The CAP and national priorities within the EU budget after 2020

INSTITUTE OF AGRICULTURAL
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CHALLENGES, CHANCES, THREATS, PROPOSALS

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7. Problems and risks linked with investment supports in agrarian sector – the Czech experience

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Abstract

The grant system under the RDP has been long prevailing for investment supports in the Czech agriculture. The current evaluation system of investment projects is based on financial plans that use normative data to simplify the administration. This limits applicants for supports, especially when their holdings have better performance than the normative approach. To the contrary, when the farms have worse performance, they obtain supports even if it is not real to repay back sources, before the end of lifetime of the investment. In the case of supports in food processing investments, the heterogeneity of products is high and, therefore, the farmers prepare the whole simplified financial plan by themselves, applying their own data. The only control is by the comparison with the average profitability of the food products. The normative values are usually low, and many projects would not pass. Therefore, the applicants can justify their real profitability. However, it requires additional assessment and complicates the evaluation procedures. Considering the above-mentioned and other problems with the grant system, it is desirable in the next programming period and for the so-called productive investments to apply other forms of supports, based mainly on financial instruments[1].

Keywords: investment supports, evaluation, Rural Development Programme

JEL codes: H43, O22, B41

7.1. Introduction

The aim of the article is to discuss problems and shortcomings of the grant system in investment supports for the Czech agriculture, enlarged also by the current system of their assessment, and to give signals for needed changes in this field under the EU Common Agricultural Policy after 2020 (CAP 2020+).

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First, there is a recapitulation of the current forms and their importance in investment supports for the Czech farms, or agrarian sector, respectively:

- Grants provided under the RDP 2014-2020, included in priority 4, up to 60% of eligible costs can be financed by non-repayable grants. Only efficient projects shall be supported. The assessment criterion is based on the payback period of the investment that is calculated by the IAEI model (see further). It must be shorter than the lifetime period set by the State Agricultural and Intervention Fund (SAIF). About 70% of all investment supports (about EUR 94 million in 2017) is provided by the grant system in the Czech agrarian sector.
- Supports provided as a state aid by the Support Guaranty Farm and Forestry Fund (SGFFF) in the form of interest subsidies, guaranties for bank credits, and returnable loans (with the application of *de minimis* principle – about EUR 15 million in 2017). The main criterion for support is financial health after investment, which is assessed by banks providing credits (or by the SGFFF in case of returnable loans, respectively).
- Particularly for non-productive investments following social priorities (e.g. land consolidation, ecological investments, etc.) there are national subsidies of the Ministry of Agriculture and partly of the Ministry of Environment, covering 100% of expenditures of projects.

So the largest part of the current investment supports for the Czech agrarian sector are supports from the EU funds in the form of non-repayable grants under the RDP for the period between 2014 and 2020. Subsidies shall be efficient and shall support only viable and efficient projects "The EU Commission highlights evaluations as important for improving common policies" [Anderson et al., 2017]. The evaluation shall be based on the criteria 3Es – efficiency, effectiveness and economy. Only economically viable and efficient projects shall be selected for support. "Evaluating the impact of rural development programmes is, however, complicated due to the widely varying policy targets of RDPs as well as their substantial heterogeneity across rural areas" [Smit et al., 2015].

Procedures under the grant system pose usually higher administrative burdens and costs for the Czech payment agency SAIF. It has to control those aspects of projects in application for support and take over political guaranty for supports. So, the whole system and processes are characterised by general and specific failures, inaccuracies and even mistakes that point out shortcomings of the grant system.

7.2. Material and methods

The objective of the article is the current grant system of investment supports in the Czech agrarian sector. The system is critically characterised using simple analytical / comparative methods.

General risks and failures of investment supports based mainly on sector approach, and which are more relevant in grant systems, are linked with opportunity costs to use public money in other sectors of the national economy, producing higher contributions to social benefits of a country. Failures in the allocation of subsidies, including investment supports, were examined, based on the theory of public choice, e.g. in Elliott and Heath [2000].

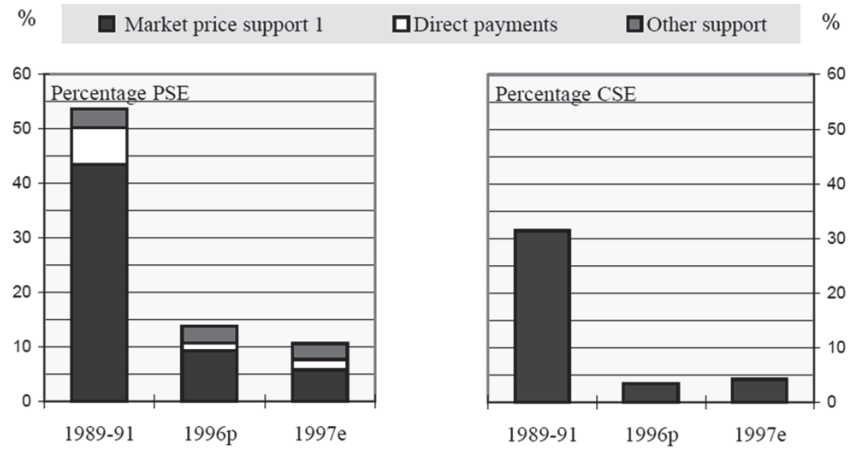
Other problems are on the sector level. They are very close to the moral hazard of the government, because they are linked with political preferences of investment supports on specific commodities (branches) or farm categories. By conditions for supports, the government increases the risk of an improper allocation of public sources among agricultural commodities and especially among farm categories. For example, the very large Czech farms – mega-farms / holdings are eligible to receive investment supports up to EUR 6 million per one application. Kravcakova Vozarova and Kotulic [2016] found out that in Slovak conditions the amounts of subsidies are correlated with the amount of gross agricultural production, which indicates that the subsides might be e.g. granted more to large farms or they increase by the size of the farms, respectively. Thus, the supports are detrimental to small- and medium-sized farms and, finally, to the rural development of the country[2].

There is also a general problem of a lower efficiency of investment supports as a kind of input supports due to a high potential or real outflow of supports from receivers – farms to suppliers of inputs. According to the previous OECD estimations, based on the Policy Evaluation Matrix model, the highest outflow of supports from farms (more than 80%) is linked with input subsidies. Real height of agricultural support in the Czech Republic is displayed at Figure 1.

There is more signal information on the Czech market that after the implementation of grant investment supports for selected inputs, the market prices of those inputs very quickly (sometimes steeply, even two times) increased.

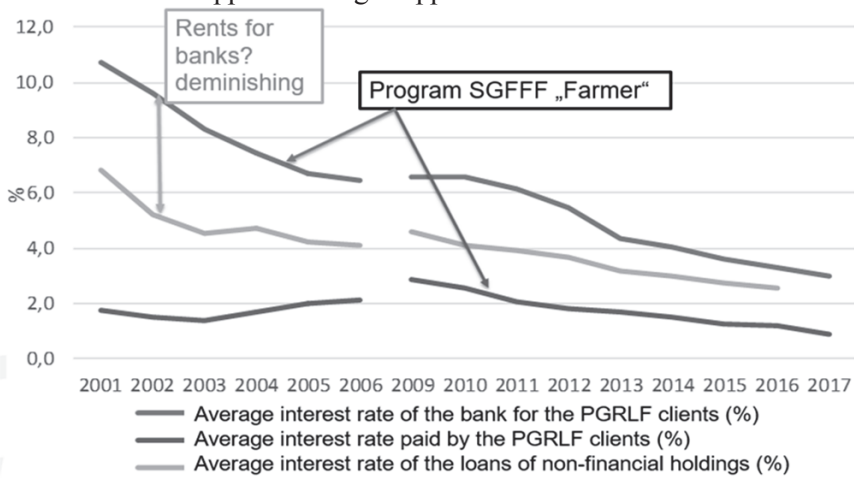
[2] The grant system in these aspects can be also analysed with the application of the contrafactual and dead weight losses methodology. The results in this field for the Czech investment supports in agriculture were presented in Doucha et al. [2017].

Figure 1. Agricultural support in the Czech Republic



Note: The % CSE shows the implicit tax on consumers. e: estimate; p: provisional.
1MPS is net of levies and feed adjustment.
Source: OECD Secretariat [1998].

Figure 2. Outflow of supports through supported interest rates



Source: Medonos et al. [2017].

Besides, there is a problem of the leakage of supports through supported interest rates from the public finances via the receivers of the support to the banks. There are different interest rates for credits. As an example can serve the interest rate subsidies provided by the Czech Support Guarantee Farming and Forestry Fund (SGFFF) on the investments into tangible assets (common bank credits versus bank credits linked with SGFFF programmes for farms). From Figure 2 it can be seen that average interest rates provided by banks to the SGFFF customers (upper line) are the highest. The actual interest rates paid by

the SGFFF customers are lower (middle line) and the average interest rates of the loans of non-financial holdings is the lowest – only around 2% (lower line). When the loan is subsidised by the SGFFF, the banks tend to set higher interest rates.

7.3. The assessment model for application of farms for investment supports

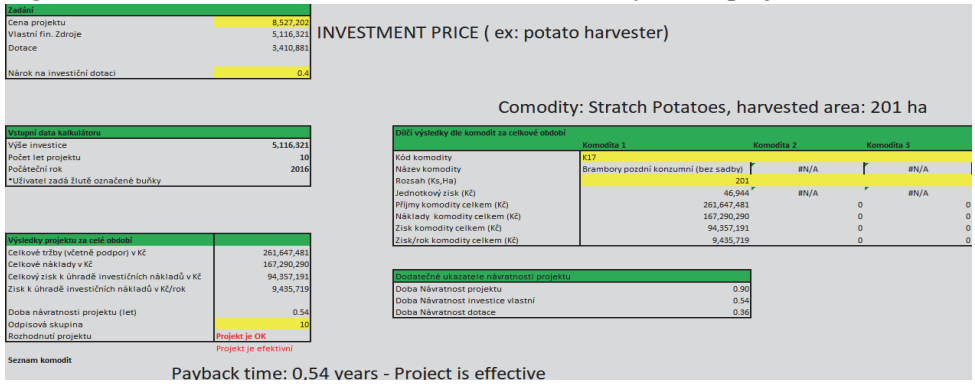
Last but not least, problems with the grant system in the allocation of investment supports are embedded in procedures and methods of the assessment of applications for supports.

The Czech Institute of Agricultural Economics and Information (IAEI) has been functioning as an advisory body for the Czech Ministry of Agriculture, also in tasks for assessment of the allocation of investment supports to farms in the current period, and at the same time in analyses for the supports under the CAP 2020+.

The current IAEI model for the assessment of applications for investment grants in the RDP 2014-2020 and under administrative (SAIF) requirements has been applying a "normative" approach. The evaluation of investment projects is based on the assessment of financial plans of farms using normative data to simplify the administrative procedures. The IAEI – RDP calculator (model)[3] is used as a tool to assess efficiency of projects from economic point of view. The model follows the structure of the general financial plan, it means it calculates revenues (based on acreages, yields, number of animal units) and costs, and based on this cash flow and payback period.

Criterion for the selection of projects in the IAEI calculator – model is payback period that must be shorter than lifetime of the investment in application. The illustration of the model is presented on Figure 3.

Figure 3. RDP calculator of evaluation of the efficiency of the projects



Source: Chaloupka [2016a].

[3] The model has the form of a software program system in the Microsoft Excel spreadsheet, version 2010. Its detail structure is presented in Chaloupka et al. [2016a; 2016b].

The applied normative approach[4] represents limitations to the applicants, especially when their efficiency is better than the average normative (lower costs, higher revenues and yields or better performance in livestock production). On the contrary, when the farms have worse efficiency, they obtain the subsidy even if it is not real to repay back sources before the end of the investment lifetime.

Normative approach also limits possibility to reflect an improvement or adaptation effect, e.g. higher efficiency or decrease of costs thanks to modernization, innovation and other changes.

In the case of investment supports for processing, the heterogeneity of the final food products is high and, therefore, the farmers have to prepare the whole simplified financial plan by themselves with their own data. It has to be controlled by comparisons with the average profitability of the given type of food products. The normative values are usually lower, and many projects would not pass. Therefore, the applicants can apply their own real profitability. However, it requires additional expert assessments and complicates the whole evaluation procedure.

Besides, the system is not able to jointly assess the processing of agricultural commodities directly on the farm because the assessments of supports for agricultural and food investments are strictly separated. Let us look on the example of wine production. Real operational costs plus other costs are CZK 64-69 per 1 litre of wine. In the calculator there is only wine grapes assessed at the normative price of 44 CZK/kg. But the minimum market prices for one litre of (late) harvested wine are CZK 85. Hence, the production of wine of higher quality (not only wine grapes) is in reality highly profitable which is not considered in the calculator.

The model and its utilisation are the examples of the typical conflict between normative (or flat rate) approach versus better targeted or even tailored measures (approaches) in the policy. In addition, grant system by its conditions predestines areas where farmers shall invest and kinds of eligible costs; however, a large part of subsidies reflects the needs to substitute unavailable labour on the Czech farms. So investments in agriculture are aimed at livestock production despite that it is usually less profitable, but "politically" preferred (pig meat, poultry).

Under the normative approach and related administrative procedures, and under the "policy" aim to spend public money as much as possible, if an original set of flat normative selects only few applicants, the original set of the normative is proportionately changed (e.g. yields increased). It represents a solution, which can be described as a "quasi-tailoring".

[4] Similar problems are linked with regional approach. Kiryluk-Dryjska and Beba [2018] present a method for region-specific budgeting of rural development funds, based on objectively measured indexes of rural development that enables the allocation supporting weaker and underdeveloped regions.

7.4. Summary and conclusions

Considering the above-mentioned and other problems and shortcomings with the grant system in investment supports for agrarian sector, it is desirable in the next programming period and for the so-called productive investments to apply mainly other forms of supports, based on financial instruments. This shift can be stimulated by a significant and serious reduction of sources in the CAP 2020+ for grant investment supports, up to now prevailing.

It could and should transfer much higher responsibility for investments on private sector (farms, processors and banks), reducing risks related to moral hazards of the government and a proper allocation of public sources.

However, politicians have to resist pressures from the non-governmental organisations of (large) farmers, which could strongly protect the current grant system in investment supports with weaker conditions of their receiving (and leaving the realisation of financial instruments only for small farms).

The shift from the grant to a different system, represented by financial instruments, can be also slowed down by administrators of public money that is by budgetary risks to utilise fully public money, regardless of their efficiency.

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