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Title:

Is Less Favourable Areas support a good value for money? Comparative regional CGE analysis

Abstract

The paper examines one of the most controversial measures within Rural Development Plans across the EU countries – Less Favourable Areas (LFA) compensations – and discusses its regional economic impact.

The controversy of the measure stems mainly from three facts: -) it takes the second highest share of the budget devoted to rural development in the EU while its impact on the development is not convincingly prooved; -) its objectives have been changing and proliferating over time yet not aiming into a clear direction; -) the form of this compensation was supposed to be decoupled but the extent of this decoupling was not fully investigated yet. The paper aims to feel in the gaps by investigating the case study of 20 regions in Finland (NUTS 3) and 16 regions in Poland (NUTS 2) over the years 2004-2006.

The methodology applied in the paper is based on two identically structured regional computable general equilibrium (CGE) models, called RegFIN for Finland and RegPOL for Poland. They are classical CGEs for small open economies, with constant returns to scale and perfect competition assumed. They are running on official data from Statistical Offices, in form of regional Input-Output tables and Social Accounting Matrices with domestic cross regional trade explicitly estimated by authors.

The main findings of the paper indicate that, LFA compensation:

- capitalized in **land rents** (causing their increase by 22% in Poland and by 8% in Finland) and pushed up **land prices**
- increased the **agricultural prices**, with the mostly affected urban regions Uusimaa (by 4%) and Śląskie (by 9.4%) and made a pressure on food price increase
- are in fact **decoupled** to high extent, so only slightly affected farmers' decisions on **agricultural production**. At the national level both Finalnd and Poland reduced slightly production (by 0.7% and 1.5% respectively) but on the regional level, in Poland the predominantly rural regions increased production while more urban regions reduced it.
- has no effect on **migration** and a negligible effect on **employment**
- made a pressure on a minor **wage** increase (by 0.2% in Finland and by 0.4% in Poland)
- caused a positive but negligible **economic growth** in 5 Finnish regions (from 0.03% to 0.21% in long run) and larger positive economic growth in 9 Polish regions (from 0.03% to 0.82% in long run).

- was the most **efficiently** used measure in the most rural regions both in Finland and Poland

As for policy recommendations, LFA support should be reconsidered during the CAP summit, because this type of area payments proved not the most efficient mean of rural development, e.g. much better are investment subsidies. Not only the economic growth effects are small but there are also some undesirable side effects (inflationary pressure, land price peaks, etc) which make this instrument even less desired. It has a "political value" because of its relative easiness, causing a high uptake by farmers, but its "economic value" is rather questionable.