

**Report “Economic impact analysis of axis 2 agricultural measures,
integrating environmental aspects”
(Rural Development Programme 2007-2013)**

Summary

Area payments of the Rural Development Programme 2007 - 2013 (RDP 2007-2013) compared to other types of support have been used by majority of agricultural holdings – 67.6 thousand agricultural holdings or 81% of all agricultural holdings have received the support. All RDP 2007-2013 area payments are related to the axis 2. The measure 2.1.2 „Payments to Farmers in Areas with Handicaps, other than Mountain Areas” or LFA payments was the only type of support applied for by approximately 50 thousand of these agricultural holdings (or 60% of all agricultural holdings recorded during the census by CSB) in the scope of RDP 2007-2013. Taking into account the considerable areas covered by the payments of the measure 2.1.2, large disbursed amount of the public funding and importance in various rural development priorities both in relation to environment and economy, the indicators of this measure are extensively used in the study in terms of LFA categories to characterize various agricultural indicators, including those related to environment. The measure 2.1.4 “Agri-environment payments” is also evaluated in the study.

Structure of the area payments based on the size groups of agricultural holdings shows that in comparison with other RDP 2007-2013 measures, they are the most accessible to the small agricultural holdings.

Regional analysis of the support recipients shows that the largest proportion of the support recipients and supported areas are located in the less developed regions – Latgale and Vidzeme. These regions have jointly received also 61% of the total disbursed funding in RDP 2007-2013 axis 2 measures 2.1.2, 2.1.3 and 2.1.4. The analyzed area payments, even though they are part of RDP 2007-2013 axis 2, the purpose whereof is „sustainable use of the agricultural land, supporting application of environment-friendly production methods, protecting, enriching and sustainably using the natural resources and landscapes in the rural areas”, had a greater positive impact on the economic situation of the agricultural holdings than on reaching the environmental goals. Agri-environment measures have been implemented to a relatively small extent in the areas with potentially greatest impact of the agriculture on environment (Western part of Zemgale, Eastern part of Kurzeme), therefore the contribution of these measures in the solution of environmental problems was small.

Findings show that the proportion of the areas declared for support in Latvia between 2007 and 2012 in general has increased by 3%, but in Less favoured areas (LFA) only by 1.7%. LFA support since 2007 has not thereby significantly facilitated the increase of managed UAA areas, but the support has stimulated more efficient and intense use of the land utilized already in 2007. More rapid increase of the areas of cereals and industrial plants during this period has taken place in LFA areas than outside them. The proportion of permanent meadows and pastures (PMP) declared for the payments has increased to a greater extent in the 1st category (by 13%) and the 3rd category (8%) of LFA areas. The proportion of sown grasslands in the structure of utilized agricultural land (UAA) has significantly reduced both in LFA areas and in the entire territory of Latvia.

The agricultural holdings, receiving LFA payments, have shown significantly better net value added results. They play especially important role in the group of small agricultural holdings (with SO between 4 and 15 thousand EUR), wherein the net value added (NVA) outside LFA between 2008 and 2012 has reduced by

approximately 35%. The most significant LFA support based on the specialization of the agricultural holdings is in the agricultural holdings engaged in the cattle husbandry. Role of LFA support is not the same each year, being the greatest in the crisis situation (in 2009), when the proportion of LFA support in NVA of agricultural holdings was 21%, but in other analyzed years – 12%.

Evaluation of the impact of the received Agri-environment support on the economic results of the agricultural holdings showed that the most important role is played by the Agri-environment sub-measure 214./1 “Development of Organic Farming” (OF), because the greatest support per area unit is paid in the scope of this sub-measure, and the amount of this support is the greatest compared to the turnover of the recipient. Role of other Agri-environment sub-measures and Natura 2000 measure in economic status of the agricultural holdings in general is relatively small, because according to available data, the proportion of these payments in the net turnover of the agricultural holdings does not exceed 1%.

The findings allow to conclude that support to organic farming is sufficient enough to ensure the income of the agricultural holdings –recipients of support (which is confirmed by the economic results of supported agricultural holdings and increase of supported areas), however, as shown in the previous studies, the current support measures are not sufficient for the invested funds to make a greater contribution in activation of organic production and availability of these products to consumers. Support policy should be linked more extensively to production and circulation of organic products, at the same time promoting the farmers’ opportunities to sell the products as organic, in order to reach the objective of the measure –facilitation of organic production.

Even though the axis 2 area payments have been the only type of RDP 2007-2013 support for 91% of their recipients, 47% of the disbursed support amount has been received by the recipients, who receive also other types of support. The total amount of support for some recipients receiving several area payments and project support means very high support intensity, thus ensuring very high total level of support.

Problematic issues identified during the study and related to application of the area payments and their impact, have not so far been studied, or the studies have been insufficient. They include, for example, research of correlation between the support for organic farming and organic production, necessary amount of the compensation payment depending on the UAA area of the agricultural holding and possible introduction of differentiated payment, taking into consideration objectively different costs in various groups of agricultural holdings, etc., as well as the owners of large areas of land, who receive large support payments, but are almost not engaged in agricultural production.

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Conclusions and recommendations

Conducted study regarding the implementation course of RDP 2007-2013 measures 2.1.2, 2.1.3 and 2.1.4, and the contribution of support in reaching economic and environmental objectives allows drawing the following main **conclusions**:

- 1) Area payments compared to other types of support are available to majority of the agricultural holdings – they have been used by 67.6 thousand agricultural holdings in RDP 2007 - 2013. The measure 2.1.2 or LFA support was the only type of support applied for by approximately 50 thousand of these agricultural holdings (or 60% of all agricultural holdings recorded during the census by CSB) in the scope of RDP 2007-2013. The structure of the area payments based on the size groups of agricultural holdings shows that this type of payments unlike the projects (measures of the axis 1, 3 and 4, where the co-funding is required for its implementation) are the most accessible to the small agricultural holdings.
- 2) Regional analysis of the support recipients shows that the largest proportion of support recipients and supported areas are located in the less developed regions – Latgale and Vidzeme. These regions have jointly received also 61% of the total disbursed funding in the RDP 2007-2013 measures 2.1.2, 2.1.3 and 2.1.4. for 2007 – 2012. Such structure is related to the layout of LFA and other areas eligible for support mostly in these regions, as well as more active participation of these regions in development of organic farming. It shows that the agricultural holdings are active also in these regions, regardless relatively less favorable conditions for farming.
- 3) Even though the structure of support recipients in the area payments is close to structure of the agricultural holdings in the country, a great portion of payments is received by the large agricultural holdings, for which these payments are not critical for carrying out economic activities. 60% of Agri-environment payments are received by large agricultural holdings.
- 4) The areas supported with area payments have slightly increased during the period between 2007 and 2012, especially in Kurzeme and Zemgale, but the number of the support recipients has the trend to reduce due to the concentration of the agricultural holdings.
- 5) Findings show that the proportion of the areas declared for support in Latvia between 2007 and 2012 in general has increased by 3%, but in LFA areas only by 1.7%. LFA support since 2007 has not thereby significantly facilitated an increase of the managed UAA areas, but the support has stimulated more efficient and intense use of the land utilized already in 2007.
- 6) Structural changes of UAA show that more rapid increase of the areas of cereals and crops during this period has taken place in LFA areas than outside them. The proportion of declared PMP has increased to a greater extent in the 1st category (by 13%) and the 3rd category (8%) of LFA areas. Increase of arable land and PMP both in LFA areas and outside them has taken place at the expense of temporary grasslands, the proportion whereof has reduced.
- 7) The worst agricultural indicators and the trends of their changes are observed in the 3rd category LFA areas. It reveals increased costs of managing the land in these areas. This category has the greatest proportion of unutilized UAA (20%), and it shows the need for additional support in reclamation of land, especially in the situation when the political objective is set to ensure 2 million ha of the managed agricultural areas.

8) Comparison of volumes of the production value and the net value added in 2008 -2012 in LFA and outside them revealed that significantly better trends are shown by the agricultural holdings, which have received LFA payments. They play especially important role in the group of small agricultural holdings (with SO between 4 and 15 thousand EUR), wherein the net value added outside LFA between 2008 and 2012 has decreased by approximately 35%, but in LFA areas - only by 10%. LFA support from all inspected groups of specialization (arable farming, dairy cattle breeding and mixed farming) is the most important for agricultural holdings engaged in arable farming.

9) LFA support plays the most important role in the crisis situations, when sufficient income is not earned from the market. Thus, the proportion of LFA support in the NVA of the agricultural holdings in 2009 was 21%, but in all other analyzed years almost twice less – 12%. Despite the increase of SAP rate in the studied period, the importance of LFA support in creation of income of the agricultural holdings in general has not decreased.

10) Evaluating LFA results in connection with the objectives set for the measure, it may be assumed that the measure has made economic contribution into facilitation of sustainable agricultural activity and maintaining open rural landscape. Prevention of the land abandonment and return of the unutilized land into agricultural circulation by 2012 may not be rated as significant. If small positive trends can be observed in the 1st and 2nd category LFA areas, negative trends continue in the 3rd category LFA areas.

11) Agri-environment sub-measure 2.1.4./1 „Development of organic farming” has the greatest impact on the economic indicators of the agricultural holdings from all types of Agri-environment support, taking into consideration that the greatest support per area unit is disbursed in its scope, and this amount of support is the greatest compared to turnover of the support recipients.

12) Approximately 75% of support of RDP 2007-2013 Agri-environment measures is paid in OF sub-measure, and despite the small reduction of the number of recipients in the recent years, the disbursed amount of support has the trend to rise upon increase of the supported areas.

13) The disbursed amount of support in 2012 compared to 2007 has increased by 63% or LVL 6 million. The supported areas have also increased from 148 thousand ha to 178 thousand ha (by 30%). The current support system, however, has not facilitated adequate increase of produced goods. Even more – the volume of several products (pork, poultry, vegetables, fruit and berries, etc.) has reduced during this period.

14) Comparison of net value added among recipients of OF support and conventional agricultural holdings gives the reason to conclude that support to organic farming is sufficient to ensure income of agricultural holdings – recipients of support, but does not create sufficient stimulus for the increase of production and value added. The trend, when the proportion of support in the income of organic farms has rapidly increased, must be rated negatively. Processing and trade chain of organic products is not working sufficiently, as the result whereof majority of products are sold as conventional. Such situation shows inadequate use of the public funding.

15) Role of other Agri-environment sub-measures and Natura 2000 measure in the economics of the agricultural holdings in general is relatively small, because the proportion of these payments in the net value added of the agricultural holdings according to available data does not exceed 1%. The support of the aforementioned

measures for some agricultural holdings, however, may form a larger portion of income.

16) Findings show that even though the proportion of area payments in net turnover for the majority of support recipients (62%) is small (not exceeding 10%), there are 33% of the agricultural holdings among the small and medium agricultural holdings, for which this proportion exceeds 30%, which, practically means that sustainable economic activity is not possible without the aforementioned payments. The recipients of the support in the measure 214/1 „Development of organic farming” have a greater proportion of the area payments in their turnover.

17) Analysis of overlapping of several area payments and the total received support showed that almost one fifth of the recipients (18%) receives three and more types of area payments (including Agri-environment sub-measures).

18) Evaluation of the total amount of the support payments received by the agricultural holdings (including entire RDP 2007-2013 public funding, as well as SAP) showed that many agricultural holdings have high support intensity. If we recalculate the total public funding, 989 support recipients have received in average over 200 LVL/ha of UAA annually. The results of the study, however, show that much greater received amounts both in absolute and relative terms (compared to UAA area and turnover) are in RDP 2007-2013 projects and not the area payments.

19) Pronounced uneven spatial distribution may be observed in Agri-environment payments of Latvia, which may not be rated positively. Agri-environment measures are to the least extent implemented in the areas with potentially greatest impact of the agriculture on environment (Western part of Zemgale and Southern part of Kurzeme).

20) Even though the quantitative indicators defined by RDP 2007-2013 are mostly reached in the Axis 2 area payments, the set objectives (especially in the field of environment) they are reached only partially.

21) One of the problematic issues is the situation that the existing support system has not facilitated significant increase of the area of managed land during this period, especially in the LFA of the lowest categories, where the greatest number of the small agricultural holdings is located. A great portion of RDP 2007-2013 area payments at the same time is received by the agricultural holdings, for the economic activity whereof they are not critical, and create a relatively small portion in their value added.

22) The study showed that many important issues related to the impact of the area payments have so far not been sufficiently researched. Such issues are as follows: the opportunities to facilitate the chain of organic products, incorporating also the experience of other countries, impact of separated payments on the use of land and the income of farmers, as well as the persons unrelated to agriculture in Latvia, etc.

23) Dependency of the necessary amount of the compensation payment on the UAA area of the agricultural holding, introduction of the possible differentiated payment, volume of rate, which would release so far unmanaged areas into the circulation, etc. may be listed as the new directions, which have so far not been researched, but have become topical as the result of performed analysis.

Conducted study and drawn conclusions allow making the following **recommendations** for the future implementation and evaluation of the measures related to the environment priority and reaching the rural development objectives:

- 1) RDP 2007-2013 measure 2.1.2 “Payments to Farmers in Areas with Handicaps, other than Mountain Areas” is necessary for the farmers of the target areas to carry out and strengthen their economic activity in the respective areas, therefore it is useful to continue it. In addition, taking into consideration the totally different farming conditions in various locations of Latvia, it is useful to keep division into LFA categories with different support rates, but the division and rates should be reviewed based on the current situation and brought as close as possible to the real difference of income from UAA ha, originating as the result of natural factors.
- 2) Taking into consideration the special role of LFA support in the agricultural holdings of individual specialization groups, as well as in the small and medium-sized agricultural holdings, further studies would be useful regarding the possibility of differentiating the rates, in order to more successfully support those support recipients, for which the amount of support is directly related to an opportunity of developing the agricultural production (as well as the impact of such differentiation on the results of the agricultural holdings).
- 3) The findings indicatively show an inadequate compensation for covering additional costs in some individual areas (especially 3rd category LFA), which results in declining of the indicators of land use therein. The necessary amount of the compensation for successful agricultural activity in these areas must be evaluated, which would allow drawing conclusions regarding more appropriate compensation for the areas with handicap.
- 4) Since the LFA measure is implemented thru environmental (axis 2) priority direction, its conditions for receiving support must facilitate improvement of the environmental indicators. Differentiation of conditions (for example, density of livestock) based on LFA categories is proposed as one of solutions, because the objectives set in 3rd category LFA areas have not so far been reached.
- 5) RDP 2007-2013 sets the organic production of agricultural products as one of the objectives of OF sub-measure, purposefully linking a part of LFA support to the volume of the sold products. Taking into consideration the current limited opportunities to sell the products as organic, additional measures are necessary for facilitation of development of organic product processing, the research whereof is the object of a separate study.
- 6) Even though the objectives of axis 2 are not linked to development of production, the economic analysis carried out in this study shows that development of production must also be taken into consideration. The existing support measures do not stimulate investment of funds in the selling and processing of products, in order to create more extensive opportunities for making the organic products available to consumers. Support to organic farming must be linked to facilitation of support for the market measures, production and organic processing, related to measures of other RDP 2007-2013 axes.
- 7) Taking into consideration an opportunity to simultaneously receive several area payments and the project support, thereby reaching very high level of the total support, it is useful to introduce the top threshold of the total support, for example, in the period of 5 years, compared to the turnover of the agricultural holding. It could not exceed by more than 2-3 times the turnover of the support recipients in this period, except for some specially designated situations, when it is economically justified. A possibility to set the top threshold of the area payments per hectare must also be considered (including direct payments), the size whereof

depends on the total support structure (for example, if a part of LFA is related to production and not the areas, etc.).

8) The current approach in Agri-environment measures, attributing it to the entire territory of Latvia and not specific problematic areas, increases the income of support recipients, but only partially facilitates reaching the environmental objectives and/or solves specific environmental problems related to agricultural activity. More detailed justification must thereby be developed for the Agri-environment measures related to improvement of water and soil quality, by specifying target audiences (i.e. the total area in ha and spatial location).

9) Since evaluation of axis 2 measures is significantly limited by lack of appropriate impact indicators (nitrogen and phosphorus load, soil indicators, data on grassland biotopes), MA must come to an agreement with the Ministry of Environmental Protection and Regional Development (MEPRD) on further provision of these indicators. Since MEPRD does not ensure monitoring of individual indicators and the basic source data (indicators of initial condition) for more than 10 years, alternative indicators must be introduced.

10) Mapping of *High nature value farmland*, which is important in implementation of RDP and CAP, is yet to be performed in Latvia. It must be carried out in 2014 in order to successfully evaluate the environmental measures.

11) An issue regarding the impact of other factors indirectly related to the agricultural industry has become topical in relation to contribution of RDP 2007-2013 axis 2 measures. For example, if and to what extent the demographical and socio - economic factors characteristic for the rural areas of Latvia (reduction of the number of population, abandonment of land, marginalization, land market, etc.), as well as the nature conservation policy impacts the implementation results of RDP 2007-2013 axis 2 measures? An additional study is necessary for this purpose regarding the role of these factors both in implementation of CAP in general (on the level of objectives), and in reaching individual priority directions of the rural development.

The matter might be discussed regarding a possibility to differentiate area payments, by setting higher rate per hectare for the small agricultural holdings, providing that the agricultural holding undertakes to maintain or increase its economic activity (if it is set as an important aspect), and to maintain or slightly reduce the respective rate for the agricultural holdings in the large groups.