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GÖDÖLLŐ**

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**INSTITUTIONALIZATION AND INSTITUTIONAL ADAPTATION OF
THE COMMON AGRICULTURAL POLICY
(The Paying Agency and the Integrated Administration and Control System
as Examples)**

Theorems of the PhD Thesis

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Ph.D. school

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1. TIMELINESS OF THE SUBJECT

The supranational Common Agricultural Policy (CAP) of the European Union has such a complex goal- and tool-system that the policy's implementation requires a comprehensive national institutional background. *Deficiencies of the institutions at the national level can easily decrease the absorption of subsidies in the new Member States (MSs).*

For the implementing institutions it is important to cope with such difficulties and to *adjust to continuous changes in the system.*

This theme is timely from the point of view of economic and social policy as well as that of science. The accession of the Central- and Eastern European countries resulted in an unprecedented enlargement of integration. That is why researchers in the field of law, sociology and economic sciences began to focus their attention on different theoretical questions and problems of integration. Economists have already studied several aspects of the integration, but only a few scientific works contain institutional analyses. The institutional adaptation of the CAP has not yet been discussed comprehensively since the last enlargement.

Objectives of the thesis

1. In addition to the examination of particular institutions the theme also requires that we place the importance of the institutions into a wider context i.e.

- to approach the questions from the point of view of the field of new institutional economics,
- to analyze the interrelation between institution and integration, including the relevance of the principal-agent model that yields insights concerning the relationship between the supranational and national institutions,
- to explore the effects of policy-related transaction costs. In the latter case special emphasis will be placed primarily on:
 - the legislative aspects,
 - the factors determining the costs,
 - the solution to the problems, especially the factors triggering minimization of policy-related transaction costs at different levels, and
 - the trade off between costs and the targeted policies.

2. I shall take into consideration and analyze the problem of misspent agricultural subsidies (EAGGF Guarantee expenditure) that have to be recovered by the EU15. By means of multivariable statistical methods I shall group the old MSs and specify the characteristic features of the groups.

3. It is also an important current issue in the old MSs to find out *why the controls concerning CAP expenditures are not adequate and what is to be done in order to improve the situation.* New MSs should pay extra attention to the experiences of the old ones because many of the problems they are facing or will be facing had been encountered previously in the EU15. It is very likely that many of those problems will come up in the new MSs. Their prevention or solution requires the new members to make good use of earlier experiences.

- It is an essential requirement to put an end to risky situations and reduce the possibility of infringements.

- It has to be studied which aid schemes are the most exposed to misuse; how effective are the Paying Agencies in preventing or discovering fraud and infringement; and how effective is the work of the Integrated Administration and Control Systems (IACSs). (The analysis is based primarily on the reports of the European Commission and the European Court of Auditors.)

The IACS is able to improve the efficiency of agricultural policy. The system has been gaining in importance due to the fact that more and more Guarantee expenditures have become covered directly or indirectly by this System. The existence of a good IACS is a prerequisite for receiving full payments that are authorized from the community budget.

The mentioned tasks can be carried out in a more expert way by assessing the operation of this System. This process of evaluation is justified by the 2003 CAP-reform and by the accession of the Central- and Eastern European Countries in 2004. The reform has changed the system of the direct payments, so the IACS has to fulfill certain modified requirements. Therefore I shall focus on:

- the elements of the system,
- the aid schemes covered by IACS,
- the reasons for the System's inadequate operation,
- the analysis of misspent sums that have to be recovered,
- the selection of those MSs that need more attention during the adaptation of the modified system,
- the determination of the efficiency (prior to the 2003 CAP reform), that could serve as basis for comparing the old and new systems, finding whether the new regulations are mainly responsible for outcome differences,
- an examination of the controls, including the quantitative expression of weaknesses. System efficiency is interpreted by means of:
 - applications with discrepancies in relation to the applications controlled,
 - controls, on the spot checks, and
 - excessive payments, i.e. misspent sums that have to be recovered.

4. In addition to the analysis of the experiences and results of EU15 the thesis aims:

- to elucidate the different phases of the building up and preparedness of the Hungarian Paying Agency (the central part of the Hungarian institutional system which is in charge of the EAGGF payments),
- to assess the operation of the old IACS (since a major part of the research was carried out prior to the recent enlargement, the reform-experiences gained are incomplete due to the short period of time that has passed since the enlargement; furthermore, public access to the available information is restricted, so the main emphasis must fall on an evaluation of the building-up of the new System at the national level.
- to provide an overview of the coming challenges originating from the adaptation of the CAP-reform,
- to apply the theories of the institutional economics within the national framework.

The adaptation of the CAP involves several institutions that are partly related and others that are not related to payment system. The introduction and examination of every single institution would be a much bigger task that could be attempted within the frame of a Ph.D. thesis. Limiting the institutional analysis is justified further by the fact that certain agricultural administrative institutions have had a long history and have been operating reasonably sufficiently (e.g. in the field of animal health). The fact that difficulties in bringing together (e.g. in the Farm Accountancy Data Network) have been overcome also spoke for diminishing the scope of the work.

2. MATERIAL AND METHOD

My research – as far as certain scientific areas and questions are concerned- was based on detailed literature written in Hungarian and in other languages:

- *The economy and integration of the EU* – by M. J. Artis, W. Molle, Palánkai T.,
- *The Common Agricultural Policy in the EU, connections of agricultural policy (changes, effects and results of reforms, further need for transformation)* – by C. Ritson, D. R. Harvey, W. Grant, Halmai P., Puskás J., Udovecz G., Popp J., U. Koester, A. Swinbank
- *Institutional economics, within that theories of the new institutional economics, transaction costs* - by O. E. Williamson, P. L. Joskow, G. Liebecap, D.C. North, A. Kieser, R. W. Johnson, L. E. Davis, F. Gatzweiler, K. Hagedorn. In the case of transaction costs the *policy-related transaction costs* proved to be an exception. The experts of OECD - C. Cahill, C. Moreddu, E. Einarsson, W. Legg, S. Buchli, C. Flury - have started to study this category intensively more recently.
- *The Hungarian institutional adaptation, the problems and tasks regarding the establishment of institutions (Paying Agency) and the Integrated Administration and Control System appear in the publications of e.g. Rieger L., Kapronczai I.*

The specialized textbooks were published among others by Ashgate, Elsevier, Oxford University Press, Cambridge University Press, Mcmillan Press, Mezőgazda Kiadó, Aula Kiadó, KJK KERSZÖV. Furthermore relevant articles can be found in the following periodicals: EuroChoices, Intereconomics, Agrarwirtschaft, Development and Finance, Európai Tükör, Közgazdasági Szemle.

The accession of the Central- and Eastern European countries was preceded by severe harmonization. That process started, however, with delays and inadequate intensity in certain cases. An important part of the eastern enlargement was to make the operation of the Common Agricultural Policy possible. *The literature on the Paying Agency and the Integrated Administration and Control System, the key elements in the new institutional framework of the implementation, is rather meager and not very focused. Moreover Hungary's experience is rather incomplete due to the delayed building up of the System and the short time (only one year) of operation.*

The lack of national literature of analytical character required the use of:

- foreign technical descriptions - e.g. technical proposals by the Joint Research Centre, ISPRA (European Commission),
- documents – working documents of the European Commission, Organization for Economic Cooperation and Development, OECD,
- manuals,
- actual Hungarian scientific publications issued regularly – e.g. several articles published in “Térinformatika”,
- conference papers of the International Society for New Institutional Economics (ISNIE) and the European Association of Agricultural Economists (EAAE),
- reports of relevant organizations concerned, first and foremost the annual and special reports and opinions of the European Court of Auditors, the annual financial reports of the European Commission, reports of research projects carried out by CEESA (Sustainable Agriculture in Central and Eastern European Countries),
- publications of research institutes, such as the Sussex European Institute (SEI) and the Agricultural Economics Research Institute (AKI) of Hungary.

- Furthermore, since the framework of the Hungarian adaptation is set by regulations I analyzed Community and national documents, such as the ad hoc decisions of the European Commission on financial corrections – misspent money to be excluded from the Community financing, the Hungarian governmental decree on the Agricultural and Rural Development Authority – (ARDA) as an important group of sources.
- Consultations and interviews with experts of the institutions affected (e.g. Ministry of Agriculture and Rural Development, Agricultural Intervention Centre, ARDA, EU Commission – DG AGRI, Agricultural Economics Research Institute) contributed to bridging the gaps of the “separated parts” and to acquiring new information originating from the continuous harmonization of the systems.

In the listing above only the most distinguished experts and sources on the relevant issues and the most important documents and legal materials are specified.

Method

The CAP with multiple objectives and a complex set of corresponding tools is characterized by the fact that the unified common rules are adopted in different national institutional systems with different implementing mechanism. So the unclear relationship between the implementing system of the CAP and the economic connections required the use of applied economic research.

With regard to the research of applied economic character, the following methods were used:

Analysis, Comparison of literature

The research was based on the wide-ranging and comprehensive comparison of national and international literature. The extensive analysis is connected directly or indirectly to the wider literature on adaptation.

Analysis of documents

Taking into account the novelty of the theme itself, the connected problems and the fact that there is either no literature or the existent literature is usually based on documents I was compelled to also consult different original documents, laws, regulations, manuals, statistical instructions, and various materials of the European Commission.

Comparative analysis

The data on the institutional system functioning in the EU in particular the data on the functioning of Paying Agencies and IACSs, on unjustified payments, on fraud, and on infringements related to the Community subsidies were studied by means of comparative analysis.

SWOT- analysis

The strong and weak points of the Hungarian Paying Agency – the Agricultural and Rural Development Authority being in charge of the functioning of the IACS were also studied.

Statistical/quantitative methods

Quantitative comparison was used mainly to qualify the controls carried out with the need to reveal the legality and regularity of direct payments. The relevant financial corrections – first of all the IACS-related misspent sums were calculated. By means of multivariate statistical methods – principal component analysis and cluster analysis the old MSs were grouped on the basis of the financial correction selected by subsidy types.

Interview methods

I considered the opinions of both national and international experts with practical experiences, those of the employees of public administration, and those of experts influencing and forming agricultural policies as sources of primary importance. Due to the novelty of the systems and the lack of literature or comprehensive documentations the in-depth interviews proved to be the most useful among the interview methods.

Participation in scientific presentations, panel discussions, field trip

By means of scientific conference programmes opportunities presented themselves to compare new theories, and to develop hypotheses related to the continuously changing systems. Furthermore I could deepen my professional skills and extend my knowledge through the trainee program organized by the European Commission. I spent 5 months (from 1 October 2003 to 29 February 2004) working for DG AGRI in Brussels. Then in July 2005 I participated in a field trip to the same destination.

3. RESULTS

1. The country-specific implementing institutions of the EAGGF Guarantee and Guidance Sections differ remarkably. The differences are due to the different legal systems and cultures, approaches to supervision, system of applications, on-the-spot controls, settling of accounts, payments and the dissimilar processes of accreditation.

Differences in the implementation of the EAGGF Guarantee and Guidance schemes

EAGGF Guarantee Section	Major tasks of the implementation	EAGGF Guidance Section
Pre-financed by the MSs from the national budget, financed exclusively by the EU, co-financing	Financial sources	The EU provides advance payments when the annual financial agreement is concluded, co-financing
Certain aid schemes require application (call for tenders) others only claims, authorization of a high number of aid schemes regulated differently	Applications, authorization	Same regulatory background, assessment of business plans
Certain aid schemes require advance payments, guarantee management, administration according to the EU-nomenclature, management of the intervention process, debtors ledger, monthly – weekly reports	Payment, settlements of accounts	Management of the available funds by contracts, quarterly reports
Tight controls – on-the-spot checks determined by aid schemes, special examinations, post-payment checks	Control	Controls of different characters depending on the individual projects, program-monitoring

Source: Own research

2. Key theoretical statements of the institutional economics can offer useful practical advice on the efficient implementation of the CAP.

„The institutions have important effects on economic performance, thus their analysis is not to be evaded. Institutions can be analyzed with rigorous theoretical and empirical methods, but the analysis should be interactive and evolve together. “[Joskow, 2003]

Among the different theories of institutional economics New Institutional Economics is considered to be the most modern. The NIE is closely linked to the Neoclassical Economics that puts emphasis on individual benefit maximization as well as on marginal analysis. At the same time it pays attention to transaction costs, information problems and bounded rationality [Libecap, 1998]. North (1990) claims, that “the institutions represent the way in which different economies cope with market failures”. Institutions are efficient in so far as they minimize transaction costs.

3. Insights gained from the „principal-agent model” help in understanding and evaluating the relationship between the supranational and national institutions implementing the CAP.

The proper design of the CAP (design takes places at EU level) and its focused targets are considered to be very important. However, the success of the policy depends in no small measure on the quality of the implementation. It is crucial how the policy is governed and managed at different levels, i.e. at Community, country, regional and local levels.

The institutions involved in decision-making, design and implementation build a multiple hierarchy system. In this hierarchy system there are principals and agents. (Brümmer and Koester, 2003).

The principal-agent problem describes strategic interactions between two contracting parties, the typically uninformed principal and the typically well-informed agent. The main goal is to get the agent with the informational advantage to act in the best interest of the principal and to bridge the informational gap despite the fact that certain interest conflicts are likely to exist. At the top of the hierarchy the Commission stands as principal and decision-maker that sets the goals and delegates different tasks (such as implementation, monitoring and enforcement) to the governments of the MSs, i.e. to the agents. However this simple hierarchical structure does not remain that simple as MSs themselves are themselves forced to implement the policy with the aid of their own national hierarchical organizational framework.

Hence the intermediaries of the system become both principals and agents. The only set position is that of the Commission as the ‘top’ principal and that of the farmer as the ‘bottom’ agent. In case of delegating tasks, monitoring, control and enforcement are always needed. The greater the information gap on the delegated tasks, the higher level of control and enforcement by the Commission that is needed. The quantity and costs of these activities influence the quality of the results of the policy and depend on several factors.

Factors that have impact on the relationship between principal and agent

Principal	Agent
	Intensity of regulation
	Incentives to break the rules
Lack of sufficient staff	
Insufficient inter-service communication in the Commission, insufficient coordination of their work	
Costs of controlling the activities of those who break the rules	
	The likely costs of breaching or bending the rules
The interest of the principal in monitoring and enforcing contracts	
	The probability of being caught if the rules have been broken
	The penalty that has to be paid for breaking the rules
The importance of embedded institutions (e.g. morals) for society	

Source: Based on the study by Koester, Brümmer 2003

The negative relationship between principal and agent, i.e. the deficient governance caused for example by the complexity of regulation and the lack of incentives to stick to the regulation, and the problems deriving from shared management, definitively aggravate the implementation of the CAP. The weak points of the shared management can be detected on both sides. On the one hand MSs fail to check the genuineness and compliance of operations financed by the Community, and thus cannot always prevent irregularities. And once misdeeds are perpetrated, they might not respond to them properly. Or they may fail to recover sums lost as a result of irregularities or negligence. On the other hand the Commission might fail to verify the conditions under which payment and checks have been made, to carry out checks on the management of expenditure, or to check that pre-financing is reimbursed.

There is a price to pay for deficient governance. That means more transaction costs, more irregularity and fraud in terms of agricultural payments of the Community, and more money to recover, assuming of course that the misdeeds are discovered. The amounts in question can be regarded as significant when one takes into consideration that the European Union spends a significant part of its common annual budget on the Common Agricultural Policy.

4. Research on policy-related transaction costs is gaining ever greater importance, especially in the case of the agricultural policy.

Frequent changes of policy and the short time-frame for their implementation lead to growing costs, that are, anyhow, the highest in the initial phase of implementation. Due to the absence of transparent data, a lack of common methodology (as was mentioned) and the complexity of TCs (as TCs at different levels have to be taken into account at the same time), it is difficult to paint an accurate overall picture of the total amount of PRTCs, i.e. it is difficult to determine PRTCs at each level in the hierarchy, all the way down to the level of individual farmers.

It is apparent on the basis of the available studies that agri-environmental measures, i.e. measures related to some kind of public good, cause the highest PRTCs. But PRTCs differ also due to the fact that they are measure-specific and dependent on regions.

Changes in a certain policy (CAP reform), i.e. the implementation of new measures result in either less or more costs than the previous ones. The replacement of the traditional policy instruments and the establishment of completely new measures are, however, pretty costly. The reason is that the switch from a broad to a targeted approach - from broad income support on a need-based system or from generalized area payments to targeted landscape maintenance - creates significantly higher implementation and monitoring costs. These costs, however, can be justified by the possibility of overall benefits to the economy (Cahill and Moreddu, 2004).

In any case the main goal is unambiguously to estimate TCs measures by measures and then to minimize them at different levels (Cahill and Moreddu, 2004), i.e. at the outset, at the level of design, at implementation, at control, and at the levels of the various institutions involved.

5. The adaptational problems of the Paying Agencies and the Integrated Administration and Control Systems in the Central- and Eastern European countries made the institutional accreditation ensuring the payment of EU subsidies more difficult, thereby jeopardizing the absorption of subsidies.

At the end of 2003 the European Commission made a warning that certain candidate countries would not be able to apply the *acquis communautaire* unless they make all of the necessary preparations in due time. During 2004 other difficulties also came to light. That is why the majority of institutions (among others those of Hungary) was accredited only provisionally and the process of their further developments was carefully monitored during 2005.

6. The integration of different aid schemes into the IACS reached such a high level in Hungary that was considered unique in Europe.

A need appeared soon that the IACS become part of a unified and complex system that can handle also measures not included in Community regulations. In view of this the new MSs had the advantage that from the outset they could make their developments in the direction of such a unified system. Hungarian experts were so ambitious from the very beginning that their intention was to establish an IACS that would manage not only the classical direct payments but all of the EAGGF Guarantee measures. The plans were of high standards, but within the available timeframe they could not be fully implemented.

7. Key failures and ancillary weaknesses in establishing and implementing IACS-elements as revealed by inspections of the Commission can be systematized as follows:

Key failures in establishing and implementing IACS-elements revealed by inspections carried out by the Commission

A system for the identification and registration of animals I&R	<ul style="list-style-type: none"> – Shortcomings in databases – Shortcomings in herd registers – Shortcomings in flock movement registers – Shortcomings in using ear-tags – Shortcomings in applying passports
An identification system for agricultural parcels LPIS	<ul style="list-style-type: none"> – Shortcomings in databases, missing electronic links between databases – Shortcomings in digitization
Integrated control system	<ul style="list-style-type: none"> – Existence and level of inspections – Quality of inspections - deficiency in inspection procedures (delay in inspections, timing, counting, reporting) – Inadequate job of the inspector (self assessment)

Source: Own research

Ancillary weakness in implementing the IACS-elements revealed by inspections carried out by the Commission

Comprehensive failures	<ul style="list-style-type: none"> – No separation of administration tasks, risk-analysis and control – No adequate IACS and veterinary service co-operation – Misinterpretation of regulations
Failures in the integrated control system	<ul style="list-style-type: none"> – Inspection statistics (different to those communicated prior to the mission) – No computerized risk-analysis – Deficiency in control of the place of retention – Control of supporting documents not fully in compliance with applicable legislation – Announcement of inspection more than 48 hours in advance

Source: Own research

8. In Hungary the structural problems that characterized the establishment of the Paying Agency had grave consequences in the period preceding and following the accession.

The development of the implementing institution was influenced by the following difficult policy dilemma: Which system, the simplified area payment scheme (SAPS) or the standard system of the old MSs, should be chosen by Hungary? The consequences of the delay were worsened by the facts that:

- the president of the ARDA had to report directly to the Minister of the Ministry of Agriculture and Rural Development,
- the ARDA operated as a totally centralized system, the president was in charge of several operative tasks – but the centralized decision-making resulted in many problems due to the high number of applicants (260-280 thousand) and aid schemes (64),
- there was no unit in the Ministry that could have managed the ARDA’s affairs.

That is why the task of continuing the reorganization of the internal structure of the ARDA maintained its timeliness. Possibly the change can be reached only by modifying the law on ARDA.

9. Adaptation to changes in the CAP (2003 reform) are likely to involve considerable difficulties.

On the one hand the control of cross-compliance falls within the competence of the system. On the other the MSs had the option to apply not only the full-decoupling but the coupled model and the product-specific supports for certain aid schemes. The partly coupled model requires different control mechanism. The coupled elements have to be controlled on the basis of the procedure used by the original so-called standard system. As a result the system does not become as simplified as it would be in the case of full-decoupling. The parallel use of the elements of the standard and the decoupled systems – even if it is ad interim – could be regarded as a burden both for the farmers and the state administration.

NEW AND NOVEL SCIENTIFIC RESULTS

1. The thesis shows the paradox of the simplified agricultural policy and the increasing complexity of its management

The fast, cost-efficient and qualitative traceability of the trend in agricultural policy and the change in the functioning agricultural administrative system is affected by their interaction. In that interaction the new goals of the changing agricultural policy might require new tools/measures. Their efficiency is determined by the extent to which of the functioning of the implementing institutions fits the new goals. At the same time the institutional frame-requirements that are partly restricting factors might assure without any changes that the new types of measures could be implemented without any remarkable transformation.

The trend in agricultural policy is influenced by social and economic pressures in and outside the EU, especially global trade situation. That was the reason for the reform in 1992, 1999 and 2003. The changes could fulfill certain requirements (the farmer's subsidy is no longer tied to the quantity produced). However, the introduction of new types of measures resulted in new – first of all administration and control – needs. The heterogeneity and the extra tasks of the implementation made the policy more complex. It became overly bureaucratic and proved to be costly ever since. The unanimous opinion of different experts usually starts with the caveat: The 2003 reform made the agricultural policy simpler, but.... On the one hand, it becomes questionable whether any noticeable simplification did actually take place in those countries which started to use the derogation and did not introduced the full-decoupling but kept the subsidies coupled to the quantity produced (at least to the maximum extent permitted by the new regulation). On the other hand the newly introduced system of cross-compliance raises new problems requiring serious consideration. Though the decoupling data on production do not have to be recorded and controlled any more, the control of compliance with certain other conditions (e.g. on the environment) might be more time-consuming, labor-intensive and thus more costly. An optimal solution should be found in between these two extremes. The determination of the criteria less costly but not adequately supported might not lead to the results required in social and ecological terms. At the same time the control of conditions that are stricter than necessary can cause exaggerated costs. It can be concluded that the simplification of the support system while facilitating the work of the farmers, it does not result automatically in simpler management on the part of the MSs. That is why the long-lasting sustainability of the new measures is often queried.

2. The problems of the decentralized management are reflected in financial corrections. The MSs (EU15) have been grouped on the basis of the amounts and types of the misspent sums. As a result of the grouping more targeted and more effective control actions can be planned.

The survey of the financial years 1996-2003 showed that 80% of the total amount to be recovered is shared among the following six categories: export refund, animal premium, arable aid, support on milk and milk products, oils and fats, financial control. These categories served as variables for the principal component analysis. By means of this multivariable statistical method I found that there is a mildly strong relationship between the financial correction related to the arable aid and the extent of financial correction related to the support on oils and fats. At the same time, I also found a weak relationship between the misspent sums related to the animal premium and the misspent sums related to the support on milk and milk products. That is why the grouping of the 15 old MSs according to financial correction could be facilitated by using the background variable related to the cultivation of plants (in the first case) and another one related to the animal husbandry (in the second case).

The imperfect separation of North and South

A homogenous group with a relatively high similarity of 80% consists of Austria, Finland, Luxemburg, Sweden, Portugal, the Netherlands, Belgium, Ireland, Denmark and Germany. With the exception of Portugal, Germany and Ireland, in the other countries listed, the quantity of financial correction related to the cultivation of plants is nearly as high as the amount of misspent sums related to the animal husbandry. But financial corrections in the above-mentioned three MSs amount to only a small fraction of those of the Italian, Greek and Spanish amounts.

At the level of the chosen similarity the Mediterranean countries which do not form a homogenous group are to be described in the following way:

- In Italy, the financial corrections on the support on milk and milk products, oils and fats, and the financial control are very high.
- In Spain, the misspent sums to the arable aid, the support on oils and fats and the financial control are quite large.
- In Greece, the financial corrections to the arable aid, the support on oils and fats and the animal premium are substantial.
- In France, the financial correction usually runs to high amounts, with the exception of financial corrections on the support on milk and milk products, oils and fats,

My study found that in all these countries the absolute value of the correction on financial control is basically high. But it does not mean that it forms a dominant part of the total financial correction.

The countries can be divided into two groups on the basis of their geographical positions. However, the separation of the northern and southern states is not complete, because Portugal is more similar to the northern group while France's pattern is more similar to those of the southern group.

3. Whether agricultural policy measures that are judged to be efficient in economic terms are also effective in social and environmental terms can be determined more precisely by knowing the policy-related transaction costs.

The complexity, the variance, and the frequent changes in the agricultural policy measures as well as the administration and control of several précised target groups – i.e. groups supported differently and within a narrow framework – enhances the bureaucratic regulation. Due to the 2003 reform and the multifunctional character of agriculture those agricultural policy measure have been gaining in importance which belong to this category.

These measures place a special emphasis on the production of public goods and are applicable to target groups with a low number of participants. They are primarily agri-environmental measures that are more effective in social and environmental terms but might, in certain cases, generate a considerable amount of policy-related transaction costs. The comparison of costs in various countries could be facilitated above all by a common methodology that reveals the causes of the differences and provides a basis to end these differences. Making good use of the earlier experiences gained in the other MSs would help to achieve that. Employing appropriate methods could help to determine which measures are the most efficient in financial terms and which are the most successful in reaching social targets. Furthermore, one may suppose that the optimal level of precision of the individual measures could be determined and set on the basis of the comparable data of the MSs.

Examining Hungary's agri-environmental policy it is evident that the tasks to be carried out at the level of design are connected with measures coming into force from 2007 on. In the present situation targeted agri-environmental policy has been introduced in recent years to counteract the negative phenomena. So the principal question is whether the institutions in charge of monitoring and controlling can organize their work efficiently, given the expected amount of the public/state transaction costs. There should be enough awareness of the need to collect monitoring and evaluating indicators so that cost-efficiency and environmental contributions of single measures or the lack of it could be proven.

4. Having in view the efficiency of the Hungary's adaptation, I made an in-depth analysis of the data on irregularity and money to be recovered in the EU15 and determined how effective the IACS had been functioning.

Having studied the different aid schemes of the EAGGF Guarantee Section I came to the conclusion that there is a lack of information on payments controlled. Furthermore, the irregularities belonging to different chapters of the budget are not clearly identified. At the same time, MSs usually report only casually the problems related to aid schemes covered by the IACS. The extent of misuse of subsidies controlled by the IACS is insignificant as compared with the amounts of other aid schemes paid irregularly.

On the basis of the data pertaining to the studied years of 2000, 2001 and 2002 one may claim that in certain cases the analysis by MSs is more useful than the average rate of deficiency in the EU15. It is advisable to scrutinize the countries one by one because the dispersion of the different data-groups is rather significant even if all the MSs had provided the information. This is so

- partly because of the very high number of controls imposed in certain MSs (as compared with other countries) that distort the average results.
- partly owing to the fact that the percentage of discrepancies differs year by year and country by country, particularly regarding the animal premiums.

In this case:

- the applications covered more animals than the real number of livestock,
- in the course of calculating the stock density factor the size of forage area was overstated,
- the farm register was missing,
- the negligent use of obligatory herd registers, animal passports and ear-tags,
- the size of areas indicated in the applications was bigger than the size of areas cultivated effectively; or some of the areas listed in the applications turned out not to be eligible for support,
- plants with higher supports were indicated in the applications and not the actually produced ones (with lower supports).

The average percentage of applications with discrepancies in the EU15 during the period studied and in relation to the total number of applications amounts to 20-25-38% in the case of arable aid and 10-14-12% in the case of suckler cow premium.

The deficiencies revealed by controls have to be amended with the rate of financial corrections in EU15. Using the clearance procedure for EAGGF Guarantee Section (reformed in 1994) the percentage of the financial corrections calculated by countries, sectors and decided in respect of IACS related schemes for the financial years 1996-2003 is 42% in relation to the total financial correction. The other 58% consists of misspent money regarding e.g. export refunds; public storage of meat, cereals, olive oil; milk and milk products – butterfat disposal measures, milk quotas – and additional levies and interests chargeable for late payments, olive oil sector – production aid.

5. EU10 – I used empirical methods to reveal the difficulties in the institutional adaptation. I analyzed and compared the IACSs in the new MSs by means of principal component analysis.

Using principal component analysis – “the technical background and administrative structure and the overall evaluation of the IACS” as background variables – I found, that the countries selected (Poland, Hungary, Latvia, Lithuania, Estonia, Czech Republic, Slovakia) are to be grouped only at a similarity level of 60%. The only exceptions are Hungary and Slovakia, countries that proved to be 100% identical on the basis of the variables (the overall evaluation of the IACS, the Land Parcel Identification System, the administrative structure and the IT background). Czech Republic, Lithuania and Estonia formed a group that could meet the requirements regarding the functioning of all IACS elements. As for the European Commission its 2003 report stated that Poland was lagging behind for the most part and Latvia was the most prepared. These countries belonged to none of the above groups.

As for Hungary the delayed establishment of the institutions and the internal structural problems of the adaptational process that is not finished yet could lead to the reproduction of the institutional tensions and could result in adaptational losses with negative consequences.

4. CONCLUSIONS AND SUGGESTIONS

1. Policy-related transaction costs and the national agricultural policy measures

The numerical expression of policy-related transaction costs requires the most precise analysis possible. During the classification and interpretation of the transaction costs connections have to be established between the given tool/measure and the policy targets. Above all cross-compliance should be focused on. The procedure of control on complying with the rules should be kept as simple as possible, i.e. let us ask the following question: Does a Forint/Euro spent to control or to prevent the risk of community irregularity worth that Forint/Euro?

2. Establish a unified monitoring system capable of numerically expressing policy-related transaction costs (data collecting and processing system, data on PRTCs)

In addition to the selection of the most representative monitoring and evaluating indicators I suggest to establish a unified monitoring system that is able to handle data both on market and structural agricultural policy measures (in this case monitoring means data collection and processing, data on PRTCs). The system should be uploaded automatically with data during each work phase and directly following them. This way the lack of precision and completeness of the data estimated in advance or provided at a later date could be prevented. Furthermore the official duties could be rationalized and the efficiency of each work phase could be enhanced.

Whether the data should be uploaded only at the level of the state, the regions, or the institutions carrying out the controls and also whether individual farmers should become a part of the system are issues that represent serious dilemmas because they involve difficulties to calculate cost-benefit calculations. It is probably much easier to oblige the authorities than the farmers to operate the system. The farmers' spending (administrative burden) is, though, a relevant part of the total PRTC. It means that farmers not only have to be urged but they should also be obliged to provide information, otherwise they would be subject to sanctions. It is absolutely necessary to prepare the farmers and to offer them consultation. However, according to the 2003 reform a farm advisory system has to be set up by 1. January 2007 the participation of the farmers is voluntary and the services of the system must at least apply to questions on the cross-compliance. That is why I think that the administration and processing of the PRTCs affecting directly the farmers should be added to this system.

3. Development of institutions and Hungary's future in the SPS system

The institutional system has to be developed also in the immediate future so that the management could be improved and the fulfillment of the requirements regarding the cross-compliance regulation could be adequately controlled. During the development of the system cost-transparency should be considered a strategic goal.

Some problems of the ARDA can be solved by more experience and practice. As for the difficulties in the recent past and the current situation the rules on agricultural production and activities (rules on environmental protection, food-safety, animal health, animal protection, good agricultural and ecological practice) are expected to involve several problems in the control mechanism. The switch over to SPS involves additional tasks to carry out.

The experiences gained in the SAPS could be mostly used in the adoption of the SPS requiring new coordinating and control mechanism when it comes to full-decoupling.

It should be taken into consideration that the administration of the IACS has to meet new requirements of the SPS and that cross-compliance controls need the cooperation between different authorities. However, their harmonious cooperation cannot be taken for granted.

4. Comparative analysis of the IACS in the new Member States

I consider it necessary that the results and experiences gained in the operation of the IACS in the first few years should be evaluated on the basis of unified guidelines applied in each MSs. The results of the sharing of best practices among the MSs are soundly comparable only when the analysis is carried out under similar conditions. The guidelines of the comprehensive reports on the preparedness of the candidate states prior to the accession made by the European Commission in 2003 could be used later to characterize how the IACS have been functioning.

5. Timeliness of the study on the institutional system

The smooth enlargement of the European Union with respect to its CAP requires that the new candidate countries make good use of the difficulties encountered by the Central- and Eastern European Countries that joined the EU on 1. May 2004. The establishment and the development of the institutional systems in the candidate countries should make use of the CEEC's problems, solutions and best practices.

5. PUBLICATION LIST

Technical book

Published in Hungarian

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