

Evaluation of the quality of the European rural policy and its Reforms

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Abstract

Rural development has been a mere appendix of the Common Agricultural Policy until last decade. Its development has often been based on the need to find new avenues to further subsidise agriculture and has even been considered a channel to re-label direct payments. Today this is changing. Rural development is considered a major instrument to support the environment, economy and cultural aspects of rural areas.

However, the rural development policy just started to develop as a credible tool for economic development recently. Plagued by inefficient and badly targeted measures, the policy requires a considerable reform. This paper presents a short evaluation of the quality and appropriateness of the rural development before the reform and the changes made to the policy.

This paper finds that while the reforms are welcome, many problems of the present rural development policies risk to be repeated. With the member states questioning the EU funding levels and the value of EU policies, special care is needed to avoid a future challenge to the rural development policies.

1. INTRODUCTION

The concept of rural development support is not recent. Already in 1964 the fund for supporting agriculture was divided into guarantee and guidance to create the still existing EAGGF¹. The guidance section was intended for rural development targeting farm restructuring through structural measures and the guarantee section funded the market support mechanisms of the CAP. This distinction between guidance and guarantee lost its rationale as other rural development needs and environmental concerns increased in importance, with the outcome that depending on the area of intervention the same rural development measures are funded either by the guarantee or the guidance funds, i.e. the CAP or the structural funds.

To reduce the existing confusion, the Financial Perspectives for 2007-2013 proposed by the European Commission group all rural development measures into one instrument with its own budget line under Heading 2 - Preservation and management of natural resources. This heading would combine the rural development measures of the guarantee and guidance sections of the EU budget into one fund. This rearrangement offers the opportunity to revisit the policy structure and performance.

Presently, rural development policies are governed by a series of measures outlined in Council Regulation No. 1267/99. This rural development policy has been highly criticised due to its incapacity to target efficiently the problems in rural areas

Recently the Council approved a rural development policy reform which should enter into force from 1 January 2007 (Council Regulation (EC) No 1698/2005). These reforms expand the scope of the rural development measures due to the important challenges of the agricultural sector specially in the new member states. It also allows investments in non agricultural and non farm related enterprises, but it is limited to micro-enterprises. Modest improvements to the eligibility criteria of funds have been introduced too.

The specific objectives for the future of rural development are set in art. 4

- Improving the competitiveness of agriculture and forestry by supporting restructuring, development and innovation;
- Improve the environment and the countryside by supporting management;
- Improving the quality of life in rural areas and encouraging diversification of economic activity.

This paper starts by presenting the features of rural areas on which a EU rural policy should be based, it then evaluates shortly the appropriateness of the present policy and the changes introduced by the new regulation. This evaluation is only on some of the main measures and thus not present a comprehensive picture of all measures available.

¹ European Agricultural Guarantee and Guidance Fund

2. WHAT ARE RURAL AREAS AND THEIR ECONOMIC STRUCTURES?

Rural areas in the EU are very varied and it is difficult to find one specific characteristic that can characterise them all. There is de facto no clear description of what constitutes a rural area in the EU and neither the old nor the new rural development policy determines it. To describe rural areas, the European Commission uses one of the most commonly used created by the OECD which categorises the rural areas as follows :

- Predominantly rural regions: Over 50 % of the population lives in rural communities;
- Significantly rural regions: between 15 to 50 % of the population lives in rural communities;
- Predominantly urban regions: less than 15 % of the population living in rural communities.

When presenting rural development problems in the EU, the situation of predominantly rural areas has often been used as an example and rationale for action. However, as there is no definition at the level of the regulation, the measures are available wherever there is farming activity. This can be in areas which are de-facto urban in nature (Nufiez Ferrer, 2004).

2.1 Role of non-agricultural activities

It is generally believed that the rural areas are predominantly agricultural, poor and are losing population, which can give an explanation for the very frequent view that rural development support should be directed to agriculture. The features of rural areas, however, appear to be rather different. While agriculture plays a very important role as predominant land user, its role in the rural economies and employment has declined significantly. In fact, in the European union even in the predominantly rural areas is employment in agriculture only 13 % with both industry and services being more important. This is acknowledged by the Extended Impact Assessment of the European Commission (COM(2004) 490 final, p.4) performed for the rural development proposals.

According to the OECD (1996-2001), provided evidence that the distribution of new employment opportunities in industrialised countries has not been correlated to the degree of urbanisation since the eighties. The rates of increase in services and industry for the 80s have been higher in rural areas than in urban areas.

Rural regions are also often successful economically. Many areas have experienced income and population growth due to increases in employment opportunities in non agricultural activities. Services and the development of industrial activities has often been a crucial element for these areas, more than the maintenance of agricultural activities. The OECD (2003a) has examples of rural areas which have done very well and even better than urban regions (e.g. Siena region (Italy) or Tirol (Austria)). The OECD attributes the main difference between lagging and leading regions to the level of infrastructures available.

Despite the fact that rural areas not predominantly agricultural and their assumed poverty and population problems cannot be generalised either, the Extended Impact Assessment of the Commission stays short of explaining this .or even mentioning that the Commission' s own working document on Rural Development (1997) shows that a higher number of rural regions present an increase in population rather than a fall (46,2 % compared to 41,6 % in predominantly rural areas and 57,2 % compared to 33,9 % in significantly rural areas). A

study by Terluin and Post (1999) confirms that population in rural areas has increased more in the 'leading' rural regions² than in mostly urban centres between 1980 and 1993.

However, the text of the Impact Assessment returns to the stylised description of rural areas as rural, remote and depopulated. It subtly mixes the undoubtedly very important role of agriculture as land manager with its position as economic engine of rural areas. It also reiterates in p.17 that rural development cannot be dissociated from its roles as 2nd pillar of the CAP. As a consequence the reform is still short to follow the OECD's position that the most successful strategy is an amenity-based development and the creation of an the "urbanised countryside", a countryside that despite low population density offers services at similar level as in urbanised areas, allowing numerous entrepreneurial activities. Information technologies are a central to such a strategy.

3. IS THE STRONG FOCUS ON AGRICULTURE JUSTIFIED ?

The agricultural sector still plays a very important role in the rural areas, undoubtedly as land manager. Its socio- economic situation has also to be taken into account when devising rural policies. However, the conception that the agricultural sector suffers generally from lower incomes and living standards than the rest of society in the rural areas is questionable and care should be taken not to use rural development measures as an income support mechanism. Rural development has to concentrate on social goods, such as environmental protection, and as investment funds to develop economic activities in lagging rural areas.

In any case, the agricultural sector, and in particular the total income of farm households is in many countries not worse than the average of the country (OECD, 2003a). Statistics on incomes in agriculture are often misleading as only data on the agricultural activity of farmers is provided, while part-time farming is widespread. When determining the financial situation of citizens for any public support, the total household incomes are taken as a measure of poverty. It is therefore odd to determine income support based on farm produce income only.

In some countries the farm household income is considerably higher than the national average, 70 % higher in France or even more than 150 % higher in the Netherlands. Interesting to note is that in most cases where the farm household incomes are the highest, the share of non- farm income is low, which calls into question the general opinion that financial returns in agriculture are low, and rather indicates that the income problem is principally a farm structure issue. Sufficiently large and productive farms have wealthy households in comparison to other households. Other "sub-optimal size" farms reach similar incomes through diversification of activities (Nufiez Ferrer, 2004).

The important share of non-agricultural incomes in OECD countries makes clear that farming is by far not the only activity possible in rural areas. OECD studies (2003a, 2004) show that in the EU, farmers in Denmark, Finland, Ireland, Sweden and the UK earn a higher share of income from non-farm activities and for many countries it is not far below 50 %.

ESPON (2005) also presents evidence that there is an increase in small farms in some countries, the UK being one of them. Operators that choose to start part time farming and depend on earnings from off - farm income. This trend is expected to increase, thus reinforcing the need to consider total farm household income to appropriately target agricultural measures which are income support oriented.

² These are regions which show higher employment growth

The farm poverty assumption has also been reinforced by enlargement to the candidate countries and in particular Poland. However, non farming inhabitants in the rural areas are in a similar situation and even worse off. Statistical data confirms this, although such data is very rare to find. The lack of comparative data at farm household level and with other sectors of society reinforce the view that agriculture is the problem area in rural regions. World Bank (2001) 'data on Poland shows that this view is incorrect. None of this denies the severe problems in agriculture in many regions but challenges the still overwhelming concentration of the policy on one sector when a proper rural development policy is supposed to help the development of rural areas in general.

Based on data from the European Commission (2003), over 90 % of funds in 2001 were directed to agricultural activities (Nunez Ferrer, 2004), basic infrastructures, village renovation and activities such as tourism and craft investments only take up 3,43 % of the EU funds or 4,36 % of total public expenditure.

Beyond these rural development measures, the EU also has implemented some Leader+ initiatives, which are integrated rural development programmes aimed at promoting endogenous growth through a bottom up approach. These are holistic programmes allowing for a comprehensive package of actions not restricted to agriculture, drawn and run by local actors. However, the size of the Leader+ programmes is modest and the scope until now was to test experimental approaches. The EPSON (2005) evaluation views these programmes as a future model of development for rural areas and the new reforms are inspired by their operations and has integrated Leader+ in the new regulation of part of the mainstream policy.

4. EVALUATING THE MEASURES, PAST AND FUTURE

The rural development policy offers a large number of measures. This section is not going to evaluate each and every one of them, but discuss the performance of the main measures. These measures are to be found with little change in the new regulations.

4.1. Measures to restructure the agriculture and food processing sectors

These measures aim at increasing productivity through restructuring and can therefore be useful, especially in the new central and eastern European member states where labour productivity represents is a mere fraction the EU 15 (11 % of the EU 15, 20 % if PPS is used, Nufiez Ferrer, 2004).

Results are mixed for this support. Apparently investments are often aimed Koester, Striewe and Loy (1996) give evidence that farms supported have tried to avoid investment induced underemployment, increasing their farmland through renting but at the cost of paying high land and quota rents. In fact, farm investments increase productivity and thug reduce labour demand in the farms. The effect of those investments is to reduce employment demand by farms. The often wishful belief that such investment increase employment is erroneous.

Investments in farms have to be accompanied by a strong investment policy in human capital (retraining) and alternative employment creation. Without off-farm employment possibilities, the full benefits of farm-investments will not be reaped.

Boosting off-farm employment possibilities is essential to ensure the success of rural development support in the new Member States, which in large part will be directed at modernising and increasing productivity in the primary, upstream and downstream sectors of

agriculture. In 1998, the European Commission estimated that with constant production, these countries would have to shed 4 million people just to reach half of the productivity level of the EU.

The new regulations have introduced new measures, which in fact are based on the SAP ARD measures for rural development of accession countries. These include support for food safety and quality standards, which is important in the new members.

4.1.1. Early retirement and support for young farmers

Structural change induced through early retirement and support for young farmers measures, which are retained in the new regulation, also aim at inducing structural change. Older farmers would be encouraged to leave farming earlier leading to either the setting up of a younger farmer on the land or to land consolidation. Thus the support should speed up land restructuring. The few evaluations performed on these interventions are discouraging. A study for Northern Ireland (Caskie, Davis, Campbell and Wallace, 2003) reveals that most farmers ready to join the scheme are those who were soon going to transfer the farm to their descendant. Thus, no structural change occurs. Farmers who do not have descendants are not interested in joining the scheme to avoid losing the land. The scheme may speed up a transfer that was going to occur anyway and the study estimates that the deadweight losses risk being considerable. Studies in France and Ireland estimate that the scheme only reduced by 3 to 6 years the retirement age. There is also a high risk of fraud if the land is transferred to a family member who is already working in the farm and the pensioner continues his farming activities. The scheme may be more successful in the new member states, as the payments are considerably more generous than national retirement schemes. The risk of fraud is however high.

4.1.2. Human Development

Training is a crucial tool to improve employment opportunities in rural areas particularly in the new member states. However, despite the need to foster alternative employment, it was and has remained restricted to agriculture and farm related skills. It excludes non-farming rural inhabitants. The slight difference in the wording of the vocational training measure allows for learning of innovative practices, which could allow the acquisition of cross-sectoral skills such as IT nor skills responding to labour market demand. However, the measure is still very agriculture oriented.

4.1.3. Targeting problems

An additional problem of most measures is the lack of socio-economic targeting. Public interventions do not necessarily correct for a market failure, as they do not target operators that have difficult access to private funding. For instance, public support to the food processing industry is questionable even in the new member states, as it is one of the most successful branches and attracts a large share of foreign direct investment. At individual level, project selection is likely to favour successful farm holdings and processors, generally located in better off areas with access to the banking system. The EU funds thus risk substituting and even crowding-out rather than complementing private funds.

4.2. Measures to enhance the environment and countryside

The objective of this group of measures is to preserve the landscape of the rural areas and their environmental quality. The two main actions are the measures for Less Favoured Areas and agri-environment.

LFA support is often labelled as an environmental policy, while the stated and most important objective of the LFA measures is to improve the incomes of farmers³ for cultural, socio-economic and natural handicaps reasons. It provides support payments which are loosely linked to actual farming conditions and costs. LFA support absorbs close to 30 % of rural development funds while support to areas with environmental restrictions does not reach 1 % (based on 2001 figures in Nunez Ferrer, 2004).

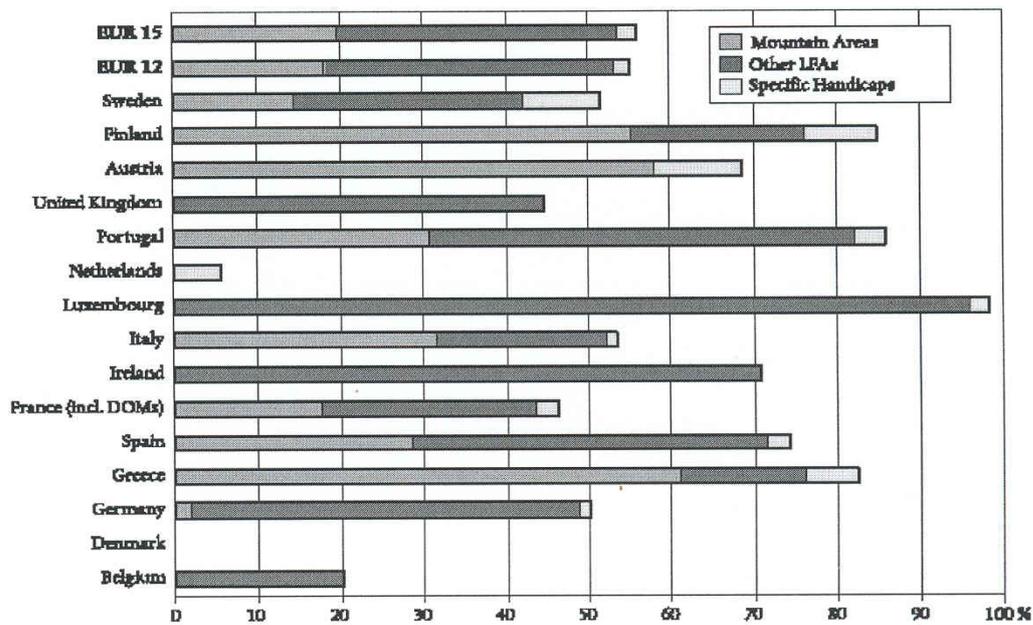
One of the important problems of LFA payments is the very high flexibility in the determination of beneficiary areas and the lack of appropriate justification and monitoring of the support. The Court of Auditors (2003) has criticised the LFA payments severely.

LFA are areas either in mountainous regions (high altitude, steeply sloped regions or areas over the 62° and thus climatically cold regions) and areas where land faces abandonment in which agriculture is important, culturally, socially or economically. The environmental payments are targeted to areas, where due to environmental problems farming faces additional costs.

Figure 1 presents the proportion of LFA in total UAA (Utilised Agricultural Area) and Figure 2 maps the distribution of LFAs at NUT 3 level. The area covers a substantial share of the EU's agricultural land, which indicates that eligibility criteria are most likely weak. Support is granted to 55.8 % of all agricultural holdings. Noticeable, and noted strongly by the Court of Auditors, 98 % of the agricultural land of Luxembourg is considered as LFA, most of it under the socio-economic and cultural category. There are thus indications on a lack of targeting. The Court complains that member states have not provided appropriate justification for the aid, nor have monitored the impact.

³ "to maintain a viable agricultural community and thus help develop the social fabric of rural areas by ensuring a fair standard of living for farmers and by off-setting the effects of natural handicaps in mountain and less-favoured areas." rural development Regulation 950/97

Figure 1. LFAs as proportion of total UAA per member state



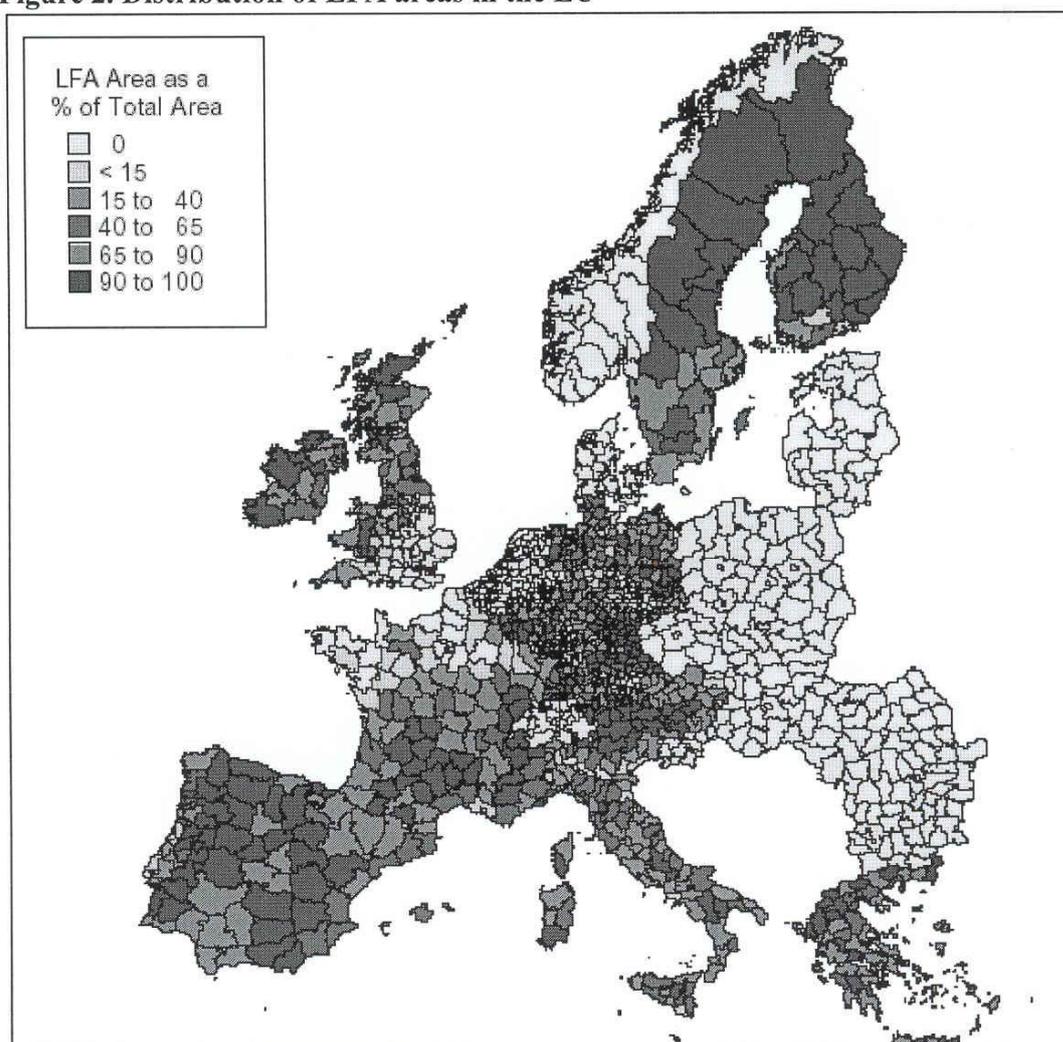
Source: Court of Auditors (2003)

The support has been probably suffering from a high deadweight cost (Nunez Ferrer, 2004). Even for mountainous areas there is no strong rationale for automatic public support, particularly in those areas which are wealthy major tourist centres and may have high levels of off farm incomes. There is also no sufficient consideration of the need to maximise land use efficiency and to question the need and opportunity costs of certain production structures in LFAs which may have originated due to subsidies (e.g. CAP) in the first place and may even be environmentally undesirable.

Despite the imbedded socio-economic objectives of supporting less favoured areas, the consistency of the support with cohesion objectives is poor. ESPON (2005) indicates that LFA payments are not more intensive in areas with lower GDP level or higher unemployment!

The partially political nature of the way LFA areas are defined and the flat rate nature of payments may have created an element of over-compensation in areas where disadvantages compared to non-LFAs were minimal, and one of under-compensation in the most severely disadvantaged regions. The ESPON study nevertheless suggests that in some countries the LFA payments helped to retain some low income cattle and sheep production in marginal areas, but this does not provide sufficient grounds for continuing the policy unchallenged. In apparent contradiction to many claims that policy helps small farmers, the average size of farms benefiting from LFA payments in non-mountainous areas is larger than the average (Table 1). Impacts of measures are also not properly evaluated and there is risk of overcompensation to farmers.

Figure 2. Distribution of LFA areas in the EU



Source: ESPON (2003)

Table 1. Farm sizes in LFA and non LFA areas in ha, year 2000

	Belgium	Denmark	Germany	Greece	Spain	France	Ireland	Italy
Total	22,6	45,7	36,3	4,4	20,3	42,0	31,4	6,1
non LFA	21,0	45,7	39,9	3,4	14,0	40,5	38,9	5,6
LFA non-mountainous	32,8		34,5	5,7	23,9	47,0	26,7	7,2
LFA mountainous			18,4	4,7	21,2	38,7		6,3
	Luxembourg	Netherlands	Austria	Portugal	Finland	Sweden	United Kingdom	EU-15
Total	45,4	20,0	17,0	9,3	27,3	37,7	67,7	18,7
non LFA		20,0	17,6	4,4	33,1	53,9	56,2	18,4
LFA non-mountainous	45,4		9,9	25,7	28,2	31,3	90,6	25,8
LFA mountainous			19,3	4,9	24,7	21,4		12,3

Source: Nunez Ferrer (2004) and New Cronos Database

In response to the Court of Auditors and the weak justification for the support, the new regulation has introduced important changes. The first is that the use of LF A for specific handicaps other than those caused by geographical and soil features (altitude, very low fertility) is limited territorially to 10% of the area of the member state. The vaguely defined LF As for socio-cultural reasons (depopulation risks, etc.) have been removed from the regulation.

4.2.1. Agri-environmental measures

Agri-environmental measures receive generally favourable evaluations, but still questions remain on the lack of targeting of actual environmental needs in specific areas. The payments are at times accused of being offered to farmers which follow practices in line with some agri-environmental standards which are not uncommon even if beyond the minimum standards. Thus, farmers can de facto be compensated for costs they never incurred, losses they never had and paid an incentive never required. The payments are also permanent, for as long as the agri-environmental method of production is maintained. This creates a situation of possible overcompensation.

4.3. Quality of life and diversification of economic activities

Though this group of measures is the most crucial for the holistic development of the rural areas, interventions are quite limited. Presently, two measures target the general living conditions of rural areas, one for rural services and infrastructure and one for village renovation. The first aims at improving access to basic services and infrastructure in rural areas, and by enhancing the physical environment of rural communities helps rural people gain access to employment. Despite their importance, the weight of rural infrastructures is modest even in the new member states. In Slovakia for example the infrastructures measure was not even present in the original SAP ARD programme and was introduced later. Uptake was rapid as soon as it was added to the programme.

The second measure aimed at revitalising the rural areas by restoring rural towns and their historic value can only have a positive economic impact in zones of exceptional tourist value.

There are two other measures oriented towards the general economic development of the rural areas. The first - Diversification of agricultural activities and activities close to agriculture to provide multiple activities or alternative incomes - can be used for marketing purposes of new or non-mainstream crops or livestock products, or the conversion of agricultural buildings to new non-agricultural uses and non-farming activities on the farm. It is thus too restrictive to trigger economic diversification in rural areas and is only open to farmers.

The second measure - Encouragement of tourist and craft activities - is similarly too restrictive as it is limited to on farm tourism and crafts activities as additional commercial diversification. Such measures are unlikely to increase the chances of finding alternative employment in rural areas and furthermore do not apply to formerly hired farm workers.

Calls for extension of the scope of the measures and an extension to cover all rural inhabitants have been taken into account in the new regulation.

While this is good news the extension for business investments is limited to assistance for rural microenterprises (Art. 54 of the regulation). This is partly due to the complications to delimit competences between the rural development funds and structural funds. However,

under a tender procedure there is a likely bias against applications from remote rural areas for structural fund support. These projects are likely to be less assured than applications from urban areas.

5. SOME ISSUES ON THE DISTRIBUTION OF FUNDS

There is a serious risk that the distribution of rural development funds suffers from serious distortions, in particular regressiveness. This is due to the tendency of member states to look at their net balance and for regions to the envelope they receive. Allocation of rural development funds should be based on needs of rural areas, in particular to those with the biggest problems.

If the increase of the rural development policy is linked to the decline in direct payments, member states will try to ensure that a share comparable to the lost CAP 'revenue' is attributed through this policy. Furthermore, the regions themselves will want to see the allocation of rural development funds based on this shift. We are already observing problems with the transfer of funds, as regions want the funds, which have been modulated, i.e. transferred from large farms to rural development to stay in their region.

The consequence is that the policy will then be larger in those regions where agriculture has had the largest historical yields, which are usually the richest and in the EU15. In time the rural development funds risk to fall on the richer rural areas.

Such a regional link has also even been incorporated by the Commission, because the intensity of rural development funds going to Objective one regions has to be kept.

6. CONCLUSIONS

Creating a single budget heading for agriculture has been an important step to improve the future policy coordination.

The reforms are certainly a step forward to improve the quality of the policy for rural development. This is important if the policy is expected to survive in the future. There is a marked even if not sufficient shift to a holistic approach for rural areas. The situation in rural areas is highly affected by the quality of the infrastructures, proximity of urban centres or the presence of particular economic activities. Rural areas should be categorised according to their entire endowments, and measures should be tailored to specific needs in those areas.

In most policy areas, be it regional policy at EU or national level, or social policy, there is a trend towards concentrating resources and targeting problem areas and in particular market failures. This is necessary to increase the effectiveness of measures and reduce the misallocation of resources, there is some scope left to continue improving the policy in this direction. Better territorial targeting is needed to address more efficiently the specific problems of lagging rural areas. Eligibility criteria, be income per capita in the area, or levels of unemployment, or access to basic infrastructures, to markets, etc. have to be considered.

This means that measures such as those for agri-environment should be available across the agricultural sector in all areas, measures economic development of the areas, including farm restructuring funds, should be limited to poorer rural areas. In those regions the limitation of funds for non farmers to micro-enterprises is too restrictive. These regions are at a disadvantage when proposing projects due to the higher risks compared to more urban regions, a wider business promotion strategy would be welcome.

Whatever the fund source, the development of rural areas will depend on the infrastructures and service provision in them. Investment promoting infrastructures for ICT and transport should be a priority if declining rural areas are to be fostered. A stronger recognition of the complex nature of the economy of rural areas would have been important, rather than continuing to protect the mantra of the role of agriculture as main activity and future of rural regions. Agricultural enterprises themselves can only benefit from a better provision of services and infrastructures in the regions too.

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