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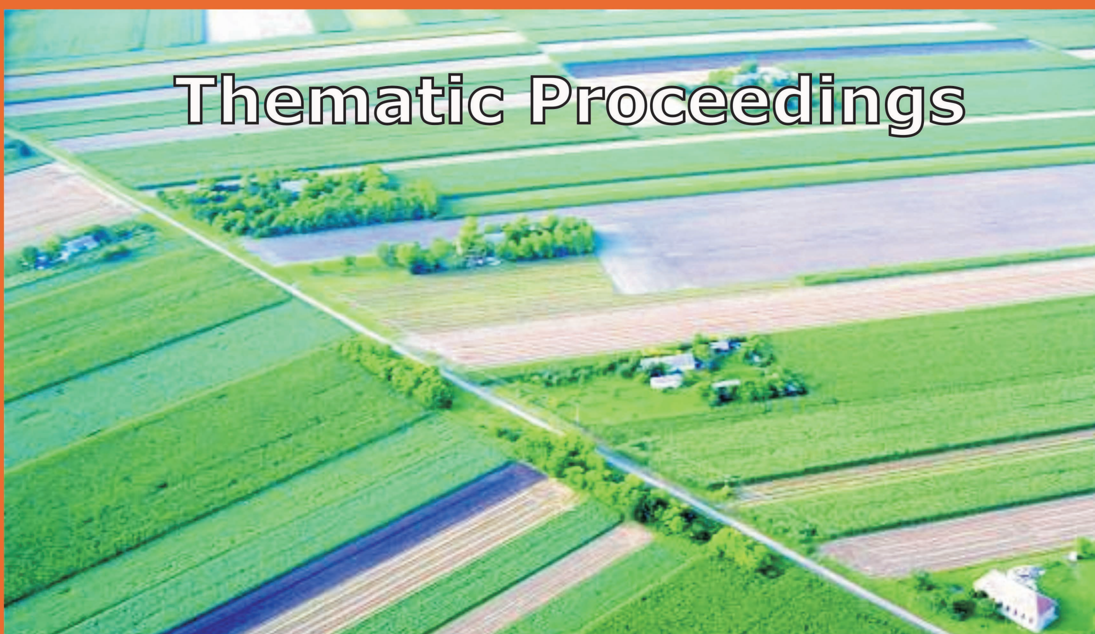
# DEVELOPMENT OF AGRICULTURE AND RURAL AREAS IN CENTRAL AND EASTERN EUROPE

## Thematic Proceedings

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# FINANCING RURAL DEVELOPMENT IN CENTRAL AND EASTERN EUROPE: OPPORTUNITITES AND CONSTRAINTS

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## INTRODUCTION

It is important to reassess the design and financing of rural development programmes in view of the changing policy framework for rural development that is emerging in the EU. The CAP Health Check is coming in 2008 and the nearly concurrent and broader EU Budget and Policy Review - in 2008-09. The CAP Health Check arises from several pressures. There is the budgetary pressure to decrease expenditure on agriculture, which claims a relatively large share of the budget compared to its employment share of 5.7% and GDP share of 2 %. There continues to be international trade liberalization pressure as well as the need to improve competitiveness of the sector in the context of globalization of markets as well as pressures to harmonise policies across the enlarged EU. Finally, there are other emerging needs for EU centralized financing on one hand and reluctance of EU member-states to increase contribution to the joint budget on the other. The cohesion policy review arises from pressures to address new challenges brought by demographic and climate changes, social issues, the changing structure of stakeholders, and the need to modernize financing instruments from grant based to loan based measures.

It is also becoming clear that current policies are not dealing successfully with closing income gaps between rural and urban areas or reducing polarization within countries of the EU, even if they may be helping to reduce these disparities across countries (ESPON). Rural development measures as designed and implemented under EAGGF Guarantee and Guidance or under EARDF are mostly farm centred, and the investment support tends to be concentrated in the more prosperous regions. Lagging areas have a low capacity to generate projects and therefore have inadequate access to development financing. Especially in NMS, national rural and regional development programmes tend to be driven by EU policies and an incentive to spend EU support money quickly rather than by national priorities and programmes. Given these various pressure points in the Commission and in member countries, it is becoming more likely that change will be a revision and not merely an adjustment in policy. Keeping in mind that during the final stages of

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negotiations on the 2007-2013 budget it was the rural development allocation which suffered the most drastic reduction from initially proposed levels, it is important to take stock of the situation and development needs in rural areas and formulate the strategy for how to secure necessary financing from different possible sources.

## RURALITY AND ITS SPECIFIC CHARACTERISTICS

Within the European Union, there exists no commonly used definition for rural areas. The Member States have generally developed their own definitions of rural areas, which are quite heterogeneous and not universally applicable. They are often based on socio-economic criteria such as agricultural patterns, density of inhabitants per square kilometre or population decline (European Commission, - Directorate General for Agriculture 1997).

A simple and widely used definition of rural areas was developed by the OECD (1994) for making international comparisons of rural conditions and trends; the only criterion used is population density. At the local level (NUTS 5[2]), communities are regarded as rural if they have a *population density below 150 inhabitants per square kilometre*. At the regional level (mainly NUTS 3 or 2); the OECD distinguishes three main categories, depending on the share of the regions' population living in rural communities:

– *predominantly rural (PR) regions*: over 50% of the population living in rural communities;
– *significantly rural (intermediate-IM) regions*: 15 to 50% of the population living in rural communities or includes a city of more than 200,000 persons with at least 25% of population;
– *predominantly urbanized (PU) regions*: less than 15% of the population living in rural communities or includes a city of more than 500,000 persons with at least 25% of population.

EUROSTAT provides another approach, which is also mainly based on the criterion of population density, although it includes additionally absolute numbers

[2] NUTS = Nomenclature des Unités Territoriales Statistiques, ranging from NUTS 0 (whole country, in CEECs corresponding to NUTS 1) via further and further disaggregated units to NUTS 5 (local municipalities and communes). NUTS-2 divides each of the CEECs into 4 to 16 regions, except for Estonia, Latvia, Lithuania and Slovenia, where this level covers the whole country. NUTS 3 comprises 188 regions in the ten CEECs, NUTS 4 consists of 1,149 units and NUTS 5 makes up 21,656 municipalities (European Commission-Directorate General for Agriculture, *Network of Independent Agricultural Experts of the CEE Candidate Countries*, 2004, section 9.1).

of inhabitants. Regions are divided into three classes according to their degree of urbanization:

- *Densely populated zones*: these are groups of contiguous municipalities, each with a population density greater than 500 inhabitants/km², and a total population for the zone of at least 50,000 inhabitants.
- *Intermediate zones*: these are groups of municipalities, each with a density greater than
- 100 inhabitants/km², not belonging to a densely populated zone. The zone's total population must be at least 50,000 inhabitants, or it must be adjacent to a densely populated zone.
- *Sparsely populated zones*: these are groups of municipalities not classified as either densely populated or intermediate.

Using population density as the only criterion for defining rural areas is problematic. Densities vary enormously across the different European countries, for example in the EU from an average of 17 inhabitants / km2 in Finland, to 470 inhabitants / km2 in the Netherlands; and in the CEECs from 30 inhabitants / km2 in Estonia, to 130 inhabitants / km2 in the Czech Republic. On average, the CEECs are less densely populated than the EU-15 (97 inhabitants / km2 compared with 119 inhabitants / km2). The ranges of population density in the CEE NUTS-3 regions are between 15 and 3,423 inhabitants per km2. The most sparsely populated areas (in many cases <50 inhabitants / km2) are located in the Baltic states, Bulgaria and parts of Romania, Slovenia and NE-Poland. The most densely populated areas (>100 inhabitants / km2) are – beside the cities – in parts of Poland, the Czech Republic and Slovakia. (European Commission-Directorate General for Agriculture, *Network of Independent Agricultural Experts of the CEE Candidate Countries*, 2004, section 2).

There are different approaches and definitions of rural areas used in the CEECs. Though they have likely changed by now, an expert survey (European Commission, 2004) revealed that there is no uniform definition applied in all of the ten countries investigated. In some of them, national definitions are used, which are rather vague. Other countries apply definitions in accordance with the OECD or EUROSTAT. Three countries have adjusted the OECD definition and decreased the ceiling from 150 inhabitants / km2 to 120 inhabitants / km2 (Hungary), and 100 inhabitants / km2 (Czech Republic), respectively. Bulgaria added a certain absolute number of population in municipalities for the OECD definition. The more sparsely populated NMS may need such adjustments to make meaningful distinctions among territories within the country.

For some purposes, it is important to classify rural territories with respect to their distance from an urban centre, since that distance has significant implications for the potential employment and income effects generated by growth in the urban centre. Different sources have used 45 minutes (Espon) or 1 hour (EuroGeographics) as the cut-off distance for this mapping. It implies that infrastructure development has a direct effect on rural well-being**.**

While it is often believed that the wellbeing of rural areas depends on wellbeing of farms and farmers, in fact rural non-farm employment and economic activity is not tied as much to agriculture as to the number and type of rural residents. One evidence of this fact is that rural non-farm employment generally does not decline when farm employment declines. Farm wellbeing depends at least as much if not more on the wellbeing and vitality of rural communities. Thus, increased evidence on this interdependence and especially the linkage of farm prosperity to the health and growth of rural economies is important in exploring the role of different stakeholders.

Rapid changes in the structures of rural communities and rural economies have been taking place in Central and Eastern Europe ever since the beginning of economic transition and will continue for years to come. It is not only that farms are fewer and larger and that population is aging, but there is also increase of services employment and other structural changes in rural economies. It is important to understand the complexity of rural economies and to anticipate how they may be evolving over the next decade.

## CHANGING ENVIRONMENT FOR RURAL AREAS AND RURAL POLICIES

In a changing and dynamic world, agriculture and rural economy is an integral part of rapid development. Changes and challenges are bringing pressure to analyse them and develop strategies how to manage them. There is a chance to turn these changes and challenges into opportunities if they are properly and timely addressed.

There are changes *within* the countryside. Dependence on agriculture is declining, and the share of employment is quickly shifting from agriculture to non-agricultural activities and especially to service activities. Aging and migration of rural populations are changing the numbers and skill structure of the rural labour force. Farm policies facilitate consolidation, which frees labour for other activities. Agricultural employment is dropping all across Europe but this process is faster in NMS. However, recent evidence from Estonia shows that while farm employment decreased by 82 percent from 1991 to 2005, non-farm rural employment increased by 50 percent (Turner and Wibberley), and this is the pattern seen in older market economies.

There are changes *around* the countryside. The mobility of the population is increasing, making it easier for people to more or to commute longer distances for work. Higher congestion and real estate prices in cities induce some urban workers to live in nearby rural areas. A "back to nature" mentality also encourages this tendency. Moreover, increased electronic connectivity and improved transport infrastructure contributes to the ease of commuting between rural living places and urban workplaces.

There is *increasing competition*. Different activities and different sectors compete for available financing and programme support. Skilled labour is in high demand and firms and agencies compete for this scarce resource. The single market and globalisation mean that competition for products and scarce human and capital resources is increased. Finally, despite the cohesion support, there are growing disparities between urban and rural territories and between regions within countries even while average wage and GDP per capita disparities across countries within the EU are diminishing.

The challenge for the future is how to adapt rural development policies, which have been heavily centred on agriculture and farm enterprises, to make them more responsive and relevant to the changing environment and evolving needs of rural regions and to deal with growing disparities within and among rural areas. In this context, the stakeholders are not only farmers and not only rural residents, but also urban workers who may choose to live in nearby rural areas if amenities and accessibility are improved and entrepreneurs who may choose to start or relocate business activity in rural areas close to a city. More generally, stakeholders are taxpayers who can realize a smaller tax burden if the cost of support and social safety net programmes can be reduced through increased development of lagging areas and reduction of income disparities. In other words, the challenge is to move from financing recent rural applicants to financing development in rural areas for the benefits of current and future rural dwellers and employees.

## REGIONAL APPROACH FOR BALANCED DEVELOPMENT OF RURAL AREAS

The new paradigm in rural policy (OECD 2006) has a place-based approach and targets economic opportunities in rural areas. Rural areas have been plagued with low and declining population density, remoteness of location, out-migration, aging population, and a declining tax base that leads to other disadvantages in financing infrastructure and public services. But rural areas also have untapped economic potential. Increased mobility and improved transport can bring new residents and new business, especially for those that are not truly remote from urban centres.

Rural areas often are custodians of cultural, historical and religious sites and natural amenities that can also generate income for rural residents.

Urban-rural linkages are key to a balanced development. Urban dwellers want access to rural amenities and some would relocate to nearby rural areas when commuting time decreases. Rural inhabitants, including farm families, can benefit from increased employment generated by improved rural-urban linkages. Rural residents also may depend on nearby towns for essential services and sometimes also for jobs. Realizing the untapped economic potential of rural areas requires a strategy that builds local assets (infrastructure, education, etc), improves opportunity for local business development and combines efforts of local, regional and national governments and stakeholders.

There are various factors that are important in overcoming constraints to successful rural development and in exploiting the opportunities that exist for rural economies. The quality and quantity of human resources is one of the most important, and this depends in turn on formal and informal education and training availability and on advisory service support. Effective deployment of development resources depends on administrative capacity and also on effective coordination of decisions and action among the numerous decision makers, stakeholders and programs. Effective dialogue can be enhanced by communication at every level and especially through widespread use of LEADER mechanisms to build local ownership of development activities. Finally, financial engineering tools are important for most effective use of limited capital resources, and public-private partnerships can significantly leverage scarce public resources.

The main concerns are how to retain and attract people to rural areas and how to diversify rural economies. We suggest three main thrusts:

1. Attractiveness. Development of services of general interest, such as accessibility (roads, railways, waterways), ICT (broadband access for SMEs, e-services, e-health, etc.), and public service delivery (water, waste treatment, energy, health, education, etc.)
2. Competitiveness. Support to SMEs, RTD and innovation in rural areas through cooperation between rural SMEs and local poles of knowledge on emerging technologies (e.g. bio-mass, bio-fuels, bio-diversity, environmental risks, etc.) and creation of SME clusters with rural/urban linkages (e.g. for food, wood, handicraft, etc.)
3. Diversification. Develop high quality rural (eco-) tourism in a sustainable way that will satisfy the needs of tourists, workers and local population, maintain the natural and cultural heritage, and contribute to the local economy with employment, improved quality of life and eco-education.

It is clearly not sufficient to rely only on funding from EARDF and FIFF for such a broad based and comprehensive rural development strategy. It should also combine the financial means available in ERDF, ESF, SME and micro-enterprise schemes, national support measures and private banking. It means focusing not so much on compartmentalization of the funds but more on potential synergies of different funds with differing scopes and priorities. Consider the prospects for such a larger scope of rural development financial resources. In the 2007-13 funding guidelines for EARDF the minimum allocation for Axis III and LEADER would be about €10-12 billion. Preliminary codification of Structural Funds for 2007-13 indicates that allocations to rural areas alone will be about €45 billion, or four times the EARDF minimum level, though some countries will surely go beyond those minimums.

Such a broad-based and comprehensive collaboration across funding programs and different levels of government and stakeholder groups is surely not an easy task. A shared vision of rural development would start with the fact that conditions and needs differ in different rural territories, so a bottom-up strategy is needed. Enhanced and strengthened partnerships would be needed between different levels of government and between private and public entities. A good partner is a strong partner, so in many cases capacity of local governance and community leadership would need to be enhanced. It would take extraordinary courage, vision and coordination and surely has some risk too; but it may be less risky than the alternative of continuing down the same road.

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