providing compensation. Since compensation is a monetary equivalent of those resources which are 'surplus' to competitive requirements in the farm sector, there is some argument that it would be in society's interest to encourage retention of such a surplus within some rural areas, suggesting some annual and conditional payment stream. But, as already noted above, such conditions will be ineffective if the surrounding rural economy is not sufficiently active and attractive to retain income and investment, and unnecessary if the local economy is sufficiently vibrant. Furthermore, other aspects of the policy's environment mean that the form of such payments will be likely to be substantially different from conventional farm policy, and much more likely to emerge as integrated rural development (or in some cases, preservation) programmes. Such programmes will take location rather than occupation as the primary characteristic determining eligibility, but will increasingly require demonstration of their contribution to the whole rural economy rather than simply to agriculture for their continuation.

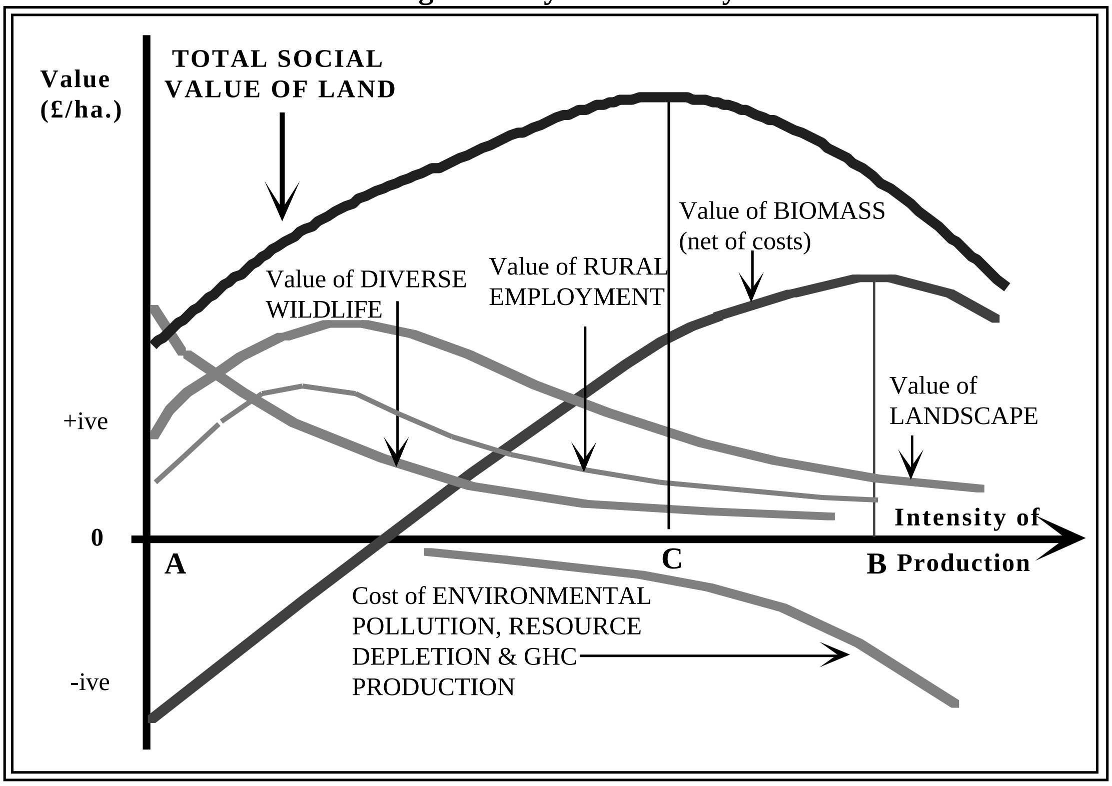
In its simplest terms, the argument that the CAP is helpful in preventing desertification of otherwise uncompetitive rural areas amounts to the argument that society should be prepared to pay people supplements so as to encourage them to remain in such areas rather than move. It is apparently clear that competitive agriculture will not be sufficient to prevent such desertification. If society is willing to encourage and support such disadvantaged areas - approximately the Objective 5b areas, then means must be found to promote such areas over the natural attractions of the more competitive regions of the community. The conventional answer to this problem is "Integrated Rural Development" programmes - though beyond the obvious provision of essential infrastructure (transport, communications and public services) the elements of such programmes remain rather obscure and debatable.

The simplest way of encouraging population and economic activity in less favoured areas is to provide definite and clear economic signals and incentives for people to stay and work in these areas. There already exist well-established systems and mechanisms for sending these signals: income and capital tax rates. If we want people to stay and develop businesses in these areas, why not reduce income tax rates and capital taxes for people and businesses operating in these areas? Such changes in tax rates would encourage retention of agricultural compensation payments within the rural areas, and would also encourage other businesses to locate in the areas. Governance of the sorts of economic activities and commercial developments in response to these signals could and should be left to regional governments and procedures.

b CARE provision.
Turning to the question of appropriate policy instruments for CARE good provision, the focus is clearly on property rights over the natural environment and land use - since these features most clearly identify the distinction between the rural economy from its urban neighbour. This focus highlights the role of agricultural policy, as both a major influence on land use and as the principle vehicle through which governments have sought (to date) to influence the specific dimensions of the rural economy.[9]

Traill (1988) presents an economic picture of the trade-offs and possible conflicts between various elements of the rural environment by concentrating on the issue of the intensity of land use - Figure 10.

Figure 10. Value of Land Using Activity as Intensity of Production Increases.



Source: modified after Traill, 1988.

In this figure, intensity is measured as quantity of inputs per hectare. The net value of marketable goods from the land base (food, wood, fibre etc.) reaches a peak at point B - the typical private profit maximising level of intensity. The other curves represent hypothetical relationships between intensity and other more or less intangible aspects of the rural environment, the CARE goods (McInerney, 1986). In addition to these CARE goods, a further curve reflects a possible

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9 There are, of course, other government policies which affect rural economies, but these do so through their particular application in rural areas rather than being specifically designed for rural economies. See Hill and Young (1989) for a discussion of these policies and their influence relative to the agricultural policy portfolio.

relationship between intensity of land use and rural employment, as one measure of socio-economic concern, here assuming that greater intensity tends to be associated with a shift in employment associated with land use (at least in terms of producing biomass) away from rural areas and towards the industrial and urban areas, or even offshore. In principle, separate curves could be added to represent contributions to reducing greenhouse gases and net costs of depleting non-renewable resources, here included in the general pollution curve.

This representation of the rural environment emphasises three critical components of analysis of land use, countryside management and rural development. First, it is necessary to understand the socio-economics of land use decisions and management practice. From an economist's perspective, this understanding emphasises responses to market and policy signals and conditions given peoples' motivations and circumstances. Second, the physical consequences of particular land use decisions and practices for the rural environment need to be identified[10]. The combination of these two elements provide the definition of the several curves in Figure 10 in physical terms and the likely position on the horizontal axis chosen by land users. The third element concerns identification of the social valuations of the several goods and services provided through the interaction of land use and the rural environment[11].

Given that these three components can be identified, then it is possible to conceive a socially optimal intensity of production at point C, defined as the maximum of the vertical sum of each of the component valuations. Typically this would imply a reduction in intensity from present levels, at least in the majority of circumstances in which the social valuations of the intangible aspects of rural land use are not reflected to the land users, who thus have no incentive other than altruism to respect such values in their private decisions. Although there is a reluctance to 'price' intangible aspects of the rural environment on the part of non-economists, this representation emphasises that all public and private land use decisions imply some societal valuation. In turn, this representation casts the debate and controversy over the rural environment as arguments about the behaviour of land users, the physical relationships between land use and the environment and the social values of the various outputs and consequences (goods and services in economic terms) from the rural environmental system.

Apart from environmental designations such as ESAs, SSSIs, NSAs, National Parks, AONBs and Stewardship schemes, and with the exception of specific pollution controls and regulations, the social value of wildlife and environmental assets is seldom directly reflected back to farmers and landusers in the form of incentives or penalties for particular land use practices. Thus the major relationship determining land use is the biomass net profit function (curve). Furthermore, notwithstanding the 1992 reforms, the Common Agricultural Policy still supports market prices and producer returns to biomass production, which artificially inflates the biomass net profit curve, tending to shift the actual intensity of use of land substantially to the right of point C (that is, has shifted point B to the right of where it would be in absence of support and intervention[12]).

Thus, the twin focus of sustainable land use and environmental policies from this perspective becomes: a) get the price of biomass "right" (without distorting and supporting it as under the CAP, which shifts the biomass curve upwards and to the right); b) "properly" reflect the public or social values of the CARE goods (including pollution) back to the landowners and users. Only then can

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10 Considerable progress has been made in representing the spatial and behavioural interactions between land use and ecology (as well as the hydrological interactions) within a geographical information system, especially by the research team at the Centre for Land Use and Water Resource Research (CLUWRR) at Newcastle University. See, for example, O'Callaghan, 1996 and also articles in a special edition of the Journal of Environmental Planning and Management, vol 38 (1), and Harvey and White, 1995.

11 Again, considerable progress has been made on this front, with researchers at Newcastle University being prominent in development of methodologies and techniques for identifying public valuations of non-market goods and services from the countryside. See, for example, Garrod and Willis, 1994 and Willis *et al.*, 1995.

12 Strictly speaking, increasing the biomass net profit through farm price support simply shifts the curve upwards. However, the feedback consequences of this increased profitability can also be expected to encourage its shift to the right as well, through encouraging investment in production-increasing technologies.

we expect market forces to encourage land users to operate at the socially optimal level of intensity at point C[13].

Hodge (1988) has suggested that Conservation, Amenity and Recreation Trusts (CARTS) may prove a useful mechanism for solving the twin problems of how much people are willing to pay for various elements of the natural environment and of providing the instruments through which such environments can be encouraged and paid for, simultaneously providing for the legitimising of the payments. The central idea is that there already exist a number of voluntary institutions concerned with the preservation and enhancement of the natural environment (such as the Ramblers' Association and the Royal Society for the Protection of Birds). These institutions depend on there being a public willingness-to-pay for CARE goods through membership subscriptions and donations, and have evolved to implement a variety of schemes (varying from direct ownership and management of land through negotiation of land use practices) to provide these goods for their members (and, of course to 'free-riders' who choose not to join).

As Hodge notes, the literature suggests that the free-rider problem will typically lead to an under-provision of public goods through the voluntary club route. Some public support is, therefore, justified. A more general application is suggested by Hodge to involve a public subsidy to such CARTS in proportion to their membership income, taken here as an indication (though biased downwards because of the free-rider problem) of the public's willingness-to-pay. Such a mechanism would provide for the continual demonstration of the legitimacy of the 'policy', while also allowing individuals (through their CART membership rights) to actively participate in the determination of the types and varieties of CARE goods provided.

IV. Future Prospects for the North's rural areas

The previous two sections have outlined the future policy directions impinging on the North's rural areas. Essentially, market and product-related support for the farm sector is likely to be continually reduced, and replaced with more specific and more targeted support towards rural development and environmental care. Under these conditions, what are the future prospects of the North's rural areas? The following analysis begins by concentrating on the farm sector, notwithstanding the fact that agriculture is an increasingly small part of the rural economy. This concentration is warranted by the fact that farming remains a key player in the management of the countryside, which in turn provides much of the attraction for incoming economic development and income generation.

The heirs and successors to the present northern farms, as well as those of small abattoirs and independent butchers and other related small and traditional businesses, are likely to find that alternative occupations are more attractive, leading to a continued decline in their number. Remaining farmers will find that alternative sources of income, especially based on CARE products and services, compete with the business of producing food products, while attempts to increase the value-added of the farm (for example, by producing finished fatstock rather than the traditional store animals sold for fattening to other farms and regions) prove costly and ultimately un-competitive. Decline in product-based policy support and diversion of public payments towards the environment will intensify these trends. Concentration and rationalisation of the processing sectors will lead to further loss of regional identity and associated regional premia, exacerbated by the trends in the retail sector of the market. The inevitable trend appears to be towards greater concentration: fewer and larger concerns throughout the food chain. Certainly, there will be increasing pressure on margins and returns for those who try to retain their independence and traditional systems of production and marketing.

The Northern Region's farming base stands in considerable danger of becoming a residual supplier - dependent on the trends and developments elsewhere in the national and international markets, and on an increasingly concentrated marketing (especially retail) chain. These trends are not encouraging, with red meat consumption declining and with substantial evidence of over-capacity and hence low prices and weak demand. The associated effects of such relative decline on local communities and services, through effects on local auction markets and processing plants, re-inforce

[13] Notice, however, that even this prescription relies on an assumption that the majority of land users are at least constrained by, if not actually driven by, the need to make normal profits and thus earn an acceptable living from their land, rather than treating their land-use activities as consumption or life-style practice.

the loss of local identity and locally-based marketing networks. The traditional appeal to the public purse for support and protection against such adverse trends is no longer a viable option. The taxpayer will not provide public support for declining industries, and anyway such production-related support is now effectively outlawed under the World Trade Organisation (see, e.g. Harvey, 1997b). In any event, public support will be sustainable only if the effects of the support can be demonstrated to be in the genuine public interest. Simply preserving traditional practices and life-styles will not do, unless there is a clear benefit to the rest of the economy and society from such preservation. The only grounds on which public benefit can be based is the conservation of the natural and social environment - which in many cases may make meat production in the uplands more expensive and even less competitive.

Under these circumstances, what might the future of farming (and hence agricultural land use) in the Northern Region, especially in the Northern Uplands, look like? It is plausible to suggest three distinct and extreme tendencies: the Ranch; the Residual/Recreational; the Original.

In pure economic competitiveness terms, the survival and future prosperity of Northern Region farming depends on it becoming cost-competitive with other national and international suppliers of farm products. Although the north has some advantages over other areas of the world in agricultural production, especially an apparently secure and reliable rainfall, it is otherwise not especially well-endowed with agricultural resources. Cereal and other arable production suffers from relatively short growing seasons, with cool summer temperatures and unreliable harvesting and grass-conserving conditions, while livestock production suffers from long and relatively cold winters, making feed costs and husbandry either expensive or leading to low levels of productivity. For farms to compete with other suppliers under these conditions, they will need to become substantially more extensive than at present, spreading (and thus reducing) their overhead costs over larger volumes and hence generally larger farm areas. In essence, world competitive livestock production in the Northern Uplands implies extensive *ranching* on the New Zealand model, rather than more intensive farming. In the lowlands, commercially competitive farming also implies larger scale and more extensive farming practices than have been traditional.

The potential emergence of such an extreme farming option, however, is predicated on farmland and fixed capital becoming much cheaper than at present, as product and farm support is eliminated. Otherwise, the necessary expansion of farm sizes will not prove profitable and commercially sustainable. However, as country ‘estates’ become cheaper, it is to be expected that these will attract buyers who are interested in more than simply commercial farming. In at least some of the more attractive landscapes and localities in the region, rural land and buildings are likely to be purchased and used more for living and working spaces, and for their environmental attributes, than for their agricultural potential, as they already are. In these cases, at the other extreme, farming will become *residual* - used as a tool for ensuring the amenity, recreational and environmental character of the countryside and landscape - or *recreational*, as a hobby or pastime for owners with other non-agricultural and increasingly non-rural income sources and occupations. In turn, in these locations, these non-agricultural (and probably relatively wealthy) residents can be expected to exert considerable social, economic and local political pressure on neighbours to farm in environmentally-friendly ways, discouraging the development of the ranch and encouraging (even to the extent of providing private payments for) more CAREful and environmentally-friendly farming systems. In any event, farm and rural policy reform is clearly in the direction of re-targeting public support and any remaining subsidy in the direction of CAREful farming, re-inforcing the tendency towards residual/recreational farming practice, with farm output becoming by-products of environmental management.

Under this residual/recreational extreme scenario, farming itself will no longer provide full-time occupations or incomes for the rural land users. For conventional farming to continue to provide a way of making a living (rather than a way of life), the marketing of these ‘by-products’ will become critical. So long as farm products are sold as commodities against international competition, their cost-advantage will depend on the extent to which their production is cross-subsidised by public and private payments for the provision of CARE goods and services from the landscape. However, developments in the marketing chain requirements for food products are tending to discourage and even prohibit conventional marketing of such by-products. The concentration and rationalisation of the food supply and marketing chains, and associated reduction in local outlets, is coupled with increased demands for uniformity, consistency and regularity of supply, and for conformity with and provenance of production norms and health & safety standards. Against these requirements, generally small-scale and extensive production and marketing systems are likely to face increasing disadvantage.

Neither of these two extreme scenarios - the ranch or the residual/recreational - are likely to be favoured by existing farmers in the North, or perhaps by those wishing to preserve the traditional farming landscapes and rural cultures. Yet the conventional recourse to political pressure and policy action to satisfy these demands for preservation of tradition is also likely to meet with strong resistance. The taxpayer cannot be expected to provide much relief from these unacceptable futures. More importantly, without a third distinct scenario, the development and evolution of both individual farms, and of the rural areas within which they operate and which they colour and condition, will prove insufficiently flexible and diverse. In the future, faced with greater variability of markets and less policy support, farm businesses will need greater flexibility and diversity of outlets and income sources in order to survive and prosper. Rural economies will need hardy and robust local businesses in order to thrive. In addition, the essential character of the rural areas requires diversity to maintain and improve the natural and cultural heritage on which the future health of rural areas depends. This socio-ecological heritage is the essential natural capital and advantage for the future development and prosperity of rural communities.

The *Original* option involves developing markets and marketing systems to deliver premium products. These production systems will have to be CAREful, and will be paid for in part because they are CAREful, both by public and private subscription towards care for the landscape and environment. This careful production itself provides valuable attributes to the stock, but to earn income, these attributes have to be marketed. Northern region products need to be marketed as products, not as commodities - they need to be differentiated from the competition.

The key characteristic of products, as opposed to commodities, is that they are distinguished from the competition in ways which are, and will continue to be regarded as valuable by the user. This implies that the product (or the resources which are needed for its production) are relatively *rare*, otherwise the consumer or user can turn to other sources. It also implies that there should be few, ideally no imitations or substitutes available, since the existence of either good imitations or substitutes will reduce the amounts consumers and users are willing to pay. In shorthand, these attributes of competitive products (valuable, rare, inimitable, unsubstitutable) can be labelled as the product's *competitive advantage*.

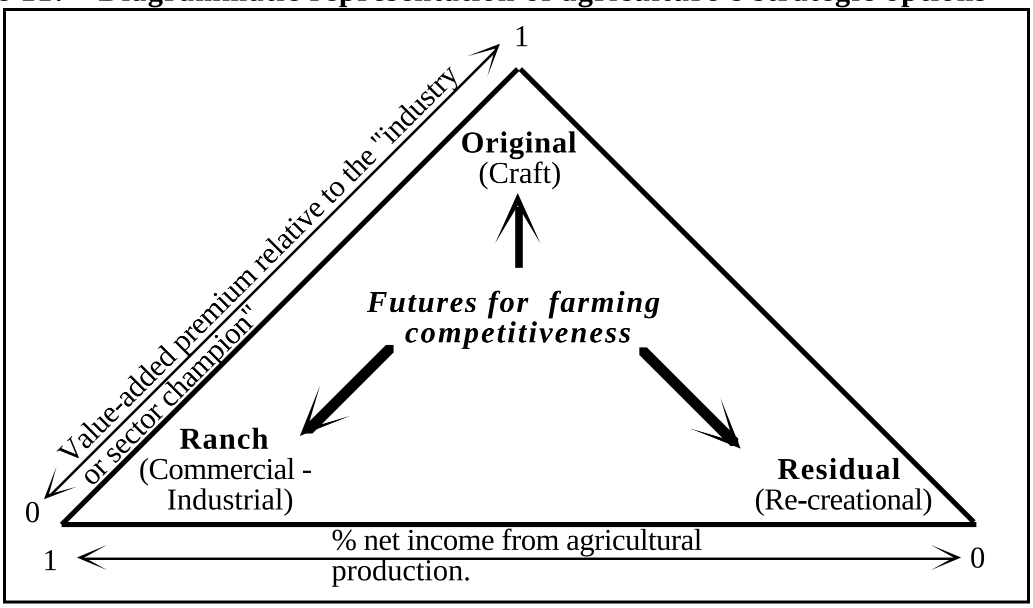
Kay (1993) identifies four key elements to a firm's (or marketing chain's) distinctiveness: i) the network of relationships the firm has with its suppliers and customers, as well as the internal networks the firm uses to keep its parts and people working together - which together Kay calls *architecture*; ii) the *reputation* of the firm or chain, which is clearly of vital importance in signalling to the customer the quality and reliability of products, especially for 'search' products - which customers buy infrequently and so have limited personal experience of the actual quality, value for money and reliability of the product; iii) *innovative capacity*, reflecting the extent to which you identify new customer requirements and new niches and invent or discover new, different and valuable ways of meeting these emerging and growing requirements - which, as Kay points out, is frequently and strongly associated with architecture, since it involves continual and accurate transmission of final customer requirements back up and through the marketing chain; iv) *strategic assets* - the extent to which you have control over a limited resource (such as a gold mine) or have a naturally or legally restricted market, and can thus trade on a degree of monopoly power. Kay labels these firm or chain characteristics (architecture, reputation, innovation and strategic assets) as the firm's *distinctive capabilities*.

Competitiveness, according to these concepts, now involves harnessing distinctive capabilities to the competitive advantage of the actual and potential products, with the primary objective of adding value to the product (as a combination of inputs and resources), since it is the added value which provides the income and profit to the firm or chain. It is this combination of competitive advantage and distinctive capability which determines the competitiveness of the firm or chain. Applying this conceptual framework to Northern agriculture suggests concentration on the actual and potential distinctive capabilities of the region's farming systems and practices. The key distinctive capability is location (hence originality), which cannot be duplicated or imitated by rivals in other parts of the country or world. Presently, location (and associated fragmentation, especially of hill farms) is frequently seen as being a commercial weakness of the farming system. Realisation of an original scenario requires that this weakness be turned to a competitive advantage. To do so requires the development of, especially, the architecture of the marketing chains to deliver an enhanced reputation of the origin - the craftsmanship and socio-environmental care of the production and processing systems. In turn, this will require innovation and imagination in developing new information, promotion and marketing systems, with an emphasis on increasing consumer perceptions of the authenticity and originality of the product package (Kusnesof, *et al.* 1997). The value to the consumer should reflect the contribution to the preservation and enhancement of their original environment, and the care and attention to detail and quality throughout the marketing chain - the originality of the final product is a package of the whole chain. In fact, the more successful of the Northern region's food businesses are already practising this strategy - for example, Wensleydale cheese - while the key elements have long been practised in some parts of the Northern region's markets, for example by local butchers' and their traditional links with particular farms and in the marketing of upland bred breeding stock (Box 2).

Figure 11 illustrates the three strategic extremes outlined here for the future evolution of Northern Region agriculture and, by implication, for land-based rural development. It is an essential part of the argument that encouragement of the original option is critical for this development. Without original production and marketing, any value added to farm production is likely to occur substantially outside the rural areas and the local regions which they colour and characterise. Without the original option, residual/re-creational farming runs the risk of generating a preservationist museum/amenity culture lacking the vibrancy and resilience of a living and growing society.

Yet the development of a genuine original option for many rural areas, perhaps especially in the North, is fragile. Most of the apparent trends within the agro-food sector appear to be antagonistic to personalised craft, personal trust and commercial relationships which are closer to family and community networks than to business practices of stock control, national distribution systems, Hazard Analysis and Critical Control Point (HACCP) protocols, and international sourcing strategies. In particular, the market power of the major supermarket chains seems certain to condemn original products to the status of up-market commodities - in direct price competition with internationally sourced brands and labels - rather than to encourage their marketing as a product-bundle of authentic craft and production practices and community relationships, combined with a strong perceptual flavour and colour of the production location and culture. While there may be some speculative reasons to question the continued hegemony of the supermarket chains (Box 3), there is little doubt of their current force in the market place.

Figure 11: Diagrammatic representation of agriculture's strategic options



Furthermore, while regional or local branding (exemplified by the Wensleydale cheese example) is important, this alone should be seen as the culmination of the development (and simple symbol of the existence) of an integrated marketing chain rather than as a substitute for such a chain (as is the case in many supermarket treatments of apparently original products). The development of original product marketing depends heavily on cooperation and trust. The economics of cooperation and the socio-business practices of networks and communities are much more important than those of competition, margin-shaving and market-share contests. It is far from clear that such networks and integration can develop easily or spontaneously in a climate of market competition and inevitable domination by large (frequently multinational) corporate enterprises and systems. Nevertheless, there are examples of public/private cooperation which are beginning to develop such networks and integration within local communities, where the European Union's 'Leader' programme is particularly relevant (see, e.g., Ray, 1996, 1997 and 1998).

Box 2: Original Marketing - Northern Upland Breeding Ewes

A relevant and important example of this logic is one livestock product from the Northern Uplands which continues to command respect and a premium in the market place - breeding ewes. Lowland flock-masters continue to value the quality and character of ewe lambs and gimmers (one year old breeding ewes) bred in the Northern Uplands as breeding flock replacements - why?

The ewes themselves are considered resilient, efficient, reasonably prolific and, especially, good mothers - ideal as lowland fat lamb producers when crossed with the appropriate rams. These qualities are a result of both the breeding of these ewes (which can be replicated elsewhere) and also of their nurture in the Northern hills, which encourage and develop hardiness and mothering instincts. The sheep are known to have been well-managed in an environment where good shepherding has a long tradition and a justifiable reputation.

The often informal but strong networks between the producers and the local auction marts (especially their well-known autumn ewe sales) also provide a tried, trusted and reliable system which lowland buyers and their agents have learned to rely on and trust. Although the hill environment and the particular breeds can both be duplicated elsewhere (especially in Scotland and Wales), the Northern upland ewe has a distinct and identifiable reputation based on the production and marketing systems and networks - the people involved and their own personal relationships.

These networks and relationships, established and maintained through the autumn ewe sales, are largely informal - there are typically no official or formal 'assurance' schemes or warranties associated with these sales. But the buyers know the reputation of both the marts and the sellers, and the ewes and ewe lambs marketed through this traditional system are very effectively 'badged' and labelled - well differentiated both from other regions and even differentiated within the Northern Uplands, between marts and their regular suppliers. Thus, while the particular products - the ewes themselves - might not be particularly well differentiated from potential imitators or substitutes, their distinctive capabilities, and the capacity of the marketing system which moves these products from the suppliers to the users, does provide a very distinctive and competitive product/service bundle.

Box 3: Competitiveness Principles and the Future Power of Supermarket Chains.

The major multiples have seemed dominant to date, but there are two major grounds for speculating that gaps and opportunities will emerge in the future. First, consumers preferences for their shopping experiences may well be changing. Much supermarket shopping consists of repeat purchases of the same products. The regular shopping trip may often be seen as a necessary but irritating chore. Supermarkets have responded by increasing delicatessen counters, in-store butchers and bakers, cafes, banks, and “home meal replacements”. These developments seek either to add enjoyment to an otherwise routine and boring task or to add to the range of chores which can be completed in a single trip, hence reducing the time taken to complete the tasks. However, self-service could become outdated as technologies allow for the development of automatic service, tele-shopping and home deliveries to order. Concerns over the destruction of both high streets and green fields, as well as over unnecessary encouragement of car use, might add to the troubles of the conventional supermarket. In the face of such tendencies, it is possible that one of the key **strategic assets** of the supermarket chains - the store itself - might become more of a liability. All that is needed to service a pre-ordered home delivery service is a regional warehouse, not a number of large stores.

However, people still like to shop, especially for speciality products and for those where personal service and/or personal inspection are considered important. The actual search for these products is considered an important part of the buying decision. The character and **reputation** of the supplier an important part of the associated service. These products are rather distinct from the routine products, frequently purchased and regularly experienced by the shoppers, where any search is an irritation. Future consumers may welcome the opportunity to avoid self-service in favour of automatic or automated service for the ‘experience’ products, and be willing to spend more time and effort being actually served with ‘search’ products. The conventional supermarket, however, deliberately combines both sorts of shopping in one package. It seeks to establish its reputation as providing the whole shopping basket pre-packaged in a reliable, convenient and value-for-money form. The real product of the supermarket is the whole shopping basket rather than the individual items.

This fact leads to the second major ground for speculating that the future may not be the same as the past. Supermarkets have built their dominance by automating the majority of food shopping by encouraging shoppers to do it for themselves from a wide range of essentially pre-packaged products. However, in competing with each other to provide consumers with the best automated product/service basket, the supermarkets have become very similar: Safeburys has become Sainsways. Their distinctiveness is undermined, and will become less and less valuable as a consequence. Customers now find that they cannot necessarily rely on a particular store or name as an experience good, and find it preferable to subject this choice to search - shopping at the competitor’s store. As a result, location of the stores and loyalty cards, bonuses (or traps) become essential parts of the multiples’ strategies. However, these strategies may be self-defeating. So long as the multiples are genuinely meeting customer preferences, their loyalty schemes and new stores will be tolerated, despite their green field desecration and high street destruction. However, if their satisfaction of customer preferences becomes weaker, then resistance to each of these strategies can be expected to grow.

Supermarkets might fail to satisfy consumer preferences if people prefer not to do it all for themselves. For many products, they enjoy and are willing to pay for being served - with the rise in catering being the obvious evidence in the case of food, with a growing proportion of total food consumption being supplied out of the home. People are also different, demonstrating and articulating their differences through their consumption patterns and shopping practices. While there is some security in shopping where everyone else does and buying what everyone else buys, the increasing differentiation in retail markets shows that as people become more secure, so they seek to differentiate themselves from their crowds.

Growth areas of the business are likely to be the highly differentiated and specialised segments of the market. In the case of food (especially, perhaps, meats), however, the specialisation will include very considerable elements of service and added-value. Higher class restaurant meals and home delivery of quality take-out meals could be seen as the pinnacle or climax consumption point, as the modern counterpart to the personal household chef and kitchen staff of the 19th century aristocracy. The distinctiveness of these services, however, is that they are not replicated on every corner - each is different and personal. Supermarkets and chains cannot easily provide these personal and craftsman product/service mixes.

They may well respond by introducing more regional and local variation (and hence more differentiated sourcing and procurement systems), and through franchising or sub-letting store space to imitation independent high street butchers. Thus, the development of the in-store butcher counter may lead to greater differentiation of the product/service through more obvious separation of the butcher operation from the main store, and hence to new opportunities for the Northern farming sector and its originality.

V. Conclusions

The development of original options presents a critical challenge for rural areas and for the agricultural and food system which will continue to underpin these rural areas' essential character and socio-ecological cultural value. There is room here for public support and collective action. But the nature of this support and action is quite different from that which has been typical in the past. National and supra-national (European) top-down schemes and product quality control procedures cannot be of more than marginal assistance to this development. The development requires the fashionable, if currently ill-defined, concepts of bottom-up participation, local emancipation and endogenous action, networking, trust and cooperation, governance rather than (public or private) government.

However, neither the socio-political institutions nor commercial market practices are yet seriously capable of providing coherent and consistent best-practice or ready-made and reliable blueprints and systems for such developments. The institutional and socio-political forms and practices (e.g. North, 1990) necessary to generate spontaneous original (endogenous) development remains embryonic. There is considerable evidence: in some commercial success stories; in the rhetoric of politicians and public pronouncements; in apparent public concerns; of the demand for the growth and development of such institutions and practices. Perhaps this demand will be sufficient to ensure the spontaneous emergence of these alternatives. However, it may be that such demands simply generate pale imitations and imperfect substitutes, as produced by existing socio-political and commercial hegemonies, rather than authentic and genuine originality and locality. If so, then both personal ambitions and collective aspirations for the sustainable development of rural areas will continue to be frustrated and even antagonised.

Furthermore, and perhaps more fundamentally, the underlying conceptual logics (or shallow presentational story-lines and plots) of the public and private management and social sciences remain embedded in (or procreators of) the current political institutions and commercial-economic practices. Development of originality and of the necessary institutions and practices requires the simultaneous development of integrated, harmonised and coherent social and management science. Hence, the challenge of sympathetic and sustainable rural development is also a major challenge to conceptual, empirical, experimental and experiential understandings of people and their social behaviours, and of the institutions and practices they develop to prosecute their ambitions and realise their aspirations.

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