



**AN EVALUATION OF THE LESS FAVOURED AREA  
MEASURE IN THE 25 MEMBER STATES OF THE  
EUROPEAN UNION**

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# EXECUTIVE SUMMARY

## Introduction

### *The LFA Measure*

In the early years of the LFA measure, Council Directive 75/268/EEC on ‘mountain and hill farming in certain Less Favoured Areas’ had one overarching objective and two sub objectives: to 1) ‘ensure the continuation of farming’, thereby 2a) ‘maintaining a minimum population level’ or 2b) ‘conserving the countryside’. The objectives were designed to address a number of needs, specific to certain LFAs characterised by least favourable production conditions. These included the need to avert the threat of the large-scale depopulation of farming areas, which would jeopardise their viability and continued habitation. In the longer term, this would lead to the abandonment of previously maintained land. The logic of intervention was to maintain a farming industry in such areas to prevent the process of rural depopulation and to take action against the abandonment of agricultural land or its conversion to alternative land uses. An exodus from farming could be prevented if farm business viability was maintained and therefore, raising farm incomes in these areas to a reasonable level was seen as central to achieving the objectives. Farm incomes were to be increased through the payment of an annual compensatory allowance which compensated farmers for permanent natural handicaps, the level of which reflected the severity of the handicap measured against a number of regional/national and European reference points.

Council Regulation (EC) 950/97 on improving the efficiency of agricultural structures amended Council Directive 75/268/EEC. Under this Regulation the objectives remained the same; ‘to ensure the continuation of farming’, thereby ‘maintaining a minimum population level’ or ‘conserving the countryside’, thus reflecting a similar set of needs and priorities. In turn, the logic of intervention was to take action to maintain the farming population and their incomes in these areas, through the provision of an annual compensatory allowance to offset natural handicaps.

The objectives of the LFA measure evolved with the introduction of Council Regulation (EC) 1257/1999. Ensuring ‘continued agricultural land use’ became the overarching objective, which, in turn would contribute to the ‘maintenance of a viable rural community’. Two further objectives relate to ‘maintaining the countryside’, which has remained consistent throughout the history of the measure, and ‘to maintaining and promoting sustainable farming systems which take account of environmental protection requirements’. An additional objective was added in Areas with Environmental Restrictions, classified under Article 16 of Council Regulation (EC) 1257/99, which was concerned with promoting compliance with environmental requirements and safeguarding farming in areas with such restrictions. This environment-focused objective reflected an emerging need within the LFAs, and more broadly in Europe’s rural areas, relating to the inimical effects of an intensive form of production and a recognition of the biodiversity and landscape values of low-intensity farming systems. Central to achieving these objectives is a logic of intervention underpinned by a commitment to retaining agricultural land use, although increasing

emphasis is placed on incentivising a specific type of agricultural management in these areas in order to address the environmental and social needs identified.

As before, the objectives were to be achieved through the payment of a compensatory allowance fixed at a level which is sufficient to make an effective contribution to compensate for existing handicaps and which avoids overcompensation. Under this Council Regulation, no reference is made to the farm income in setting the level of the compensatory allowance, which reflects the fact that the intervention is no longer directed at the farmer or agricultural community per se, rather at maintaining a specific type of land use. This acknowledges implicitly the inevitability of socio-structural change within the LFA in the future.

Under the forthcoming Council Regulation (EC) 1698/2005, the LFA measure, through the 'continued use of agricultural land', should contribute to 'maintaining the countryside' as well as 'maintaining and promoting sustainable farming systems'. In addition, it should contribute to ensuring that environmental requirements are met and to safeguard farming in areas with environmental restrictions. The social objectives have disappeared which implies a significant transformation in the needs the measure seeks to respond to and therefore in its intervention logic.

Since its introduction in 1975, the objectives of the LFA measure have evolved, reflecting a shifting constellation of social and environmental needs in less favoured areas, and a changing set of priorities. In general terms, the social need has lessened, and specifically, the measure is no longer seeking to address rural depopulation, although concern for the maintenance of a certain type of agricultural land use and environmental protection has increased. Furthermore, with successive amendments, Member States have been offered increased flexibility in the implementation of the measure. Member States are now responsible for fixing the levels of compensation, defining the types of production to be covered by the scheme, and modifying LFA boundaries. This has meant that in many countries an additional layer of national or regional objectives is pursued.

A change and proliferation in the measure's objectives, along with a concomitant shift in the logic of intervention, suggests that the way in which the measure is implemented in different Member States through the classification criteria, the farm level eligibility criteria, and the modulation and structuring of payments, should be subject to review. This is in order to assess the measure's continued relevance and effectiveness in the face of an evolving set of needs and objectives and to consider whether these objectives continue to be achieved in the most efficient way. This forms the basis of concerns expressed in a Special Report No 4/2003 of the Court of Auditors which drew attention to the existence of considerable disparities between Member States in terms of the area classified, the level of payment per beneficiary, and the effects of the measure on farm incomes with implications for its effectiveness and efficiency. Through a critical examination of farm incomes and structures in the LFA, and of the measure's socio-economic, land use and environmental impacts, this evaluation seeks to address some of these questions.

### ***Less Favoured Areas***

Under Council Regulation (EC) 1257/99, an area may be classified as less favoured according to one of four categories. Each category characterises a specific cluster of handicaps, common to certain areas of agricultural land across Europe, and which threaten the continuation of agricultural land use.

Under Article 18, **Mountain Areas** are characterised as those areas handicapped by a short growing season because of a high altitude, or by steep slopes at a lower altitude, or by a combination of the two.

Under Article 19, **'Other' Less Favoured Areas** are those areas in danger of abandonment of agricultural land-use and where the conservation of the countryside is necessary. They exhibit all of the following handicaps: land of poor productivity; production which results from low productivity of the natural environment; and a low or dwindling population predominantly dependent on agricultural activity.

Under Article 20, **Areas Affected by Specific Handicaps** are areas where farming should be continued in order to conserve or improve the environment, maintain the countryside, and preserve the tourist potential of the areas, or in order to protect the coastline.

Under Article 16, payments are made for costs incurred and income foregone by farmers in **Areas Subject to Environmental Restrictions** resulting from the implementation of limitations on agricultural land use imposed by Community environmental protection rules.

## **Methodology and Geographical Scope of the Evaluation**

This report provides an evaluation of the LFA measure and presents the results from a 10 month study conducted in the 25 Member States of the European Union between December 2005 and September 2006. The study is framed by seventeen evaluation questions and sub-questions which fall under six Evaluation Themes. It serves to evaluate the implementation of the LFA measure (Themes One and Two), along with its effects on farm structures and incomes (Theme Three), and its impacts on land use, the environment and the viability of rural communities (Themes Four – Six). All six evaluation themes are investigated in the EU-15 Member States. However, given the recent introduction of the measure in the EU-10 Member States following their accession in 2004, the study focuses exclusively on implementation issues (Themes One and Two) in these countries. It is accompanied by a report on the 'Implementation of Articles 18, 19, 20 and 16 of Council Regulation (EC) 1257/1999 in the 25 Member States of the European Union' (IEEP, 2006) which provides an inventory of the classification criteria used by Member States, along with data on the area classified as LFA and on compensatory allowances.

The evaluation covers the period since the introduction of Council Directive 75/268/EEC in 1975 up to the present day (2004, in practice). Certain questions seek to address the whole period while others concentrate on the most recent period of implementation since 1999 when the Rural Development Regulation (1257/1999) came into force and significant changes were made to the LFA measure in the context

of Agenda 2000. That said, historical databases are rare, which has proved a limitation in the collection of time series data.

The evidence base for the Evaluation comprises secondary data including official documentation, scientific studies and earlier pan-European and national evaluations of Rural Development Programmes. Quantitative data have been derived from pan-European datasets including the Farm Accountancy Data Network (FADN) and the Farm Structure Survey (FSS), and from national statistical databases. Qualitative data have been gathered through semi-structured interviews with 260 informed experts. In addition, fifteen case studies were carried out in Germany, Ireland, Spain, France, Italy, Austria and Sweden to provide fine-grained evidence under a variety of political, administrative, economic and natural conditions and to explore the measure's varying impacts at a regional level. Data to answer the evaluation questions were collected by national consultants in each of the 25 Member States whilst the analysis has been conducted by a group of eight experts, with special consideration afforded to the relevance of the measure with regard to the needs, problems and issues at the regional, national and Community level; its effectiveness and the extent to which intended objectives are being achieved; and the efficiency of its implementation.

### **Classification of LFAs**

To compensate farmers in areas subject to permanent natural handicaps and with environmental restrictions, the EU Regulations establish overarching criteria for the classification of LFAs and for the setting of rules to determine eligibility at the farm level. Flexibility is afforded to the Member States in the interpretation of these criteria, and many have introduced additional classification criteria to reflect national and regional disadvantages.

For areas classified under Articles 18 and 16, the EU criteria are well defined and measurable and Member States have adopted them in a consistent way. In this regard, there is a clear correspondence between the classification criteria used and the handicaps they seek to identify, although together they only account for 29% of the total area of LFA (28% and 0.8%, respectively, in 2004/5). For the classification of 'Other' LFAs, Member States use a wide variety of criteria, including 17 relating to the productivity of agricultural land, 12 to economic performance and 3 to rural population issues. Most are well defined, although the severity of disadvantage varies and the criteria are not all directly comparable across the EU-25. In measuring the condition and productivity of agricultural land, for example, Germany, Austria, Finland and six new Member States use criteria based on national indices of soil and land quality. Article 20 areas are defined according to a wide range of criteria which are often qualitative in nature and refer to local conditions. As such, the handicaps they describe are relative and context-specific, and cannot be compared to a European baseline of disadvantage.

Almost all Member States have shown a steady increase in the area classified as LFA and the proportion of the total UAA classified as less favoured has risen from 33% in 1975 (EU-9) to 55% in 2005 (EU-15). This equates to a farmed area of about 77 million hectares in 2005, drawing on European Commission data. Germany, Spain,

Greece, Portugal, France and the UK are ‘expansionists’ in this respect and have increased their LFAs by 10% or more from 1975 or accession. Since 1988, much of the growth in area has been in ‘Other’ LFAs, which in 2004/5 accounted for 66% of the total LFA, whilst there has been a decline in the area of Mountain LFAs. The new Member States have followed the EU-15 in classifying significant areas of land as less favoured, equivalent to 52% of the total UAA in 2005. The enthusiasm for classifying a large area as LFA reflects, in part, the relevance or perceived relevance of the measure, along with the financial incentive conferred by access to EAGGF funds and the fact that national authorities are under no compulsion to make LFA payments.

The relationship between the classification criteria and an objective measure of handicap is only clearly defined for Article 18 and 16 areas. However, over the period 1998 – 2004, the area of land classified under Article 18 has declined and under Article 16 remained small while the total area of the LFA has expanded, with the biggest increase in ‘Other’ LFAs. Given the increase in the size of Article 19 areas, it is of concern that the basis for classification in relation to a robust measure of handicap is less secure compared to Article 18 and 16 areas. Classification under both Articles 19 and 20 has occurred with reference to a wide range of national criteria, many of which are not comparable at a European level. This is not in contravention of the requirements of the Regulation, although it reduces transparency with regard to the equitable distribution of compensatory allowances. Furthermore, some of the classification criteria under Article 19, and in particular the three which relate to rural population issues, no longer reflect the core objectives of the LFA measure and have been inherited from earlier iterations under which areas were classified on the basis of needs that are no longer as pressing.

Given the progressive reorientation of the LFA measure towards sustainable land use and environmental objectives, and the absence of social objectives relating to the viability of rural communities under the forthcoming Council Regulation (EC) 1698/2005, the relevance of these population criteria as a basis for classification is open to challenge which, in turn, raises questions about the less favoured nature of some existing classified areas. In light of these revised objectives, a further concern is that Member States have made only limited use of the environmentally focused Articles 16 and 20, which accounted for 0.8% and 5% of the total LFA in 2004/5, respectively. Article 16 is a special case in that the need for compensation depends considerably on the way in which Member States implement the EU Birds and Habitats Directives and the implications for farm income. There are variations in the attitude of governments to pay compensation in these areas.

## **Eligibility**

Not all farms within an LFA receive a compensatory allowance, with some excluded under the eligibility rules. In Spain and Italy, for example, half the holdings in the LFA fall below the eligibility thresholds of two and three hectares, respectively. Under Article 14.2 of Council Regulation (EC) 1257/1999 three mandatory eligibility criteria are established, including a requirement to farm a minimum area; to undertake to farm for at least five years; and to apply Good Farming Practice, all of which are consistent with the measure’s core objectives. In addition, Member States apply a

range of specific eligibility criteria mainly at a national but in a few instances at a regional level, which reflect a variety of objectives and administrative requirements. Common eligibility criteria include restrictions on farmers over 65 years of age from receiving payments, place of residence conditions, and a requirement to keep livestock. Many of these are inessential to the main objectives of the measure and could exclude farmers contributing to the maintenance of agricultural land use. Whilst it is reasonable to focus on livestock farms in many regions, this needs to be clearly linked to sustainable land management, including the application of minimum and maximum stocking densities. Other valued agricultural landscapes, including mixed farming, for example, should not be excluded from LFA support. The exclusion of very small farms may impact on holdings offering landscape diversity in some regions, but this has to be balanced against the likely limited impact of very small payments and the administrative cost of making payments and monitoring a large number of small farms.

Since 2000 in particular, Member States have made changes to their national criteria, including a broadening in the types of farming systems eligible for receipt of the compensatory allowance; a relaxation in the restrictions on recipients; and a change in stocking density requirements, with a ceiling removed in many cases. In some Member States the minimum farmed area requirement has also been increased. These changes go some way to reorient national aid schemes towards the revised objectives of Council Regulation 1257/1999, although relatively few new environmental criteria have been introduced by Member States.

## **Implementation and Expenditure**

All 25 Member States have chosen to implement an LFA aid scheme, which indicates a widespread view that the policy is relevant to the needs of the European rural territory. It is only recently that a few regions or Member States, such as Wales, for example, have considered discontinuing their scheme. Between 1995 and 2003, there has been a decline in the number of holdings in the EU-14 receiving a compensatory allowance from 1.213.000 to 965.000 (this figure excludes approximately 6.000 farms in Belgium because of data inconsistencies). The decline is likely to be due in part to the changes in eligibility conditions introduced in 2000, and to the substitution of livestock headage by area payments that occurred in this period. Following the accession of the new Member States, 1.782.323 holdings received the LFA compensatory allowance in 2004 (EU-24, excluding Hungary), and an overwhelming majority of these additional beneficiaries were in Poland, with 520,000 recipients. The effect of enlargement was to increase the number of beneficiaries by nearly 90 per cent.

Seven Member States (France, Finland, Germany, UK, Ireland, Poland and Austria) account for more than two thirds of total LFA expenditure - €2.2 billion out of a total budget of €3.07 billion in 2004. In terms of EAGGF expenditure, the seven largest budgets are in the same Member States but with Italy and Spain displacing Austria and the UK. Expenditure on LFA compensatory allowances has risen over time in most Member States, with considerable apparent fluctuations between years in some cases. There have been significant increases in Ireland, from around €150 million per annum in the mid 1990s to €230 million in 2004, and in Spain, Italy, Luxembourg,

Austria, Portugal, Finland and the UK since the mid 1990s. By contrast, in Germany and Sweden there has been a significant decline in expenditure. Some increases took place around the time of the switch from headage to area payments and seem to have been motivated partly by a desire to reduce negative impacts on farms which otherwise would have lost out financially as a result of this change.

Total public expenditure on rural development measures was €10.15 billion in 2003. Thus, committed expenditure on the LFA measure in the EU-15 of €2.3 billion approximated to one fifth of total rural development expenditure. The amount invested in the LFA measure varies widely between Member States, however France, Finland and Germany allocate the largest budgetary share to the LFA scheme, more than 30 per cent of the total compared to 12 per cent in Spain and 7 per cent in Italy which also has large areas classified as LFA. Prior to EU enlargement, resources have been concentrated in North West Europe rather than in Mediterranean countries where environmental values are high in many areas and marginalisation more widespread.

### **Compensation Payments**

Since the introduction of Council Regulation 797/85, Member States have had a prominent role in fixing the level of the LFA payment which, in principle, should reflect the degree of handicap affecting farmers. Levels of payment vary significantly between Member States, ranging from a national average payment per eligible hectare of €15 – 55 in Spain, Estonia, Sweden, Poland, Lithuania and the United Kingdom, to €175 – 250 in Austria, Finland and Malta. These average payment rates mask a wide variation in the actual amounts paid per hectare and per farm because payments are differentiated according to multiple criteria as well as varying between eligible groups and categories of LFA in several countries. In 2004, there existed 156 payment rates, and the minimum average rate applied was less than €10 per hectare, compared to a maximum rate in excess of €300 per hectare in certain Austrian and Italian mountain farms.

Under Article 15.2 of Council Regulation 1257/1999, guidance is given for the differentiation of payments according to the situation and development objectives of the region. This reflects the severity of the permanent natural handicap; the particular environmental problems to be solved; the type of production and, where appropriate, the structure of the holding. Following these four criteria, Member States actively differentiate payments, with the exception of Malta, the Netherlands and Estonia which pursue a flat rate approach. A majority define payment rates at the area level and only in Austria and Germany are payments differentiated at the farm level, using criteria based on a detailed land classification system. The most widespread differentiation is related to farm size, with payments typically restricted to a limited number of hectares and/or subject to a declining scale. This has the effect of distributing resources in favour of smaller farms which reflects national socio-agricultural objectives. In most formulations, it reduces expenditure on larger farms achieving some budgetary savings without appearing to prejudice the willingness of larger farms to keep the whole holding under management.

Member States deploy a mix of quantitative and qualitative approaches to measure the severity of the handicap as a basis for determining the level of payment. The process is less systematic than the classification of areas. Payment levels are typically calculated in relation to a baseline - the absence of disadvantage - defined in most cases in terms of agricultural income. This is measured, either in relation to a norm - typically conditions in the national non-LFA - or to previous LFA payments levels or historic income. The fixing of rates is embedded in a matrix of national or regional considerations and does not refer to a consistent European baseline. There is a strong element of path dependency in the setting of payment rates in many national aid schemes, which, while providing stability for farmers, leads to a divergence from the measure's present day focus.

The link between the handicaps conferring the disadvantage, the consequences for farm profitability, and the level of payment is often not sufficiently transparent and there appear to be inconsistencies at a European level. An analysis of several different possible causal factors which might be expected to explain differences between Member States in payment rates reveals low correlations with the actual payments within the EU-15.

In the EU-15, only one variable amongst those tested statistically to display any significant correlation was a measurable, yet indirect proxy of disadvantage. This is the share of Farm Net Value Added (FNVA) per hectare in the LFA compared to the non-LFA in each country. Taken from FADN data, FNVA per hectare reflects a variety of factors explaining productivity on the farm amongst which will be the severity of handicaps. It is effectively a measure of resource income rather than a direct measure of disadvantage, but it allows comparisons to be made with the non-LFA to investigate the relationship between the payments and levels of disadvantage. As expected, the 2004 LFA payment rate per hectare had a negative correlation with the share of FNVA per hectare in the LFA indicating that payments are higher where handicaps are greater (based on the FNVA per hectare proxy of disadvantage). Nonetheless, this explained only about a quarter of the differences in LFA payment rates relative to the apparent disadvantage between Member States.

### **Coverage of LFA Compensatory Allowances**

In the 2000 – 2003 period, the number of beneficiaries of LFA payments was less than half the total number of farms in the areas classified in the EU-15. It ranges from around 90% or greater participation in Ireland, Finland and Austria and the Mountains LFA in Germany, to around 15% in Spain and below 10% in Italy. In most Member States, the proportion of farms within LFAs receiving compensatory allowances is greater in the Mountain than the 'Other' LFAs. The overall pattern is greater participation in North West Europe than in Mediterranean regions partly because of the prevalence of small farms below the minimum size threshold in southern Europe.

A similar pattern arises with respect to land use, with a greater proportion of the Utilised Agricultural Area (UAA) receiving payments in North West Europe than the Mediterranean. More than 90% of the UAA is covered in Luxembourg, Ireland and Finland, around 61% in Germany, 42% in Spain and 35% in France. Less than 20% of the UAA received payments in Greece and Italy.

## **Contribution to Farm Incomes**

Since the core objective of the LFA measure is to sustain agricultural land use, farms need to achieve a sufficient income level to remain viable, accepting that structural change will occur and that land may be managed by fewer people over time. Farm families within the LFA receive income from both agriculture and other activities rendering it difficult to forecast the minimum level of purely agricultural income required over a period of years to maintain farming. In the long run, the income required to sustain agricultural use may be expected to relate to alternative sources of income achievable within the LFA. Parity with agricultural incomes on similar farms outside the LFA is not the goal of the measure although it is sometimes mistaken as such, and some Member State governments do refer to non LFA agricultural baselines in calculating the level of compensatory allowances.

Aggregate LFA payments per Family Working Unit (FWU) represented less than 10% of Family Farm Income (FFI) per FWU in Spain, Greece, Italy and Belgium in 2003, drawing on FADN data. This was also true of the 'Other' LFA in Portugal, France and Austria. By contrast, it was 20 – 30% of FFI/FWU in the Mountain areas of Austria, France and Finland and 45% in the Swedish Mountain LFAs. In Germany, the UK, Ireland, Luxembourg and Sweden it was 20 – 30% of FFI/FWU in the 'Other' LFA, rising to 50% in Finland. Other methods of estimating the income contribution of LFA payments reveal similar variations and a marked North / South divide, although precise figures differ. If payments are expressed as a percentage of mean farm incomes from agricultural sources net of costs, the proportion can rise to well above 40% in some cases. Contributions to agricultural income are more significant for livestock than crop farms in most Member States.

Taken as a whole, the data suggest that while the aggregate contribution to farm incomes is small in many Member States, it is significant in half the EU-15 and likely to be so in many of the EU-10 where FADN data is not collected but average payments per hectare are similar to the Community average. At the same time, although comparisons between similar farms are difficult, a gap remains between aggregate farm incomes in the LFA and non-LFA in most Member States and therefore incomes including LFA allowances fall short of non-LFA incomes.

## **Farm Structures**

Differences in the evolution of farm structures in LFAs and non-LFAs are small over the period 1990-2003, although variations between Member States are quite significant. In addition, no evidence of a large decline of the UAA in LFAs was found. The small differentials in the development of farm structures in LFAs and non-LFAs could, in principle, be attributed to the effectiveness of the LFA measure in slowing down the exodus from farming. However, given that the convergence in the development of farm structures in LFAs and non-LFAs occurred both in countries with high and low levels of LFA payments, it seems likely that LFA policy was only one among a range of factors that contributed to this trend.

## **Maintaining Agricultural Land Use**

Ensuring the continuation of agricultural land use and preventing the abandonment of previously managed land is an overarching objective of the LFA measure. A major threat to the continuation of agricultural land use is the marginalisation or abandonment of land, therefore, an incentive based measure targeted at improving the viability of vulnerable farms through partial compensation is potentially an efficient instrument. Where the threats to the continued use of agricultural land come from urbanisation or afforestation, alternative instruments, including land use planning and redesigned afforestation measures will play a key role. Data from the FSS reveal that the area of land under agriculture has been maintained in the LFA over the period 1995-2003, with minor percentage changes in the Utilised Agricultural Area in certain Member States, explained in part, by amendments to the area classified. In the EU-14 (excluding Germany), the UAA within the LFA was 60.84 million hectares in 1995, falling to 60.41 million hectares in 2003.

Europe-wide data, however, mask some more significant trends at a micro-scale, and the case studies show agricultural land use contracting in some areas and increasing in others. In addition, there is evidence of a progressive withdrawal of agricultural management in some areas, particularly on permanent pasture and steeper slopes. Portugal and Italy are among the countries where such marginalisation could lead to a cessation of agricultural activity.

The continuity in agricultural land use at European level has occurred against a backdrop of structural change unfurling both within and outside of the LFAs, a key manifestation of which has been the rationalisation of holdings and a decline in the number of farmers. The role of the LFA measure in ensuring continued agricultural land use and in preventing land abandonment, however, is not clear cut and there are several reasons for this. First, there is little evidence about how recipients would have acted in the absence of a payment. Second, in certain Member States, a significant number of farmers and farmed areas within the LFA do not receive a compensatory allowance and therefore, there are large areas of agricultural land which continue to be farmed irrespective of the LFA payment. This strongly suggests that complete coverage of the existing LFA is not necessary to maintain agricultural land use. Third, at an aggregate level, the contribution of the LFA payment to farm income is quite small in many Member States, and at most contributes to less than 25 per cent of the total subsidy received by farm households. It is likely, therefore, that in addition to the LFA payment, the contribution to farm income of direct payments, other subsidies, and off-farm income sources is also of importance in sustaining the viability of farm businesses and in turn in supporting continued agricultural land use. Evidence from the case studies supports this.

The LFA compensatory allowance does not operate in isolation from other measures affecting farm viability and agricultural land use. The support measures under Pillar One of the CAP introduced in January 2005 are of particular significance. However, these support measures do not have an explicit land use objective. Other measures within Pillar Two have different objectives and are not sufficiently focused on agricultural land use to offer an efficient alternative to an LFA compensatory measure, although agri-environment schemes, early retirement schemes, investment in

agricultural holdings, and improving the processing of agricultural products, all have objectives which are complementary to those of the LFA measure. As such, it is likely that a mix of instruments is required in order to maintain an appropriate level of agricultural land use in the LFA.

### **Environmental Impacts of LFA Payments**

The LFA measure is targeted at areas with natural handicaps, so the majority are characterised by low-input, low-output farming systems due to the physical and socio-economic constraints farmers face. Consequently, there is a sizeable overlap between areas of high environmental value, especially those dominated by low intensity livestock production, and areas currently classified as less favoured. Few areas have been classified specifically for their environmental value, however, and Member States have made limited use of Articles 16 and 20 to capture these. In any future review of LFA classification, the opportunity should be taken to incorporate criteria which improve targeting to environmental priorities such as High Nature Value (HNV) farmland and valued traditional landscapes.

In areas currently classified as LFA, the processes of agricultural intensification, specialisation, progressive marginalisation and land abandonment represent key threats to environmental value. Several important environmental concerns are addressed by the continuation of agriculture per se but in most cases, the type of management pursued is also essential to meeting environmental requirements. The LFA measure has been part of a set of policies which has proved successful in maintaining farming but with variable results at the more specific land management level. The focus on livestock farms has helped to address the key environmental issue of continued grazing on farms where profitability tends to be low and this has made a major contribution to meeting nature conservation and landscape goals over a significant area. Other habitat types have benefited less from the LFA measure and intensive production is a concern in some areas.

In environmental terms, there have been synergies with other CAP measures with respect to maintaining land management. The LFA measure compliments rather than competes with agri-environment schemes. Conflicts have arisen with respect to intensification, notably the growth in sheep numbers in the 1980s, leading to overgrazing in some areas. However, the transition to LFA area payments in 2000 combined with the subsequent decoupling in Pillar One removed the incentive for overstocking within the measure.

Achieving environmental objectives through the LFA measure requires its application – in terms of eligibility criteria, payment conditions and rates – to be done in such a way as to incentivise behaviour that leads to environmental protection and to target those recipients best able to contribute to achieving such objectives. This implies a more precise targeting on farms where the threat of land abandonment is greatest, and on low intensity systems, with irrigated land generally excluded. Good Farming Practice standards have played a useful role but need to correspond more closely to key environmental conditions within the LFA, including those which relate to soil, landscape and biodiversity concerns, and thereby to promote sustainable agriculture, a

key objective in Council Regulation (EC) 1257/1999. In most cases, the standards set have contributed to a baseline of protection, and not to environmental enhancement.

As the LFA measure has developed over time, additional objectives concerned with sustainability and the environment have been added. Some Member States have responded by classifying new areas or altering eligibility rules and payment conditions. The majority, however have made relatively few, if any, steps in this direction and sought continuity rather than a new focus. There is scope for greater environmental ambition in tuning national implementation rules to the most widespread issues of intensification, specialisation and marginalisation and LFA payments could be more focused on enabling the survival of sustainable farming systems rather than agricultural management per se.

### **Impacts on Rural Communities**

In principle, the LFA measure could contribute to the socio-economic viability of rural communities both directly through the payments received by farmers and indirectly through the maintenance of open landscapes and continuation of agricultural activity. It does not directly promote the diversification of the rural economy.

The LFA compensation payments result in a transfer of about €3.07 billion to recipients in the EU-25 (2004 figures), making a contribution to farm incomes in those rural areas where more vulnerable communities are most likely to be concentrated. Some additional income and employment opportunities will arise from economic activities upstream and downstream of agriculture and from recreation and tourism dependent on open landscapes.

It is difficult to measure the scale of this impact over a large area of farmland in extremely diverse conditions. While there will be positive impacts on the recipients of support, it is not clear that the prolongation of agricultural land use is necessarily conducive to improving the viability of rural communities. Only farmers are direct recipients of LFA payments and although numerous (almost 1.8 million in 2004) they represent only one section of rural societies. Payment structures favour smaller farms in most Member States, which may help to prolong existing agricultural structures and perhaps more traditional rural societies, but not necessarily strengthen longer term viability.

When Council Directive 75/268/EEC was first implemented it was a reasonable assumption that a significant proportion of rural communities in the LFA were economically vulnerable. Rural economies are now much more diverse and complex, with a mixture of dynamic and more affluent communities in some areas including certain mountain regions. Elsewhere there are more marginal societies, including significant parts of the new Member States where economic transition in the countryside has disrupted rural employment. Within the EU-15, the historically low levels of expenditure in the Mediterranean relative to North Western Europe suggests that the measure has not been targeted at depopulation issues or at regions with clear social requirements despite the widespread use of Article 19.

## **Conclusions**

### ***Relevance of Objectives***

The core objectives of the LFA measure are concerned with securing public goods. Under the most recent Council Regulation 1698/2005 the purpose of the measure is to contribute to ‘maintaining the countryside’, through the continued use of agricultural land, and also to ‘maintain and promote sustainable farming systems’. Whilst objectives have evolved over time, throughout the history of the measure payments have been intended to provide an effective contribution to the additional costs of agricultural activities arising from specific handicaps in classified LFAs. Farmers were to be compensated not to bring their incomes up to a given level, such as those outside the LFA, but in order to secure the continuation of appropriate agricultural management.

The LFA objectives remain relevant because to a large extent, the environmental and related public goods that are of value in the countryside stem from appropriate land management, and in particular, agricultural management over large areas. Continued agricultural management contributes most to the countryside where it supports the maintenance of valued open landscapes, semi-natural habitats and biodiversity; it assists in the control of forest fires; or it contributes to good soil and water management. Furthermore, features such as grazed semi-natural grasslands and hillside terraces stem from farming practices.

It happens that the farms and farming systems where these forms of management arise are generally subject to natural handicaps which act as a constraint on more intensive practices. In turn, these handicaps exert an impact on the viability of the farm business and its relative competitiveness. As such, these farms are potentially under the greatest threat from the decline and cessation of management, with a consequent risk of the loss of environmental values. A decline in land management potentially preceding eventual abandonment is reported in several regions of the EU suggesting that continued land management cannot be taken for granted.

On the other hand, the original objective of seeking to prevent rural depopulation through continued agricultural activity has ceased to be relevant in most parts of the EU-15 as the share of employment directly dependent on agriculture has declined. The removal of this from the formal objectives of the LFA measure was therefore appropriate.

### ***Impacts and Effectiveness***

Relatively little farmland in the LFA has ceased to be managed by agriculture. The area of outright abandonment is small although it is not possible to determine this precisely from the data available. Thus the principal goal of the measure has been reached in the EU-15. This contrasts with substantial areas of farmland abandonment in other industrialised countries, for example in parts of the United States.

The LFA measure is one of a number of policies that have contributed to this outcome. It has been most effective on livestock farms, which have been the focus of complementary payments in most Member States and where the contribution to farm incomes has generally been higher. There are variations between farms and Member States in the extent to which LFA payments contribute to incomes and in the income level required to maintain farming. It is difficult to be confident that the payments offered match these differentiated requirements suggesting that there is no uniform pattern of effectiveness. Some farms in the LFA rely heavily on compensatory allowances, or a combination of these and agri-environment payments, but support under Pillar One makes a greater contribution to farm incomes in all Member States.

The measure has been more effective in maintaining land use than in securing the most appropriate forms of management with both intensification and undergrazing significant issues in some areas. Over intensive management in parts of the LFA in the 1980s was attributed to the livestock headage payments that were obtainable under Pillar One market support as well as the LFA. Such pressures have been alleviated by the change from headage to area payments and decoupling in Pillar One.

Changes in agricultural employment since the 1990s have been broadly similar in the LFA to those outside it. This is true of Member States where the application of the LFA measure has been light as well as those where most farmers have received payments. While LFA payments will have played a part in preventing a more rapid decline in the labour force in those Member States where they have been widely implemented, their effect is difficult to separate from other factors.

### ***Efficiency***

In principle, the EU Regulation provides a flexible framework for an efficient system of targeted compensatory payments. The present combination of classification criteria, eligibility rules and payment structures at Member State level, however, does not result in resources being targeted sufficiently precisely on areas where public goods are most apparent and the hazard of abandonment is greatest. Expenditure is skewed towards a limited number of Member States and it is difficult to reconcile payment rates to the severity of handicap at a European level.

This inefficiency in the compensation structures does not mean that the majority of farmers are being over-compensated for handicaps. Indeed large areas of land receive no compensatory payments and FADN data relating to FNVA per hectare, itself a rather crude indicator of relative disadvantage, suggests that compensation levels in the EU-15 are below what might be expected given the handicaps in many cases.

To improve efficiency, the wide scope of the measure could be reduced to focus more on areas at greatest risk and where the benefits of continued agricultural land use are most evident. In addition, greater clarity could be sought about the relationship between the intensity of the handicaps faced and the level of payments, accompanied by the development of more transparent payment calculation formulae.

### ***Future Role of the LFA***

The objectives of LFA policy have always been different from those of other policy measures within the CAP. With the advent of decoupling and support for farmers under the Single Payment Scheme (SPS), there is more convergence between Pillar One and LFA compensatory allowances. The SPS is not connected to specific types of production, takes the form of an annual area payment, and is subject to cross-compliance, including the obligation to keep the whole farm in 'Good Agricultural and Environmental Condition' (GAEC). This is intended to prevent under-management and abandonment on all farms receiving the Single Payment. It provides a good opportunity to review the role of the LFA.

Complying with GAEC is potentially more onerous for farms in the LFA where the presence of handicaps is often associated with low yields and returns per hectare, while the potential for scrub invasion and land marginalisation is relatively high. Progressive abandonment on the less productive land in the LFA is more probable than elsewhere. By contrast, however, the Single Payment generally will be lower per hectare than on farmland outside the LFA because of low historic yields. The Single Payment per hectare is therefore likely to be lowest in regions where continued agricultural land management is most important from an environmental perspective and where marginalisation is most probable.

Hence there is an argument for focusing LFA policy in future on compensating farmers in such regions for continuing with land management in the face of handicaps and increasing legislative requirements. As such, payments need to be concentrated on areas where there is a clear need for agricultural management and there are genuine risks of abandonment or inappropriate land use change. The criteria for selecting areas and the rules governing eligibility and payment structures need to be adjusted to support this more explicit objective. The current objective of supporting sustainable agriculture in the LFA remains relevant but should give rise to more specific environmental conditions, relating directly to handicaps and the required form of management, including limits on stocking densities.

A revised measure of this kind would not overlap to any significant degree with agri-environment measures which are distinctive in that they apply potentially to all farms irrespective of whether they are in the LFA and they provide compensation for a range of prescriptions, many unconnected to natural handicaps. Furthermore, they are negotiated on an individual farm basis, whereas a revised LFA would be based on relatively simple rules applying throughout a specific region, underpinning sustainable farming rather than guiding management more precisely.

## **Recommendations**

This evaluation has focused on the implementation of Council Regulation 1257/1999 and its predecessors. Looking ahead, LFA policy will continue within the framework of the new Rural Development Council Regulation 1698/2005 but with the provisions of 1257/1999 unchanged until January 2010.

The fundamental objectives of the LFA measure as cast in Council Regulation 1698/2005 remain relevant to the needs of substantial areas of the farmed countryside

in the EU. Payments in areas with handicaps should contribute, through the continued use of agricultural land, to maintaining the countryside as well as sustainable farming systems. This is in the public interest and is compatible with the Community's wider rural development and environmental goals.

The LFA measure provides a useful mechanism for pursuing these goals and has a distinctive role alongside other policy instruments embodied in the CAP. Nevertheless, there is scope both in the shorter and the longer-term to improve the effectiveness of the measure.

On the basis of this evaluation, the following recommendations can be put forward:

- A more explicit approach is needed to ensure coherence in the application of the LFA measure with respect to the mechanisms and objectives of the Single Farm Payment.
- With a view to the renewed focus of LFA policy on 'maintaining and promoting sustainable farming systems' (Recital 24, Council Regulation 1257/1999; Recital 33, Council Regulation 1698/2005), the criteria for the classification of LFAs as well as the eligibility criteria need to be revised in view of adapting them more precisely to recognised environmental priorities and region-specific land management requirements.
- Given the high degree of path-dependency in establishing payment levels perceived today, a fresh approach is needed to revising payment levels to better reflect the handicaps to be compensated for.
- Clarification needs to be sought regarding which classification criteria of LFA areas should be applied at the EU level and what degree of discretion should be left to the Member States. In particular, this clarification is needed for the criteria concerning Articles 19 and 20 where, for the time being, only a few criteria exist which are comparable at a European level.
- Better guidance is needed on the measurement of handicaps, the use and interpretation of baselines, and the presentation of compensatory payment calculations in order to afford a more effective and transparent implementation of LFA policy in the future.
- Given the political concern about land abandonment and the central goal of LFA policy to maintain land under agricultural use, it is recommended that approaches to the collection of land use and management data with greater sensitivity to abandonment are investigated, with data collected on a regular basis.