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Impact of Direct Payment Reform of CAP 2014–2020 on the Economy of Agricultural Enterprises in Slovakia

New Common Agricultural Policy (CAP) in 2014-2020 introduces the changes in direct payments. Progressive reduction and capping of the payment will have impact mainly on big enterprises managing large land area. This is a reality in the Czech Republic and Slovakia. The paper is devoted to quantify and model the impact of forthcoming changes on the management of farms in Slovakia. As the results in chosen enterprises in Slovakia proved, these changes have a negative effect on the enterprises which are mainly the large ones with the low sales as well as the small salaries paid per hectare in comparison with the rest of the companies in Slovakia. In sense of effectiveness and rural development we do consider planned changes in direct payments as rational.

Introduction

The agriculture is one of the most controversial and most debated areas of European Policy. CAP was created more than fifty years ago as an answer on memories of hunger after the World War II. One of the objectives was to secure the supply which was later fulfilled. The agriculture was over stimulated and it is known that in this time food surpluses were existed. This resulted to a big crisis, which has led to the first reforms in the years 1988 and 1992. In the year 1988 were the costs on agriculture limited (78% of GNP). The main objective of the next reform in the year 1992 was a drastic decrease of intervention prices and the system of direct payments was established.

The next intensive reform took part in 2003 which considered the removal of the link between subsidies and production (decoupling- the new "single farm payments" are subject to "cross-compliance" conditions relating to environmental, food safety and animal welfare standards (OECD 2006), Cross Compliance which is the respect of standards on the level of farms, single farm payment which means that the farmer will receive only one payment, Farm Advisory System, Set aside, modulation which will be addressed only those farmers which receive direct payment over 5000 Euro for rural development. This was a first step of the CAP adaptation for the 21st century.

The reformed CAP is due to come into force after 2013. On 18 November 2010, the European Commission presented "The CAP towards 2020" in which are presented two pillars which are the base of CAP and CAP should remain a strong common policy. Here were mentioned new challenges like food security, environment and climate change or territorial balance (EC 2010).

On 12th October 2011, the Commission presented a set of legal proposals to reform the CAP after 2013 (EC 2011) which includes 4 basic regulations as direct payment, Common Market organization, rural development, regulation of finance, governance and monitoring of CAP.

Direct payments have changed over the years and their introduction has supported and established farmers' income. Farmers can reply to the market demand and find new efficient and profitable markets. A negative reaction was expected after the introduction of capping because of a reduction of direct payments for all farmers in the EU. These problems were also mentioned by Medonos et. al. (2009). Resources "stopped" in capping are redistributed in that member state in which they belong. They are used for rural development programming financed under Regulation (EU). In the article we focus on three issues. First part is dedicated to the proposal for direct payments in the CAP post 2013, then we focus on the expected impact on agricultural enterprises in Slovakia and the last issue is to analyze which enterprises will be affected.

Methods and Resources

For the analysis we used individual data for a sample of agricultural enterprises from the official database of the Slovak Research Institute of Agricultural and Food Economics in 2010. The data include balance sheets, profit and loss statements and other selected indicators for agricultural enterprises. The Number of enterprises evaluated was 1131 which means 60% of all cooperative farms, limited liability companies and joined stock companies in Slovak agriculture.

Results and discussion

The proposal establishing rules for direct payments to farmers under support schemes within the framework of the common agricultural policy presented on 12.10.2011 is setting new aspect in the direct payments. The change, which sets the maximum amount for direct payments will affect mainly the large enterprises. The article 11 (EC 2011) of the proposal introduces a progressive reduction and capping of the payment. The amount of direct payments to be granted to a farmer in a given calendar year shall be reduced as follows:

- by 20 % for the tranche of more than EUR 150 000 and up to EUR 200 000;
- by 40 % for the tranche of more than EUR 200 000 and up to EUR 250 000;
- by 70 % for the tranche of more than EUR 250 000 and up to EUR 300 000;
- by 100 % for the tranche of more than EUR 300 000.

The amount shall be calculated by subtracting the salaries effectively paid and declared by the farmer in the previous year, including taxes and social contributions related to employment, from the total amount of direct payments. The goal of the reduction is to eliminate moral hazard of decoupling the direct payments from production. Because the negative aspect is paying public funds to companies without producing public benefits. Generally, it is a political decision and we do not see any economic theory (except for the economy of scale) for such a decision. The impact of the regulation will differ across the member states. The average direct payment per beneficiary and hectare are presented in the Fig. 1.

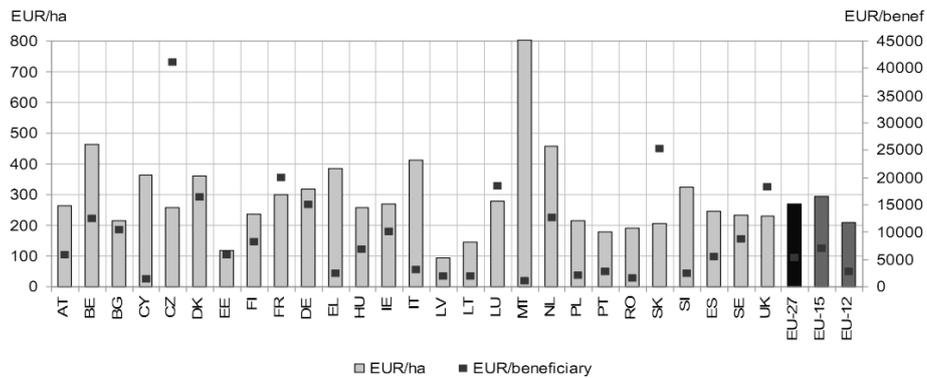


Figure 1. Average direct payments per beneficiary and hectare in each Member State
Source: DG AGRI

The expected impact in States with higher payment per beneficiary is higher. Therefore Czech Republic and Slovakia will be affected. Another aspect is the distribution of direct payments between small and big farms. In the EU a high level of subsidies is received by a small group of beneficiaries. And the disproportion is higher in EU-12. Only 5% of beneficiaries receive 60% of direct payments – Fig. 2.

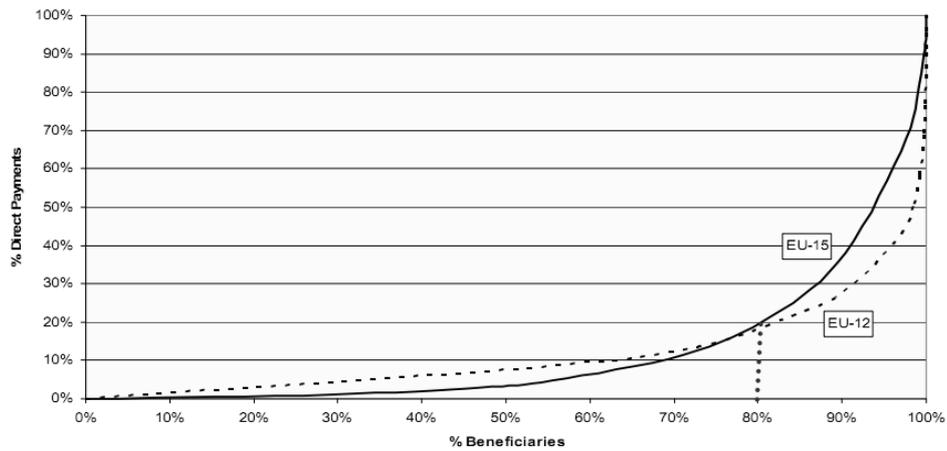


Figure 2: Distribution of direct payments between beneficiaries in EU-15 and in EU-12
Source: CATS data (2009 financial year corresponding mainly to claim year 2008), DG AGRI calculation

We analyzed the impact of progressive reduction and capping of the payment on a set of enterprises in Slovakia. The total number (1131 enterprises) represent 60% of all agricultural limited liabilities companies, joint stock companies and cooperative farms in Slovakia based on year 2010. The size, average managed hectares and proportion on the total number of hectares in Slovakia is in the Tab. I.

I: The size, average managed hectares and proportion on the total number of hectares in 2010 according the enterprise form in Slovakia

	Land area in hectares							Number of firms	Total area in hectares	Average land area	Proportion on total area (%)
	0-5	5-10	10-50	50-100	100-250	250-500	500				
Farm Co-op	13	2	17	17	23	49	469	587	750 087	1 277	39,95
Ltd.	64	45	224	121	159	194	348	1 191	619 859	520	33,01
Self-Employed farmer	827	740	1 823	600	511	155	96	4 752	309 609	65	16,49
Joint stock company	2	4	6	7	13	13	63	108	142 124	1315	7,57
Natural person	6 885	1 699	822	13	3			9 422	42 404	5	2,26

Source: Agricultural payment agency, www.apa.sk

The main part of agricultural land in Slovakia is managed by relatively big companies, which is the result of the history. As the table 1 shows, 80% of agricultural land is related to analyzed companies.

In the first part of the analysis we focused on number of enterprises as well as the regions, which will be affected by the proposal of progressive reduction and capping of the direct payments post 2013. The results of the analysis are shown in the Tab. II. The total number of companies, which would receive less direct payment according to the article 11 of the proposal is 56 out of 1131 (4,95%). The main part of these enterprises is doing business in LFA – less favorable areas. Out of the 56 enterprises – 19 would be affected by reduction of 20%, 17 by 40%, 4 by 70% and 16 enterprises by the reduction of 100%.

To conclude this part: Progressive reduction and capping of the direct payments will have an impact on 5% of analyzed agricultural enterprises in Slovakia, mainly on enterprises in LFA.

II: Impact of progressive reduction and capping of direct payments across Regions in Slovakia (based on year 2010)

<i>Region</i>	<i>BA</i>	<i>TT</i>	<i>TN</i>	<i>NR</i>	<i>ZA</i>	<i>BB</i>	<i>PO</i>	<i>KE</i>	<i>Total</i>
Number of enterprises affected by the reduction	4	6	2	9	4	13	8	10	56

Source: Own calculations



In the second part we simulated the increase of the average direct payment from the average 188.5 Euro/hectare to 200, 210 and 220 EUR/hectare in 2010. The results of the simulation are in Tab. III. The increasing direct payments will increase the number of affected enterprises with higher growth rate than the growth of direct payments. To summarize this part we can conclude, that the growth in average direct payment in the future will result in more enterprises affected by progressive reduction and capping of the payment.

III: The impact of growing direct payments per hectare on the enterprises affected by the regulation (number of affected enterprises)

	<i>BA</i>	<i>TT</i>	<i>TN</i>	<i>NR</i>	<i>ZA</i>	<i>BB</i>	<i>PO</i>	<i>KE</i>	Σ	<i>Proportion of all enterprises</i>
200 €	5	6	2	12	6	16	16	13	76	6.7%
210 €	7	9	3	14	7	19	17	17	93	8.2%
220 €	7	11	4	15	8	20	21	22	108	9.5%

Source: Own calculations

The last issue of the article was to identify the differences between enterprise affected and not affected by the progressive reduction and capping of the direct payments. We focused on two aspects: on the sales per hectare and salaries including taxes and social contributions related to employment per hectare. The results are shown in the following tables 4 and 5.

IV: Average sales of own products and services per hectare in enterprises affected and not affected by the regulation in Euro.

	<i>BA</i>	<i>TT</i>	<i>TN</i>	<i>NR</i>	<i>ZA</i>	<i>BB</i>	<i>PO</i>	<i>KE</i>	<i>Average</i>
Enterprises affected	238	927	377	1 012	170	353	385	376	487
Enterprises not affected	1 241	1 456	829	1 091	481	688	349	506	832

Source: Own calculations

Enterprises affected by progressive reduction and capping of the direct payments have average sales of own products and services per hectare significantly lower as the rest of companies. Therefore we can conclude, that the affected companies are not production oriented but use the possibility offered by decoupling to maximize the amount of received subsidies.

V: Average salaries including taxes and social contributions related to employment per hectare in enterprises affected and not affected by the regulation in Euro.

	<i>BA</i>	<i>TT</i>	<i>TN</i>	<i>NR</i>	<i>ZA</i>	<i>BB</i>	<i>PO</i>	<i>KE</i>	<i>Average</i>
Enterprises affected	56	76	187	66	106	106	95	50	86
Enterprises not affected	377	403	326	312	262	206	194	192	279

Source: Own calculations

The second comparison was focused on salaries including taxes and social contributions related to employment per hectare. From the table 5 we can conclude that there is a huge difference between the number of employees in affected and not affected enterprises. The affected companies pay only 30% on salaries compared to the rest. The question is whether the lower rate of employment in rural areas, huge amount of received subsidies per one beneficiary and lower activity is the goal of direct payments. But not according to the official goals of CAP. The results of the analysis point at the fact, that small part of the companies in Slovakia do business exactly like that.

Summary

Through the instruments of the EU budget is a large volume of financial resources allocated in the national economy. More than 40% of this budget is allocated to address the priorities and the objectives of the CAP of the EU. Specification of objectives in the form of food production, sustainable management of natural resources, impacts of climate change and balanced regional development in Europe requires the formulation and methodology for establishing a single market for agricultural commodities and food. In this respect, the reform of CAP direct payments post 2013 is a significant help in sense of progressive reduction and capping of the direct payments. As confirmed by the results of the analyzed companies progressive reduction and capping direct payments (direct payments without taking into account the greening aspect) is in the accordance with the priorities and objectives of the EU's CAP.

The results of the analysis have proved that only 4.95% (56) companies would have been affected by a reduction of direct payments in the calendar year 2010 according to this structure:

- by 20% for the tranche of more than 150 000 EUR and up to 200 000 EUR - 19 enterprises
- by 40% for the tranche of more than 200 000 EUR and up to 250 000 EUR - 17 enterprises
- by 70% for the tranche of more than 250 000 EUR and up to 300 000 EUR - 4 enterprises
- by 100% for the tranche of more than 300 000 EUR - 16 enterprises.

The primary goal of enterprises in agriculture should be food production and production of other technical products for energy purposes. Therefore agricultural business is a production system. Non-commercial functions of agriculture are contribution to sustainable development, environmental protection and support of rural areas. Fulfilling these objectives assumes a developed agriculture, viable and dynamic rural communities and sustainable and balanced socio-economic development in the state and region.

The farms, which contribute to the achievement of the objectives are not negatively affected by the progressive reduction and capping direct payments. Characteristic parameters such as sales per hectare of land and labor costs per hectare in these companies significantly differ from the companies affected by new CAP presented on 12th October 2011.

The key problem of the Slovak agriculture is not the analyzed EU CAP reform, but historical approach of direct payments between the EU countries. Also the fact that agricultural policy done at the national level is two steps behind other EU member states. Especially in sense of programs offered and institutions, ensuring the implementation of the EU's CAP.

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