The Political Economy of EU Agri-environmental measures: An empirical Assessment at the Regional Level

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Abstract—**The paper deals with the political economy determinants of EU agri-environmental measures (AEMs) applied by 59 regional/country units, during the 2001-2004 period. Five different groups of determinants, spanning from positive and negative externalities to political institutions, are highlighted and tested using an econometric model. The main results suggest that AEMs implementation is mostly affected by the strength of farm lobbies, political institutions and the demand for positive externalities. On the contrary, AEMs do not seem implemented by the willingness to address negative externalities.**

Keywords—**Agri-environmental Measures, Political Economy, EU Regions**

I. INTRODUCTION

Agri-environmental measures (AEMs) are the most important rural development instrument in terms of both financial expenditure - about 44% of the Pillar II CAP money - and land coverage area - 25% of EU utilized agricultural area. As an effect of this prominent role and because of their particular nature, AEMs represent one of the most debated instruments of the new CAP. For example, the European Commission underlines the positive effects of AEMs, claiming future expansion. By contrast, sceptics express doubts regarding their genuineness, accusing them of disguising agriculture protection (Anderson, 2000; Swinbank, 2001).

Two broad objectives are formally assigned to AEMs by the ruler: i) reducing environmental risks and ii) preserving nature and cultivated landscapes (EU Commission, 2005). Thus, the question arises of whether AEMs real driving forces correspond to those declared by EU legislators or, whether, differently, other 'hidden' determinants affect their implementation.

Making an attempt to better understand the real motivation behind agri-environmental schemes, this paper proposes a political economy analysis of the AEMs implementation determinants, focusing particularly on their political bargaining process. From this perspective, few papers have systematically investigated the issue (see Baylis et al., 2005, 2006; Salhofer and Glebe, 2004) and, more importantly, they have treated the problem only at a national level. However, it is important to note that EU legislation allows MS to design schemes at the national or regional level in order to adapt schemes to the different farming systems and environmental conditions. Thus, since AEMs are established at the regional level Regions, not Member States, are the relevant decision-making units of the analysis.

Our paper covers the implementation of all 59 agri-environmental programs of the EU-15 members from 2001 to 2004. Apart from focusing on the effective units of analysis, we also try to better characterize some important dimensions of the AEMs political bargaining process, by highlighting the important role played by political institutions. Specifically, the analysis tests five main hypotheses about the driving forces leading AEMs diffusion: *i)* agricultural political weight, *ii)* negative externalities limitation, *iii)* positive externalities social demand, *iv)* public budget constraints, and finally *v)* political institutions.

The remainder of the paper is organized so that the next Section reviews the evidence from previous literature, while Section 3 puts forward our key testable hypotheses and the model specification. Section 4 presents the results.

II. PREVIOUS EVIDENCE

Only a few papers have investigated the determinants of AEMs from a political economy perspective. Indeed, to date, this approach has been adopted by Baylis et al. (2005, 2006) and Sahlofer and Glebe (2004, 2007). However, although related to local compensation payment for providing landscape amenities, Hackl et al. (2007) offer a convincing interpretation of the political bargaining process of agri-environmental policies.

Starting with the US and EU diverging attitudes towards agri-environmental policies, Baylis et al. (2005, 2006) analyze the economic and political determinants of AEM expenditure of EU countries, from 1993 to 2003. The authors investigate the extent to which AEMs are driven by genuine objectives to reduce negative externalities and by

satisfying public demand for landscape amenities or, differently, how they are a disguised attempt to support farmers' income. The paper proposes four plausible policy scenarios (or 'lenses') for which AEMs could be encouraged. In the *pollution lens* AEMs aim at reducing agriculture environmental impact, while in the *green demand lens* they correspond to social request for positive externalities. Other scenarios are represented by the *budgetary lens* in which is hypothesized a partial substitution of traditional farm income support with 'green' labeled instruments, and by the *cynical lens* in which the only purpose is to merely maintain traditional farming subsidies.

Analogies with the above mentioned approach can be found in Glebe and Sahlofer (2007), who aim to understand the heterogeneity in the uptake of AEMs across EU countries. They empirically test a political preference function model on AEMs implementation between 1998 and 2002, focusing on factors like environmental benefits, agricultural lobby influence, private costs of adhesion, and both national and EU budget pressure. The latter determinant is strictly related to the so-called 'restaurant table effect', for whom non-cooperatively acting countries split co-financed policy costs among other contributors, thus determining total public-resource overspending (see Pokrivcak and Swinnen, 2004).

Hackl et al. (2007) modeled the political bargaining process related to Austrian local agri-environmental programs. Considering factors affecting this process, they stress the role of transaction costs existing within and among categories of involved stakeholders (farmers, beneficiaries and politicians). Environmental benefits, opportunity costs, structural differences and budget constraints have also been taken into account. A key advantage of the Hackl et al. study, over the previously mentioned papers, is its focus on the *local* actors responsible for the decision and implementation of the agri-environmental policies. Indeed, a national focus may mask several key details that could be very important in the analysis of AEMs, given their particular nature of site-specific policies.

III. HYPOTHESES, DATA AND SPECIFICATION

Starting from the previous evidence, we advance, in what follows, some hypotheses on the most influential factors potentially affecting AEMs intensity across EU regions. To organize the discussion we focus on five broad determinants: i) agricultural political weight, ii) negative externalities limitation, iii) positive externalities demand, iv) budget constraints and, last but not least, v) political institutions. It is important to observe that these hypotheses are not mutually excludable.

A. Hypotheses and explanatory variables

Hypothesis 1: *AEMs implementation should be positively affected by agricultural political weight.*

Generally speaking, the agricultural lobby strength is characterized by its ability to seek public transfers. Thus, we expect a positive relationship between Pillar I and AEMs expenditure. To construct our key proxy to capture the farmers' political weight we use the total regional transfer to the agricultural sector (price support plus direct and other payments) as a share of the regional agricultural gross value added at basic prices (EU Commission, 2001). Moreover, to better capture the strength of the farm lobby we also include the agricultural labor share, land inequality[1], the female and young farmers share. The first two variables make it possible to control for traditional factors like relative group size and sector heterogeneity, both elements that affect the transaction costs of the political bargaining process. Differently, the female and young farmers share are indicators of higher environmental sensitivity and a better education level (Hackl et al., 2007).

Hypothesis 2: *AEMs implementation should be positively affected by the level of agriculture negative externalities.*

Agri-environmental schemes provide economic compensation for those farmers who choose to adopt more extensive agricultural methods, in order to reduce negative externalities. In such a scenario, intensive farming areas represent the most suitable target for measures (European Commission, 2005). Hence, to confirm the assumption that reducing agricultural pollution is an AEMs key objective, we expect a positive correlation with agricultural productivity linked variables. On the other hand, intensive farming incurs higher opportunity costs in complying with program commitments, thus discouraging adhesion. In line with previous literature, the intensity of agricultural production is measured by three proxies: regional average yield of wheat, regional nitrogen surplus, and the share of pasture and permanent grassland over the whole agricultural area. AEMs payments are calculated on the basis of the additional costs and the loss of income involved in complying with environmental standards beyond a reference baseline. These baseline requirements, called Good Farming Practice (GFP), represent the minimal environmental quality standard from which a farmer's efforts are compensated. As GFPs are not univocal, but are defined

1. Land inequality is measured by the Gini index of operational agricultural land holdings, based on Eurostat data.

locally, it is conceivable that a high degree of environmental compliance might act as a deterrent to the farmer's involvement in AEMs. To quantify the GFPs level we use the European Environment Agency (EEA) IRENA project indicators and, particularly, IRENA 02 indicator 'Regional levels of good farming practices'.

Hypothesis 3: *AEMs implementation should be positively affected by agricultural positive externalities social demand*

Social demand for agricultural positive externalities and, more generally, for environmental amenities is linked to individual economic welfare. Thus, our primary proxy for the demand of positive externality is the regional GDP per-capita in real terms.

However, because this variable only imperfectly captures the social demand for environmental goods, other proxies have been included in the analysis. Tourism intensity, which is captured by the rate of tourism arrivals per 1,000 inhabitants, should approximate the direct landscape fruition. Moreover, access to an information network, measured as internet users per 1,000 inhabitants, might indirectly approach similar concerns. Other relevant proxies used to disentangle the demand for positive externalities are the severity of environmental legislation and the green voters share. Moreover, the last variable also proxies for political pressure from environmentalist lobbies. Following Baylis et al. (2006) environmental legislation is measured by the EEA (2005b) ranking, that classifies countries with a score from 1 (worst) to 5 (best). The Regional green voters share was built starting from the 1999 European Parliament Elections.

Hypothesis 4: *AEMs implementation should be affected by public budget constraints*

Following the Glebe and Sahlofer (2007) paper about the AEMs co-financing system, we tested the 'restaurant table effect' by taking into account the 'regional contribution' to the whole EU budget, proxied by the share of regional GDP on EU-15 GDP. In order to smooth the strong regional/national size differences we express such variable in a logarithmic form.

The regional/national budgetary pressure linked to the adhesion to agri-environmental measure is closely related to the public budget deficit, configuring itself like a public administration opportunity cost (Glebe and Sahlofer, 2007). Due to the lack of data on regional deficits, the budgetary pressure variable is indirectly based on the previous five years average regional growth rate. An analogous meaning is attributable to the variable indicating the share of farms located in less favoured areas (LFA).

Hypothesis 5: *AEMs implementation should be affected by political institutions.*

AEMs regional implementation has many points in common with EU Structural (or Regional) policies. One of these is represented by the chance to define the policy intervention at the regional level, thus involving local political bargaining, in addition to national and communitarian bargaining. From this perspective we follow Kemmerling and Bodenstein (2006) in indicating the strong influence of political partisanship in regional funding allocations. These authors refer to a positive effect of left and euro-sceptic partisan ideology in the regional redistribution of EU Structural Funds. These effects are respectively motivated by left-wing parties' traditional preference for redistributive public expenditure and by the attempt to compensate EU integration process losers or, in other words, voters who gain little benefit from the Common Market or Monetary Union. Moreover Hackl et al. (2007) find a positive relationship between AEMs intensity and left parties' share. In their opinion, such results could reveal discontinuity in innovative agri-environmental contracts from long-established income support instruments, put forward by political groups to whom farmers traditionally refer, like conservatives. These predictions are tested by using the 1999 European Parliament Election results referred to each of the AEMs territorial units. Following Kemmerling and Bodenstein (2006), if we point our attention to left ideology or euro-sceptics, we can include in these categories those parties enrolled in specific European Political Groups.

Strictly related to party competition is the mean electoral district magnitude, i.e. the average number of Members of the Lower House elected in each constituency. On the one hand, the larger the district magnitude, the greater the probability for minority parties without territorial concentration, like environmentalists, to obtain political representation. On the other hand, the literature on comparative politics (see Persson and Tabellini, 2000) suggests that majoritarian elections, characterized by small district magnitude, tend to be associated with political incentives directed towards local public goods. This variable, collected at the national level, comes from the World Bank Database of Political Institutions (Beck et al., 2001).

B. The dependent variable

The basic data to measure AEMs intensity are extracted from the Common Monitoring Indicators collected by the UE Commission for the programmes' evaluation process. For each European country, AEMs have been drawn up at the geographical level, deemed as the most appropriate.

Following this prescription some States have implemented schemes at the national level, while others realized regional programs. At the former level we find France, Ireland, Sweden, Austria, the Netherlands, Greece, Denmark and Luxembourg. Instead Germany, Italy, Belgium and the United Kingdom, in relation to their institutional differences, chose to apply AEMs regionally. Overall, to explain the main economic and political constraints on the implementation of agri-environmental measures, we use data from 59 EU territorial units observed for the years from 2001 to 2004. Thus, our panel has a total number of 236 observations.

The AEMs implementation intensity is expressed as the ratio between agri-environmental payments and agricultural gross value added . This choice is motivated by two main considerations. First, the heterogeneous nature of agri-environmental measures, where, for example, several schemes could cover the same surface, have generated problems of double counting in quantifying the physical share of the total utilized agricultural area under agri-environmental commitments (see EEA 2005a). Thus, a measure based on the effective expenditure overcomes such problems. Moreover, by measuring AEMs intensity in terms of expenditure on agriculture value added, we stay close to the literature that has investigated the determinants of agricultural support using endogenous variables, like producer subsidy equivalent.

Table 1 shows a statistics summary of the explanatory variables described above.

Table 1. Descriptive statistics

	Mean	Maximum	Minimum	Std. Dev.
Dependent variable				
AEMs Intensity	3.12	20.14	0.16	3.34
Agricultural political weight				
Pillar I expenditure	36.46	88.94	2.80	17.61
Agricultural labor share	4.61	14.95	0.36	3.41
Agricultural labor share squared	21.28	223.59	0.13	11.60
Land inequality	58.69	82.03	2.72	12.59
Female	20.46	41.88	7.65	9.95
Young	10.77	18.63	3.89	4.06
Negative externalities limitation				
Nitrogen surplus	56.36	202.00	9.00	44.92
Yield	5.14	9.81	0.84	2.45
Pasture	37.91	99.13	0.92	24.73
Level of good farming practices	59.12	82.00	33.00	9.50
Positive externalities demand				
GDP per capita	24,385.00	59,778.79	10,5636.31	7,873.91
Tourism intensity	1,895.72	10,000.40	504.00	1,745.01
Green voters share	4.71	22.61	0.00	4.60
Environmental legislation	2.85	5.00	1.00	1.46
Internet	25.86	45.60	9.20	7.02
Budget constraints				
Region GDP/EU GDP	1.69	16.85	0.01	3.01
Region 5 year avg GDP growth	4.24	14.96	-0.51	2.39
Less favoured area	55.79	100.00	0.00	26.79
Political institutions				
Left	38.83	64.03	11.64	13.42
Left * land inequality	2,276.34	4,938.82	91.57	948.08
District magnitude	9.17	150.00	1.00	19.14
Eurosceptics	20.45	46.55	0.00	13.31

IV. REGRESSION RESULTS

Table 2 displays the regression results of the model specification described in the previous section. In particular, we report the results of two specifications. Model I is a pooled regression where we do not control for country fixed effects, whereas in Model II we control for unobserved country heterogeneities by including a set of country fixed effects. The key differences between the two models, other than fixed effects, come from some variables that lack a regional variation. Indeed, we are forced to omit them from Model II due to their perfect collinearity with the country fixed effects.

Following the previous discussion, we organized the results presentation by grouping the set of explanatory variables into five categories, that should represent the main driving forces affecting the level of AEMs implementation. However, it is important to bear in mind that the borders across these groups are not always so sharp.

At the general level, the explanatory power of the models, measured by the adjusted R^2, appears quite high, also taking into account the cross-sectional nature of the data set. Model I accounts for about 72% of the variation in AEMs expenditure, while in Model II the overall explanatory power reaches 89%. The proxies related to farmer political weight are all significant at the 5 or 10 percent level, with the exclusion of the agricultural employment share squared that, in Model I, is insignificant, and land inequality that, in Model II, is insignificant. The signs of the estimated coefficients are, generally speaking, in line with *a priori* expectations, suggesting that the relationship between the power of the farm lobby and the agro-environmental measures are not so different from the vast literature on agricultural support determinants (see de Gorter and Swinnen 2002 for a review). AEMs expenditure is strongly, and positively, related to the level of Pillar I expenditure, suggesting that the two policies tend to be complementary. In model II the agricultural labor share displays a U-shaped relationship with agro-environmental expenditure. This means that the relationship is negative for a low level of agricultural labour share but, beyond the threshold of about 8%, any further increase in the size of the farm group tends to increase AEMs expenditure. The proxy finalized to capture heterogeneity in the farm group, namely land distribution inequality, affects the level of AEMs expenditure negatively, a result in line with recent literature on inequality and collective action problems (see Bardhan et al. 2001; Olper 2007).

Finally, an increase in the share of females and young farmers affects AEMs implementation positively, although the latter variable is only significant in Model I.

AEMs expenditure is not particularly affected by the level of existing negative externalities, namely regions where agriculture is more intensive, causing environmental damage, have not a high level of agro-environmental expenditure. Furthermore AEMs expenditure is lower in regions where the nitrogen surplus is higher. Thus, from this perspective, even at the regional level we find confirmation of the evidence of Baylis et al. (2006), who show how countries systematically having the largest production of negative externalities are investing the least amount of money in AEMs measures.

Table 2. Determinants of agri-environmental expenditure

	Model I			Model II		
	Coefficient	P-value	*B* coeff.	Coefficient	P-value	*B* coeff.
Agricultural political weight						
Pillar I expenditure	0.045	0.000	0.239	0.069	0.000	0.362
Agricultural labor share	0.574	0.006	0.585	-0.368	0.011	-0.376
Agricultural labor share squared	-0.007	0.532	-0.106	0.024	0.007	0.346
Land inequality	-0.073	0.088	-0.274	-0.031	0.376	-0.118
Female	0.177	0.000	0.528	0.099	0.000	0.294
Young	0.144	0.020	0.175	-0.046	0.379	-0.056
Negative externalities limitation						
Nitrogen surplus	-0.015	0.000	-0.202	-0.009	0.043	-0.127
Yield	0.025	0.843	0.018	-0.081	0.480	-0.059
Pasture	0.001	0.909	0.006	-0.013	0.095	-0.094
Level of good farming practices	0.009	0.685	0.024			
Positive externalities demand						
GDP per capita	0.0002	0.000	0.523	0.0001	0.000	0.304
Tourism intensity	0.0005	0.000	0.255	0.0003	0.000	0.153
Green voters share	0.068	0.060	0.094	-0,130	0.002	-0.179
Environmental legislation	0.922	0.000	0.404			
Internet	0.292	0.000	0.614			
Budget constraints						
Log (Region GDP/EU GDP)	-0.227	0.117	-0.099	-0.504	0.000	-0.220
Region 5 year avg GDP growth	0.586	0.000	0.418	-0.050	0.572	-0.036
Less favoured areas	-0.022	0.028	-0.178	-0.012	0.058	-0.098
Political institutions						
Left	-0.184	0.004	-0.741	-0.184	0.000	-0.738
Left * land inequality	0.004	0.000	1,078	0.003	0.000	0.825
District magnitude	-0.036	0.000	-0.205			
Eurosceptics	-0.009	0.493	-0.035	-0.048	0.003	-0.190
Year fixed effects	Yes			Yes		
Country fixed effects	No			Yes		
Nr. observations (Nr. Regions)	236 (59)			236 (59)		
Adjusted R-squared	0.72			0.89		
F-statistic	25.4			53.3		

Notes: OLS regressions robust to etheroschedasticity. β coefficients are calculated by dividing the standardized estimated coefficients by the standard deviation of the dependent variables

In contrast, AEMs expenditure is strongly positive when related to positive externalities demand. More specifically, the level of GDP per capita, tourism intensity, the strength of environmental legislation, the diffusion of internet and, finally, the share of regional votes going to Green parties, all exert a significant positive effect on AEMs intensity. However, the strength of Green parties is not robust to specification changes, as the inclusion of country fixed effects induces a change in the sign of the estimated coefficient, that now turns out to be significantly negative. Thus, while these results are broadly consistent with the previous evidence, it also appears that working at the regional level can lead to more complex relationships than previously suggested.

The 'regional contribution' to the EU budget negatively affects the AEMs intensity. Thus, the result tends to give some support to the so-called 'restaurant table effect', namely the tendency of the CAP decision-making process to overprotect agriculture, a result in line with the Glebe and Salhofer (2007) evidence obtained at the national level. The positive coefficient of the real GDP growth of the previous five years (although becoming insignificantly negative in Model II) and the negative coefficient referred to LFA show the role of public opportunity costs in co-financing policies.

The last group of considered variables are political institutions. Both partisan ideology and district magnitude negatively affect agri-environmental expenditure. Moreover, and this is quite interesting, the effect of left-wing ideology orientation is conditional to the level of land inequality, namely an interaction effect between these variables has a significant positive effect on AEMs expenditure. The negative effect of the left-wing orientation on AEMs expenditure contrasts with the hypothesis and results obtained by Kemmerling and Bodestein (2006), who find a positive effect of left orientation on EU structural funds expenditure. However, this result is in line with the notion that farmers are traditionally represented by political conservatives (see Hackl et al. 2007; Olper 2007). Moreover, a possible interpretation of the interaction effect between left-wing orientation and land inequality is that in regions with a strong unequal land distribution, the resulting large fraction of small farmers tends to be affiliated with left oriented farm groups. Examples in this direction exist in some European countries, like France and Italy, where small farmers have their ad hoc organization related to left-wing parties.

On the other hand, the negative relationship between district magnitude and AEMs expenditure appears in line with the prediction of the recent political economy model about the effect of electoral rules on policy outcomes (see Persson and Tabellini, 2000). Indeed, these models predict that majoritarian electoral rules (vis-à-vis proportional ones), characterized by small district magnitude, tend to benefit especially narrow, and not broad, interests, and the production of local public goods.

Finally, columns 3 and 6 of the table display the β coefficients, with the purpose of addressing which variable or, better still, which group of determinants contributes the most to the regression. By taking into account the less than perfect categorization of our proxies in each category, what emerges from the analysis of the β coefficients is that the proxies related to farmer political weight, to political institutions and to positive externalities demand are the

most important explanatory variables affecting AEMs expenditure.

V. CONCLUSIONS

Agri-environmental measures represent the most innovative, and important, rural development policies of the new CAP. At the same time, AEMs are one of the most debated instruments. Indeed, the European Commission underlines AEMs positive effects, pushing for their future expansion; however, some scepticism still exists concerning their genuineness, accusing them of disguised agriculture protection.

Thus, in order to better understand the real motivation behind agri-environmental schemes, this paper proposes a political economy analysis of their implementation determinants.

To this end we exploit the rich information of 59 agri-environmental programs implemented at both national and regional level, over the 2001-2004 period. We test five main hypotheses about the driving forces leading to AEMs diffusion: *i)* agricultural political weight, *ii)* negative externalities limitation, *iii)* positive externalities social demand, *iv)* public budget constraints, and finally *v)* political institutions.

The main results suggest that variable proxies related to farmer political weight, political institutions and the demand for positive externalities are the most important explanatory variables affecting AEMs expenditure. Also budget constraints seem to play a significant role.

However, AEMs expenditure and diffusion do not appear particularly affected by the level of existing negative externalities, suggesting that regions where agriculture is more intensive, causing worse environmental damage, are only marginally affected by the potential environmental benefit due to the diffusion of agro-environmental measures. This is quite a notable finding, and subsequent policy implications become evident if we observe that 2/3 of the AEMs public funds are devoted to minimizing negative externalities.

ACKNOWLEDGMENT

This paper has been realized with the financial support of CNR 'Progetto promozione ricerca 2005' funds.

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