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**THE COMMON AGRICULTURAL POLICY'S SECOND  
PILLAR: THE ROLE OF PUBLIC SUPPORT FOR  
VOLUNTARY COLLECTIVE ACTION**

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# THE COMMON AGRICULTURAL POLICY'S SECOND PILLAR: THE ROLE OF PUBLIC SUPPORT FOR VOLUNTARY COLLECTIVE ACTION<sup>1</sup>

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## **1. Introduction**

This paper makes suggestions for the next step in CAP reform to **complement the Bond Scheme proposal** (Swinbank & Tangermann, 2000). More precisely it makes suggestions about the use of part of the funds that could be released if the CAP reform were to follow the Bond Scheme proposal. The proposals discussed here would enhance the environmental and rural development programmes (ERDP), the so called “second pillar” of CAP.

## **2. Complementarities between the Bond Scheme proposal and the "second pillar" of CAP**

There are two justifications for presenting this paper as a complement to the Bond Scheme proposal:

- the first is related to the **direct complementarities** between the Bond Scheme and the "second pillar" of the CAP:
  - o the adoption of a Bond Scheme would release budget funds which raises the question of what should be done with that money (Should it be retained for continuing support to rural areas and, if yes, for what kind of support? Or should support for rural areas be discontinued?);
  - o the adoption of a Bond Scheme could be resisted by those appealing to "rural development" concerns (risk of increasing land idleness and rural desertification);
- another reason is related to **political trade-offs** rather than direct complementarities between the Bond Scheme proposal and the "second pillar" of CAP.

The issue here is that the discussion of a Bond Scheme, or any other type of proposal to change the current system of direct payments, necessarily raises the issue of a broader policy reform than the one addressed by those proposals. Rural development and environmental issues would almost certainly be a part of that broader framework of policy reform.

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<sup>1</sup> The motivation and the contents of this paper owes to the discussions with the other partners during the course of the BONDScheme project. Special thanks are due to Alan Swinbank for his comments and editorial improvements to the previous draft version of the paper.

### 3. Scope of the paper

The Bond Scheme proposal (Swinbank and Tangermann, 2000) acknowledges those complementarities and endorses the proposals of the Buckwell Report (Buckwell *et al.*, 1997) as appropriate mechanisms to deal with them. Since the purpose of the Bond Scheme proposal was not to deal in detail with those complementarities it did not go further than endorse the Buckwell Report. Our purpose here is to elaborate on an important issue that is referred to in that report, but not dealt with in detail, which is crucial for the type of policy instruments contained in the second pillar of the CAP. These are what we will call "**voluntary collective action**" issues, as mentioned in the following passage:

*"A purposeful action programme is required to stimulate the bringing together, training and encouragement of local authorities, regional authorities, interest groups such as farmers and landowners, and relevant NGOs."* (Buckwell *et al.*, 1997, p. 76)

### 4. Voluntary collective action issues: the "absenteeism problem"

Voluntary collective action issues have strong ties not only with the contents of the CAP's second pillar (rural development and environmental protection) in itself, but also with this pillar viewed in combination with a reform of the first pillar along the lines of the Bond Scheme.

We will begin by analysing this second issue which we will refer to as the "absenteeism problem". Some people legitimately fear that a policy reform like the Bond Scheme will raise two problems:

- one is that it will facilitate the exit of farmers who, in some regions, will not be replaced by larger and more efficient farmers, but instead result in increasing land idleness and more rural desertification;
- another problem is that those farmers and landowners in receipt of bonds who decide to sell their land or leave it idle will not be reinvesting those funds in agriculture, nor even necessarily in the rural areas.

This is what we call the "absenteeism problem". It is an empirical issue to determine how serious this problem might be and where is it more likely to arise. To undertake this kind of empirical forecasting with a good chance of anticipating what is actually going to happen is not an easy task. However acute this problem might be, what we can say for sure is that the **expectations** of increasing land idleness and more rural desertification resulting from a Bond Scheme **exist**, and have to be minimized, if one wants to make this proposal politically and socially accepted.

Since the "absenteeism problem" is a relevant one, why does it involve voluntary collective issues?

Absenteeism is not an unfortunate genetic and fatal feature of some farmers and rural landowners. If, with the Bond Scheme, they decide to sell their land or to increase land idleness it is probably because **they do not expect there will be an attractive enough commercial opportunity in which** to invest part or all that money in their original rural area. Past and current trends of rural desertification in those areas without prospects of future rural development initiatives will certainly contribute to raise that type of expectations. To create momentum for development and reverse those negative expectations, a "**growth mentality**" **has to be engendered**, to use Hirschman's words (Hirschman, 1958). Such initiatives cannot be limited to scattered individual projects. They have to be more **comprehensive** efforts engaging, in a **collective** way, individual

private entrepreneurship, organised interest groups, and public authorities at the local, regional and central level.

The connection between the "absenteeism problem" and voluntary collective action is not reduced to the expectation issues mentioned above. There is a more direct connection in most of the less favoured rural areas. In these regions we find very often the following factors impeding local reinvestment of the income earned by landowners, farmers and other people with rural interests:

- in many instances rural activities have a relatively small economic size;
- there is insufficient provision of services (accounting, technological assistance, training, market information, etc.) to the firms at the local level.

What has been observed in several regions facing this type of problem is that landowners, farmers and other people with rural interests respond positively in terms of local reinvestment of their income when they find what we will call here "**catalysers of voluntary collective action**". These catalysers can be very diverse: individuals, NGOs, local or regional public authorities, etc. What they have in common is they help local people overcome **transaction costs** in the following domains:

- they help small business entrepreneurs to engage in partnerships with other small businessmen in order to take advantage of economies of scale and scope;
- they help to set up services to small businessmen in the domains they need most to develop their activities;
- they help small businessmen and other local people and institutions build up an awareness of their common interests.

## 5. Voluntary collective action issues: the "**multifunctionality problem**"

In the talks about the CAP's second pillar, and in the agricultural trade negotiations, the issue of multifunctionality has taken a prominent position. Agriculture is viewed as a **joint production** activity of marketable goods and positive externalities with a public goods nature. These public goods include: protection of biodiversity and environmental quality, cultural landscape and cultural heritage, viability of rural areas, etc. For some people, the fact that these public goods are provided by farmers as a by-product of their normal farming activities justifies **public direct payments** to the farmers. For those who oppose this type of payments, the argument is that they can be a disguised form of continuing farm income support with distorting effects on agricultural trade when those payments are not fully decoupled from production. Furthermore they are paid on a flat-rate basis regardless of whether or not additional costs are incurred by individual farmers, or the public goods are in fact supplied.

Even though one can find ways to justify production coupled public payments to internalise externalities which are not trade distorting, and therefore are WTO compliant (Paarlberg *et al.*, 2000), this is not a settled issue. Even if there was agreement at a theoretical level on some kind of non trade-distorting environmental payments, the practicalities of their design and implementation are not an easy task. Just to mention some of them:

- the identification of the externalities and public goods to be paid for by society;
- the need for agreement on common methods of economic valuation of agriculture's environmental services;
- determination of the marginal costs and benefits of the environmental services in order to specify the optimal level of the payments which is contingent on the choice of a social welfare function and on the knowledge of the technical relationships between farm production and environmental externalities;

- monitoring of farmers' compliance with the environmental standards required to receive the payments, and the moral hazard problems that might arise in this matter, etc.

Another problem with direct **public** environmental payments to farmers is that a strong case needs to be made which not only demonstrates that farmers make **more** of a non-market contribution to social welfare than other producers (Anderson, 2000), but also that this contribution cannot be compensated by **voluntary private** contributions. To settle the first part of this problem involves all the difficulties mentioned before about the practicalities of implementing environmental payments to farmers, with the same type of problems for assessing the economic value of non-market contributions by other producers.

We will deal later with the important issue of the existence or non-existence of voluntary means to internalise agriculture's positive externalities.

Still another problem with public direct payments is that a case should be made to demonstrate that they do not involve "**government failures**" more serious than the market failures they are supposed to correct. Government failures are very likely to arise because of the following issues, some of which were already mentioned before:

- the "**microdecoupling**" (Wolf, Jr., 1993) between the particular group who receives the payments (the farmers) and the broadly dispersed group of taxpayers who carry their burden;

- the **difficulty of defining and measuring in a commonly agreed and transparent way the output** of environmental services to be purchased (Wolf, Jr., 1993);

- **moral hazard** problems related to monitoring farmers' compliance with environmental standards.

Most of the theoretical discussion and policy proposals related to multifunctionality, including the Buckwell Report's "Environmental and Cultural Landscape Payments" (ELCP), are direct public payments aimed at the internalisation of externalities. Therefore they face all the problems we raised before. What has received much less attention in the theoretical and policy discussions related to multifunctionality are voluntary collective action solutions to the internalisation of externalities and the production of public goods. What we are suggesting here is simply to go back to Ronald Coase's seminal paper (Coase, 1960) calling attention to the possibility of internalisation of externalities through private bargaining between generators and recipients of externalities when property rights are well defined and bargaining costs are low. For this kind of internalisation to be possible public intervention might be needed, but it is an **indirect intervention** much less prone to the "government failures" that arise with direct public payments. The indirect public interventions which might be needed to facilitate voluntary collective action are the following:

- laws or other public regulations to define and guarantee property rights to the interested parties;

- financial and/or technical assistance to "**catalysers of voluntary collective action**" which lower transaction costs of bargaining by helping the private interested parties to get together and establish forms of voluntary internalisation of the externalities.

In the LEADER programme, and in other local development initiatives, there is a wide array of successful projects where payments for the protection of environmental quality and cultural landscape are being made to institutions providing these services by concerned citizens, tourists or other visitors. For these projects to get started the kind of

public intervention that was needed was some **initial financial or technical assistance** for creation of those local development associations. The level of this public support may decrease over time as these associations become more able to provide marketable services jointly with their services with a public goods nature.

To close this discussion, let us sum up the advantages of indirect public intervention for the internalisation of externalities through financial and technical assistance to voluntary collective action catalysers compared to direct intervention through direct payments to farmers:

- it can be made **WTO compliant** more easily than direct payments;
- there is no need for the public administration **to evaluate the externalities** that are going to be internalised;
- the "**microdecoupling**" **problem** will be much less severe because those who bear the burden of providing environmental and cultural landscape services are mostly the same as those who will receive the voluntary contributions and payments for such services, and those who benefit from these services are mostly the ones who pay for their costs;
- the **moral hazard problem** of complying with the environmental standards is much less severe because the voluntary contributions and payments are conditional on the contributors and other payers observing that those standards are met.

## 6. Further arguments in favour of voluntary collective action support<sup>2</sup>

In the previous sections we called attention to the fact that most of what comes under the umbrella of CAP's second pillar has to do with the provision of public goods and positive externalities with a public goods nature. Since the efficient provision of these kinds of outputs needs some form of collective action (bargaining schemes, partnerships, local development associations, producer groups, etc.), we came to the conclusion that the support for these forms of organisation should be given an important place in the CAP's second pillar policy mix.

This proposal implies some **substitution of taxpayer (or at least EU Budget) funding by "user" or local community funding** of rural public goods provision. All these "users" do not have to be local. That depends on the geographic level of consumption of the public goods (pure or with exclusion):

- some are **local** or **regional** such as forest fire prevention and suppression, protection of local watersheds, landslides and avalanche protection, soil conservation and erosion control, local parks, landscape quality protection, microclimate regulation, outdoor recreation;
- others are **national** like protection of watersheds of national importance, national parks;
- there are also some which are **global** such as biodiversity protection and global warming prevention through forestry, protection of world heritage cultural values.

Local public goods provision and internalisation of externalities can be appropriately accomplished by instruments such as local taxes, charge systems (user fees, pollution and betterment charges, impact fees) or voluntary contributions of local users.

National or global public goods can be paid through national and international mechanisms which might appeal to taxpayer funding, but also to international donors

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<sup>2</sup> I thank Alan Swinbak whose remarks triggered and inspired this section.

and even to some innovative forms of market creation for global public goods provision (for example, the markets for carbon sequestration in line with the Kyoto protocol).

Also we should not forget the contributions of farmers and other rural producers themselves which can be triggered by those forms of organisation. In fact, it is not rare to find in "poor" regions that they are not that poor in terms of financial capital. Often local banks have considerable amounts of savings accounts of local residents. What those regions lack most is **human and social capital** of the kind than can be provided by local development associations, producer groups, and other forms of collective action. If farmers and other rural producers, instead of coping individually with all the barriers to the development of their economic activities in those "poor" regions, can find support to have access to **knowledge production** (research and development) and **knowledge management** activities (technical training, extension, exchanges of experiences), **appropriate input supplies**, **easier access to national and international markets** they may be more willing **to reinvest their savings locally** instead of placing all that money in savings accounts.

Finally, it is important to remember the fact that public goods provision may be the source of **increasing returns to scale**, generators of **endogenous growth**.

So, even though our proposal does not have to lead to a total substitution of user and local community funding for taxpayer funding, it certainly contributes **to lower the burden of rural development policy on public budgets** and to engender mechanisms of endogenous growth.

This being said, it is important to note that we don't advocate the total scrapping of taxpayer funding of rural development policy. Among the several instances where this type of funding is necessary, we would like to point out two. One may look contradictory to what we advocated before. In fact, we think that most of the possible forms of organisations for collective action in rural areas **need a continuing, sustainable and predictable flow of taxpayer funding**. In most cases this public support should be **generous in the initial years** of life of those organisations, **declining** after that, as they become more capable of providing marketable services and raising private contributions from local, national and international donors. Allocation of public funding subject to appropriate monitoring should remain as a **safety net** justified by the public goods nature of some of the outputs of these organisations.

Another reason for taxpayer funding is that in some **more remote regions** it might take a long time to raise the local demand and the local capital up to the point of making those organisations and their members less reliant on public funds.

## 7. Problems with voluntary collective action

Even though voluntary collective action for the internalisation of externalities and the provision of public goods has advantages with respect to public direct payments to the individual generators of those positive externalities and public goods, it also faces serious difficulties in implementation. Some of these difficulties are the following:

- voluntary collective action is in itself the production of a public good and therefore the **"free rider problem"** arises;

- when voluntary collective action is structured in the form of a non profit organisation, the **absence of a market test** together with **moral hazard problems** impeding the members from perfectly observing the behaviours of the organisation leaders, can be the cause of serious inefficiencies.

## 8. Some recommendations for successful voluntary collective action solutions to the "absenteeism problem" and the "multifunctionality problem"

Olson (1971) has drawn attention to the possibility of generating voluntary collective action in the provision of a public good. That can be done if the organisation responsible for that provision jointly provides **private** services to their members, that is, what Olson calls "**selective incentives**". There are many examples in rural development projects where some private organisations (local development associations, producer groups, etc.) successfully manage to provide **public** goods (representation of the interests of the members, promotion of the public reputation of some product, etc.) combined with the provision of **private** services (technical assistance to production activities, marketing services, etc.) to their members.

Other authors (Oliver, Marwell & Teixeira, 1985; Oliver & Marwell, 1988) called attention to the fact that if the technology of the production of a public good has **increasing marginal returns** the existence of some start-up contributors will attract an increasing number of other contributors with lower willingness to pay for the public good. One form of useful public intervention in this case could be to provide for those start-up contributions which could trigger private contributions afterwards.

Drawing on our own research (Mendes, 1998, 2001) on non profit organisations which **jointly provide a public good and private services** to their members, like Olson's "selective incentives", we can make the following recommendations about the conditions that should be met by the organisations targeted for public support (technical and/or financial assistance) in the provision of rural public goods:

- the organisations should provide not only public goods, but also **private services ("selective incentives")** to their members;

- if the members only contribute to the organisation with **fixed membership fees**, independent of the amount of services they get from the organisation, the board of directors has a "dominant strategy" (what they decide to do is independent of their members' decisions in operating their private businesses, and therefore there is more room for "moral hazard problems" such as directors behaving opportunistically when members cannot control well their behaviour) so that the organisation might not be successful in stimulating less absenteeism in their members;

- to reduce the absenteeism problem one condition that should be met is **to relate the contributions the members pay to the organisation to the amount of private services the organisation provides to them;**

- the condition mentioned above has to be supplemented by the fact that the services provided by the organisation to their members should be **technically complementary** (increases the marginal productivity) to the time each member spends in managing his private business.

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