

# **Agricultural Policy Reform and Less-Favoured Areas Policy: Application of EU Policy to Japan**

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## **Summary**

This paper aims to overview Japan's implementation of the EU's Less Favoured Areas (LFAs) direct payment support. Furthermore, we discuss the limitations of Japan's LFA payments to the development of rural policy. Japan's LFA direct payment policy was formed through adjustments to the small-scale Monsoon Asia terraced paddy field farming which still strongly relies on the community function. It has been effective in preventing further increases in farmland abandonment. However the long-term effectiveness of this policy is questionable due to the likelihood of further depopulation and ageing in Japan's LFAs. We suggest the need for a conceptual shift from current support that maintains the *status quo* to one that emphasises investment in rural regeneration.

## Introduction

Many developed countries have reformed their agricultural policy to be able to respond to a variety of social problems such as food safety, food security, animal welfare, environmental protection and the viability of rural areas (OECD, 2006a). Post-war agricultural policy was mainly targeted at achieving stable farm incomes by means of directly supporting agriculture and farming activities. Rural development was also targeted by agricultural policy through agricultural commodity supports and market protection. Japan through these changes now has one of the highest levels of agricultural protection in the world. For example, the OECD's 'Producer Support Estimate (PSE)' indicator in 2004 showed that Japan had approximately 56% (62% in 1986)<sup>1</sup> of the value of agricultural production induced from support policies. Although Japan has also applied territorial rural policies, they historically highlighted rural infrastructural development so that rural residents could benefit from modernisation. Despite these policy efforts, Japanese agriculture and rural areas have declined significantly and continue to face problems of sustainable livelihoods in rural communities. With increasing pressure on agricultural policy reform nationally and internationally, the Japanese government has sought to re-think its policies for rural areas.

The EU's Common Agricultural Policy (CAP) has been ahead in terms of the transition from agricultural policy to integrated rural policy. Japan has studied CAP reform as a potential model on which to base its own agricultural policy reforms (e.g. Korenaga, 1994; Shogenji, 1998; Takushoku, 1999; Yaguchi, 1995). However, these studies also highlighted Japanese differences in land use, rurality and culture from Europe, and argued the need for a Japanese model. Although Japan introduced direct payment supports for hilly and mountainous areas in 2000 based on the EU's Less-Favoured Area (LFAs) support the adaptation process was complex due to those differences.

This paper reviews the background to the implementation of the EU's LFA policy to Japan, and examines this in the context of an evolving rural development policy. The Japanese experience of implementing this policy is considered to provide both a comparison and useful insights into future rural policy and rural development options between EU and Monsoon-Asian countries.

### **EU Less Favoured Areas Policy: A brief overview**

From its beginning, Less Favoured Areas (LFA) policy was conceived as a structural policy aimed at the prevention of land abandonment, by preserving the farming population in such areas. From a broad policy perspective, it was the first explicitly regional approach in agricultural structural policy (Dax & Hellegers, 2000; Fennell, 1997). The LFA scheme aims to respond to the widely divergent regional

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<sup>1</sup> According to the '*Producer and Consumer Support Estimates [OECD Database 1986-2004]*', EU average PSE in 2004 was 34% (44% in 1986) and the US accounted for 4% (4% in 1986).

situation of European Union (EU) agriculture, with respect to both the socio-economic and natural characteristics of regions. Originally support for European hill farming, which was first adopted in the immediate post-war period, was provided on the basis of the Less Favoured Areas (LFAs) Directive (75/268) (CEC, 1975). Article 1 of the Directive outlines the aims, which are predominantly demographic (social) but also seem to suggest a secondary environmental function,

“...to ensure the continuation of farming, thereby maintaining a minimum population level or conserving the countryside”.

Originally, the EEC Directive 75/278 was specifically introduced to counter the trend of depopulation in the uplands by maintaining the economy of such regions via subsidising production and was not intended to perform any specific environmental function (Haigh, 2000). However, through the 1980s and 1990s agricultural policy had to be reconfigured to accommodate increasing conservation concerns and this also applied to LFA policy (Lowe and Baldock, 2000; Midmore et al., 2001; Whitman, 2006). This progressive ‘greening’ of LFA policy accelerated through the Agenda 2000 reforms of the CAP and the introduction of the Rural Development Regulation (1257/1999) and specifically with the switch from headage to area payments in the uplands (Lowe and Baldock, 2000). With both the Mid Term Review of the CAP in 2003 and the more recent debates surrounding the next Rural Development Programming period of 2007-2013 the LFA areas of Europe are being asked to move away from a production orientated approach to the uplands to one in which a wider suite of public goods are generated from Europe’s upland areas (LUPG, 2002; DEFRA, 2006)

## **Origins of Less-favoured Area Policy in Japan**

### ***Depopulated Area Policy***

From the mid 1950s until the early 1970s, Japan achieved rapid economic growth. The rapid industrialisation emphasised by the pacific belt zone’s “National Income-Doubling Plan (1960)” accelerated population migrations from rural areas to cities (i.e. Chugoku and Shikoku regions). Depopulation in rural areas and income disparity between regions became a serious social problem, and was recognised as such through the ‘Depopulated Areas Problems’ at the political level (Kashiwagi, 2002). Initially Japan attempted to tackle the problem through developing new industrial cities to provide off-farm employment opportunities for surrounding rural areas. However, the failure of this approach resulted in the following two measures being applied to directly support depopulated areas; “The Mountainous Village Development Law (MVDL)” and the “Law on Emergency Measures for Depopulated Areas (the Law for Depopulated Areas)”. Both laws aimed at improving the infrastructure and living conditions within designated areas. Therefore, the National Land Agency, Ministry of Home Affairs and the Ministry of Construction mainly focused on targeted measures for depopulated areas, and there was little involvement of the Ministry of Agriculture, Forestry and Fisheries (Japan’s MAFF heretofore) in these.

### ***Agricultural Policy and LFAs: Background***

Japan's Agricultural policy since the enactment of the Agricultural Basic Law in 1961 has targeted reducing the productivity gap between agricultural and non-agricultural sectors and to equalise living standards between them. Although agricultural support policy has played an important role in underpinning agricultural incomes, there have been no targeted agricultural policy measures to LFAs. However, in anticipating the market liberalisation effects of the General Agreement on Tariffs and Trade (GATT) Uruguay Round, Japan's MAFF started seeking reform of its agricultural policies. The end of 1980s is regarded as a turning point for agricultural policy in Japan (Hayami, 1990; Tashiro, 2005; Kashiwagi, 1994). The price of rice was cut in 1987 for the first time since 1965, and Japan's MAFF started taking initiatives for tackling rural socio-economic problems (including rural depopulation and ageing). "Hilly and Mountainous Farming Areas (Japanese LFAs)<sup>2</sup>" were introduced as a new definition for farming areas considered less favoured for agricultural production. Japan's MAFF explained that these areas would seriously suffer from any reduction in commodity price support and the introduction of market mechanisms (MAFF Japan, 1986 and 1992). The distribution map is showed in Figure 1. The importance of these re-targeted policy measures to such disadvantaged areas was argued at the Agricultural Policy Council (APC), as was the possibility of direct payment support to these areas.

Although the EU's LFA payments were often suggested as a model for this new policy measure, there was reluctance to the direct application of EU LFA payments to Japan. Shogenji (1998) highlighted a confusion between the justification and the difficulty of applying EU-type LFA payments to Japanese LFAs due to the lack of comparative studies that resulted in a questioning of their validity and feasibility<sup>3</sup> at APC about EU-type LFA payments.<sup>4</sup> Consequently, the actual application of LFA direct payment supports was kept out of political debate until the formation of an exploratory committee for direct payments to hilly and mountainous area in 1999.

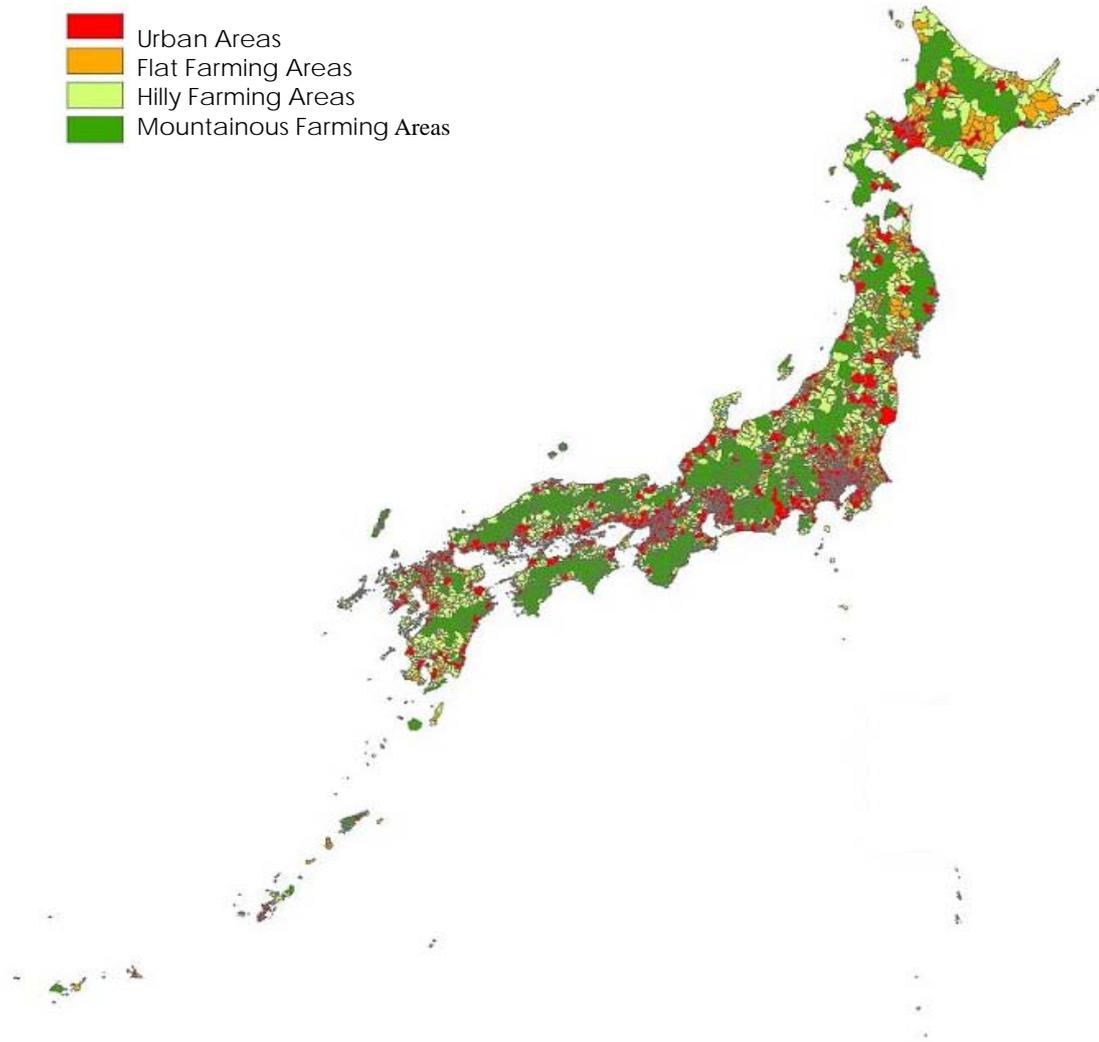
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<sup>2</sup> Hilly farming area: Municipalities whose proportion of total cultivated land is less than 20 % except those which are classified as "Urban area" and "Mountainous farming area". On municipalities whose proportion of cultivated land in total land is 20 % or more except those which are classified as "Urban area" and "Flat farming area". Mountainous farming area: Municipalities whose proportion of forest land and grazing land is 80% or more and the proportion of cultivated land in total land is less than 10 %.

<sup>3</sup> Particularly about different level of public understanding towards 'income supports' for farmers; different farming system and scale; the difficulty in adjustment to confine the area and the type of farm and farmer; the consistency with the other policy objectives.

<sup>4</sup> There were a lot of descriptions about EU LFAs policy, but few studies of simulation and feasibility in the context of actual application to Japan.

Figure 1: The distribution map of Hilly and Mountainous Areas in 2003



Note: This is mapped by Hiroyasu Sugihara and Yoriko Ikoma based on the data of MAFF Japan at September 2003.

#### ***Targeted Agricultural Policy Measures to LFAs***

Instead of LFA direct payments Japan introduced several targeted measures through its "Law Concerning the Promotion of Infrastructure Development for Vitalization of Agriculture and Forestry in Designated Areas<sup>5</sup>" (1993). Under this, LFAs were designated mainly by geographic features and the importance of agriculture in the area<sup>6</sup>. These policy measures mainly focused on improving farm

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<sup>5</sup> This is the official English name of the law defined by MAFF, Japan.

<sup>6</sup> The details of the requirement for local authority to be designated are as below:

- 1) High rate of steep sided agricultural land (e.g. more than half of agricultural land consists of 1/20 degree paddy field and more than 15 degree vegetable field), or more than 75 per cent of forest in the area.
- 2) More than 10% of population are engaged in agriculture and forestry, or more than 81 % of land is used for agriculture and forestry.
- 3) Not a part of a built-up area or metropolitan city.

management systems by providing technical training and advisory services.

Although the implementation of this policy to LFAs in Japan was considered novel, several problems remained. Firstly, these measures were not designed based on a rigorous examination of less-favoured characteristics in these areas. LFAs were defined by geographical disadvantage, which often brings drawbacks not only in terms of reduced agricultural production but also in lack of human resources, market access and marketing channels. Nevertheless, there was an optimistic view that it was possible to convert LFAs to non-LFAs by applying 'absolute advantageous agricultural products' to be produced in limited areas such as organic food or indigenous vegetables. However those products are normally more labour-intensive than modern paddy farming and given an ageing population and a lack of successors in such rural areas the introduction of such labour intensive products was unrealistic

Consequently, these measures only had limited success. In response to the substantial failure of this policy, the implementation of direct payment support for LFAs appeared on the political agenda again but now within a wider debate on agricultural policy reforms.

## **Direct Payment System in Hilly and Mountainous Areas<sup>7</sup>**

### *Toward The Application of EU LFAs Payments to Japan*

In response to the failure of previous attempts at targeting policy to LFAs, direct payment supports were clearly stated as necessary in the 'The Report Submitted to the Prime Minister by the Investigative Council on Basic Problems Concerning Food, Agriculture, and Rural Areas' (MAFF Japan, 1998). This report is based on recognition of the present state of Japan's agriculture. It states that,

"even though various support measures have already been implemented, it is becoming increasingly difficult, as the market economy progresses, to maintain agricultural and community activities (p. 23)".

It goes on to state that,

"direct payments to hilly and mountainous areas to support sound and sustainable agricultural production, in order to promote the diversification of food production and preserve multi-functional roles, is an effective public support measures if such payments can appropriately target farmers who are in real need, and if the transparency of these payments can be ensured (p. 24)."

There are three main reasons why policy makers' attitudes towards the application of LFA direct payments to Japan shifted.

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<sup>7</sup> This is official English name of law defined by MAFF, Japan.

### ***The failure of the previous targeted policy measures to LFAs***

In spite of the implementation of the “Law Concerning the Promotion of Infrastructure Development for Vitalization of Agriculture and Forestry in Designated Areas”, the decline of rural areas, which is characterised by an increase in farmland abandonment and degradation of rural environment, continues. Although some prefectures have taken initiatives to overcome or compensate for the inefficiency of central government policy, it was difficult for them to form a long-term support framework with a limited local budget.

### ***International trends surrounding agricultural supports***

The EU LFA support, which has been applied since 1975 in the EC/EU countries, was categorised as ‘green box’ by WTO as an agricultural support payment that had no trade-distorting effects. This had a big impact on Japanese policy makers’ in that LFA direct payments could be one of the alternative policy measures instead of price supports within the limited options under the WTO framework. The positive externalities from rural agriculture particularly terraced paddy fields have been increasingly recognised in Japan. Therefore, keeping and enhancing the multifunctionality of agriculture in LFAs also became one of the important objectives for Japan’s agricultural policy reform.

### ***The change of the concept toward direct payment support***

Thirdly, a change in the interpretation (into Japanese) of ‘compensatory allowances’ used in EU documents as an explanatory term of LFA payments was also an influence on policy makers. Initially, ‘compensatory allowances’ was interpreted as ‘income support’ in Japanese, which resulted in a strong rejection from the Ministry of Finance due to the potential fiscal burden. However, with subsequent studies into the principles and background of EU LFA policy, Japanese agricultural policy makers have changed their notion of the EU LFA. The term ‘direct payment supports’ now used in Japan suggests compensatory payments for disadvantaged agricultural production compared to non-disadvantaged areas. As soon as consent was obtained from the Ministry of Finance, Japan’s MAFF rushed to establish a structured LFA support system.

### ***The Examination Committee of LFAs Direct Payment Support***

Before applying LFA direct payment supports an examination committee was formed to further discuss the detailed requirements. The first meeting was held in January 1999, and 9 meetings followed until August 1999.

The committee consisted of 10 examination members and 8 expert members including local governors. Throughout the meetings, the following two topics were particularly debated: the

interpretation of 'a block of farmland' and how this new payment can have consistency particularly with agricultural structural measures such as production control. Of particular concern was that there are minimal land use differences across farming areas (see Table 1).

**Table 1: Land use in Japan (percentages)**

Area	Paddy field		Vegetable field (Grassland)		Orchard	
	1995	2000	1995	2000	1995	2000
Urban	63	65	24 (4)	25 (2)	9	8
Flat farming	58	59	34 (2)	36 (1)	5	5
Hilly farming	50	52	35 (5)	36 (2)	10	9
Mountainous farming	53	55	35 (6)	36 (3)	6	6

Source: Agricultural Census 2000.

Japan has over-produced rice for a long time and a lot of policy measures have been applied to encourage farmers to convert to other crops. However, direct payment supports, which are not subject to land use, could distort the impacts of previous policy frameworks. While some members insisted that the new support payment should be combined with production controls on rice, other members opposed this on the grounds that the aim of this new support is fundamentally different from that of production control. Agreement over this issue could not be reached and the interrelationship between the two policy measures remained unclear even at the end of the series of meetings. Apart from these issues, the activities that enhance multifunctionality were considered for inclusion as a mandatory requirement for receiving this payment. Whether the support should be paid to either an individual farm or a certain group of farms was also discussed and contrasted with the EU policy which has larger farms and pays to an individual farm. In addition the *pros and cons* for setting a limit to the amounts paid from this policy were discussed focusing on concerns about the exceptionally large scale of farms such as the public agricultural corporations and farms in Hokkaido. The distribution of the expenses for this policy application between the central government and local governments was also an important issue to be agreed at the committee. The details of main discussions at the committee and the agreement points are reviewed in the Table 2.

**Table 2: The Discussion and Agreed Points at the Examination Committee**

List of Discussions	Discussion Points	Background	Agreed Points
Targeted Farm for Support Agreement	Paying to a plot of farm with a lower size limit (1 ha) or to scattered but grouped farms in the area	<ul style="list-style-type: none"> <li>- Small and scattered individual farms<sup>8</sup></li> <li>- Serious shortage of successors and concerns for community sustainability</li> <li>- Importance of community function for consistent land use in rural areas</li> <li>- Importance of community farming system in LFAs</li> </ul>	Community payment subject to farming community agreement (At least 50% of the payment has to be used for the community activities.)
Production Control	The consistency with rice production control	<ul style="list-style-type: none"> <li>- Dilemma between high multifunctionality of terraced paddy fields in LFAs and pressure to reduce rice production</li> <li>- Little land use difference between LFAs and non-LFAs</li> </ul>	Could not reach an agreement
Multifunctional Activities	Application of Cross-compliance	<ul style="list-style-type: none"> <li>- Different awareness and expectations of rural agriculture between EU and Japan</li> <li>- Concern for the duplication with future agri-environment policy application</li> </ul>	Obligation to do some farming activities for maintaining and enhancing multifunctionality (not specified as agri-environment)
Upper Limit of Payments	Setting the upper limit of payment amounts	<ul style="list-style-type: none"> <li>- Consideration of WTO requirements</li> <li>- The importance of some rural farming organisations which manage a large area of marginal farms in rural areas</li> </ul>	Upper limit is eliminated in case of rural land management bodies playing a important role in marginal communities
Source of Budget	Sharing expenses between central and local governments	<ul style="list-style-type: none"> <li>- Huge financial burden for local governments under the crisis of local finance</li> <li>- Recognition as an inevitable duty for local governments under the decentralisation trend</li> </ul>	Local governments have to share the expense, a part of which could be compensated by tax revenue allocations from the Ministry of Home Affairs

<sup>8</sup> The average area of farmland in one rural community is 9.4 ha as the national average and only 6.7 ha in Chugoku region where the geographic disadvantage is recognised particularly serious.

## **Applying Japan's New LFA Policy**

The amount of direct payment was set at 80 per cent of the difference in production costs between flat farming areas and hilly and mountainous areas. This was regarded as an appropriate amount which does not discourage farmers' motivation for productivity growth in the favoured areas.

For receiving LFA payments, farming communities in the designated areas have to reach an agreement with local authorities over their farming practice plans for the following 5 years. Initially the payment is made to the farming community, and then it is distributed to individuals, although more than half of payments must be allocated for community activities. The proportion of payments allocated between the community and individual farmers varies from agreement to agreement, but a lot of communities pool a large part of the payment for the community. The average size of community farm under the agreement is only 10 ha in prefectures for 19 farmers while Hokkaido has 672 ha for 31 farmers. Thus, the average size of farms in LFAs is so small that the payments to individual farms is £333<sup>9</sup> and consequently it is much more effective to use them collectively for the community benefit rather than individual payments as the EU does.

### ***Policy Impact***

LFA payments under the farming community agreement have given farmers group's great flexibility in terms of utilisation from environmental activities to economic activities (e.g. operation of community enterprises for rural tourism or agro-food business). 665,000 ha which is 85% of the targeted areas are under the agreement, and it has been claimed that there have been significant effects to prevent in preventing increases in farmland abandonment in 'The Report of Surveys to Representatives of Farming Community Agreement' (MAFF Japan, 2004). In this report, nearly 90% of respondents stated that a part or all of farmland would be abandoned if the direct payment support was abolished.

### **Towards the further development of LFAs policy: Discussion**

Japan's LFA Policy represents the first implementation of direct payments to Hilly and Mountainous areas based on an official recognition of their disadvantage and aims to prevent further farmland abandonment. Moreover, this was the first implementation of 'decoupled' agricultural support in Japan. Although Japan's LFA support programme was based on EU LFA policy, its emphasis is clearly on farming community agreements that recognise the importance of 'community' for rural land management in Japanese rice farming culture. However, there are difficulties concerning the long-term impacts which are summarised below:

- There is a lack of understanding about the concept of farmers' income stability, which is one of the most important elements for farming community sustainability.

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<sup>9</sup> £1 = 240 yen

- There is no long-term vision to tackle an ageing agricultural population (i.e. 28.6 % of agricultural population is over 65 years old in 2000).
- The relationship with production related policy, particularly with production control programmes, is still unclear.
- LFA programmes are a huge financial burden for both the nation and local authorities as a single policy measure (about £200 million annual).
- The success of this programme is dependent on grass-root efforts and the existence of engaged community leaders

As the OECD (2006b) observes, many OECD countries are shifting into the “new rural paradigm (p16)” It highlights the two principles of this “new rural paradigm” as being: 1) the shift from a sectoral approach to a territorial approach and 2) a conceptual change of government support from subsidy to investment. If we consider Japan’s LFA policy in the context of this new rural paradigm, this is a territorial approach that aims to enhance the multifunctionality of agriculture. In this sense, this policy represents a shift in Japanese agricultural policy towards an ‘integrated’ rural policy. However, the effective utilisation of these payments in the long-term depends on local community efforts, and currently there is a lack of a clearly differentiated purpose to these payments. Therefore, such a shift will potentially lead neither to income stability nor to rural development resulting in both environmental and cultural losses (Kashiwagi, 2002).

We suggest that to utilise government payments for investment in rural development, it is important to have management bodies that enhance community participation and manage community plans and projects. In the past, local governments often played an important role in this. Some local governments<sup>10</sup> which face serious shortages of agricultural successors and increases in farmland abandonment, have even established public agricultural corporations. Particularly since the 1980s, a number of agricultural corporations have appeared through joint investment between the public and private sectors. However, these corporations often face financial difficulties without subsidies because they are often under pressure to rent less profitable lands in danger of farmland abandonment rather than profitable lands. Therefore most corporations have high cost/low return characteristics<sup>11</sup>. Furthermore, recent trends from merging municipalities have brought less direct involvement of local government into local activities. Consequently, it is becoming difficult for local governments to play the same role in rural development as they used to. In comparison Japan’s Agricultural Cooperative (*Nokyo*) is distinctive through its provision of comprehensive services from agricultural production support to rural life support, including daily shops and financial services in rural areas. However, recently they have rationalised their business through amalgamating several

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<sup>10</sup> For instance, Kashiwagi (2002) refers some examples of public agricultural corporations which directly involve farming activities as well as incubation for new entry farmers in Shimane prefecture, Kyoto prefecture, Niigata prefecture.

<sup>11</sup> Even in the case of public corporations, they often pay over-valued rent through received public money, which is pointed out a kind of subsidising rural farmers who already retired.

rural branches due to the financial slump<sup>12</sup>. There are some cases where community people have invested in establishing enterprises to keep providing services instead of the Cooperative<sup>13</sup>.

In terms of the utilisation of LFA payments the Policy Examination Committee for Hilly and Mountainous Areas (2004) observed that the farming community plans with local participation (such as local farmers' cooperative and NPOs) achieved more efficient and long-term territorial effects on the area during the first phase of the programme (i.e. 2000-2005). Given this fact, local involvement was encouraged in order to receive LFA payments for the second phase (i.e. 2006-2011). Thus the Japanese government has increasingly recognised the importance of local initiatives and management bodies, although the role of existing rural entities needs to be redefined to reflect these recent change.

Ideally, local government should play a coordinating role among the three sectors (i.e. public, private and not-for-profit private) and manage public funding and monitor the optimal allocation of public goods from the projects. Learning from the experiences of the Public Private Partnership (PPP) in the UK, it is argued that PPPs have a role to play in rural development in Japan (Kashiwagi, 2002). However, the application of PPP concept is still in the early stages in Japan, and there is a huge gap between the speed of policy reform and the actual capacity at the local level to catch up with these changes. The more policy becomes integrated, the more local areas need to reflect this integration. We suggest it is important to establish an effective local support system to help build partnership systems and to collaborate towards a common purpose of local development. Without this central government reforms of agricultural policy towards a 'new rural policy paradigm' will be as limited and interim as the old rural development policies were.

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<sup>12</sup> Kitajima (1997) explains the slump of Japan Agricultural Cooperative stemmed from the lack of competence of business and management skills due to the dependence on post-war agricultural protectionist policy.

<sup>13</sup> Particularly Kyoto prefecture is prominent about community enterprises for rural services based on the residents need.

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