



Subsidies and Tax Relief Harm Bulgarian Agriculture

A review of state support to Bulgarian agricultural producers in the period
2001 - 2007

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EXECUTIVE SUMMARY

In the last ten years, the share of the agricultural sector in GDP has decreased by **five times**, despite the sustained growth of the Bulgarian economy. This development is surprising given the active support to sector.

Forms of supports to agricultural producers in the period 2001-2007 consist mainly of **tax relief and subsidies totaling over 2.5 billion leva**.

In the period 2001-2007 agricultural producers **have not paid taxes amounting to 779 million leva** as a consequence of preferential tax policy including income tax, corporate tax, and excise taxes.

Apart from preferential tax policy, in the period 2001-2007 agricultural producers received a total of **1.750 billion leva in subsidies**, with a very strong concentration of the funding towards specific producers. Data regarding funds received pursuant the Single Area Payment Scheme for 2007 clearly show that 80% of the subsidies have been paid to less than 7% of farmers (or 5,000 beneficiaries) and the remaining 70,000 beneficiaries have received less than 20% of the total funding.

The research paper clearly shows that only **about 2% of the agricultural producers have declared high income and receive the overwhelming majority of all funding**. The rest, i.e. the majority of farmers, do not declare all their income and/or receive additional income, and at the same time receive minimal funding – be it from the national budget or the EU.

The constant interventions in the agrarian sector do not bring about the desired results. The engine of progress in every sector is the people, who, following their self-interest, are willing to take the risk to invest and develop their business. The behavior of these people is defined by incentives, which are greatly distorted in the case of agriculture. **Agricultural producers are no longer focused on the customers (consumers) but rather on the government. The incentives are no longer aimed at creating wealth but rather at redistributing most of it towards some interest groups.**

In practice, **subsidies create a vicious circle of inefficient activity**. Agricultural workers are much more than those who receive subsidies. Some of them will have to exit the sector in time as it has to be more effective. The presence of subsidies, financing inefficient producers will slow down this process at the cost of millions of leva and will postpone needed reforms.

The analysis of agricultural support in Bulgaria leads to the **following conclusions**:

- ✓ Agriculture has declined significantly, as measured by its share in GDP and GVA – by more than two times
- ✓ State help in the form of subsidies and tax relief increase by almost four times
- ✓ The agricultural sector does not develop and slows down the whole economy

- ✓ Agricultural producers are no longer focused on the customers but on the government
- ✓ Distorted incentives harm everyone – producers, consumers, third-parties and the state

Therefore agricultural reforms are highly needed. Bulgarian agriculture need a change, which would enable producers to make their own decisions (regarding quantity, price, etc.) based on market signals; so that their income depends solely on their customers and not on the state, respectively the taxpayers.

Based on economic logic and good international practice, the following **measures for improvement of the agrarian sector in Bulgaria are recommended:**

- 1) **Abolish tax relief** – direct taxes are of the lowest in Europe and therefore an immediate removal of all tax relief is necessary
- 2) **Stop state budget subsidies** – EU-level agricultural support will reach its peak in the coming years anyway
- 3) **Improve the business environment** – entrepreneurship and efficiency in all sectors will increase
- 4) **Stop market interventions** – state interventions are more of a obstacle than a solution to any problem
- 5) **Decrease bureaucracy**
- 6) **Abolish all subsidies in the medium-run** – subsidies have a marked negative effect on citizens, the state budget and agricultural producers through unrealistic prices, distorted incentives and decreased productivity.

I. Introduction

The agricultural sector in Bulgaria has been going through a true collapse in the period 1997-2007. In those ten years, the share of agriculture in GDP has decreased almost **five times**, despite the years of economics growth. The slight increase in 2008 cannot obliterate the resulting trends from the past ten years.

Agrarian Report 2008, Ministry of Agriculture and Foods:

*"The sector shows a **decrease of 29.7% of physical volume** in gross value added in comparison to 2006. This decrease combined with the significant increase of gross value added of other sectors continues the trend of decreasing the relative share of agriculture in the economic gross value added in Bulgaria. "*

*"Initial results from the review of the structure of agricultural farms in Bulgaria (2007) show that the number of those farms **decreases** with 11% in 2007 compared to 2005.*

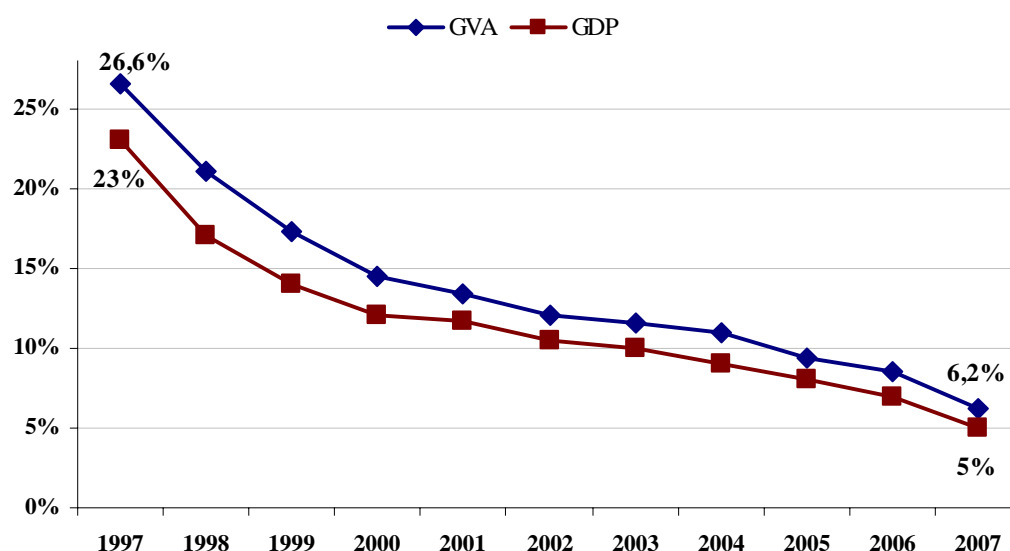
*"In the last two years about 41 thousand agricultural farms have **discontinued** their activities."*

*"The workforce in agriculture follows the downward trend exhibited by agricultural farms. In 2007 those employed in agriculture are about **14% less** than in 2005. It is only in the age group above 74 that no decrease is observed."*

*"The volume of labor of full-time agricultural workers in farms continues to **decrease**."*

The current research paper reviews the type, size and scope of tax relief, subsidies and preferential credits given to the sector in the period 2001 to 2007.

Figure 1: Share of agriculture in GDP and GVA



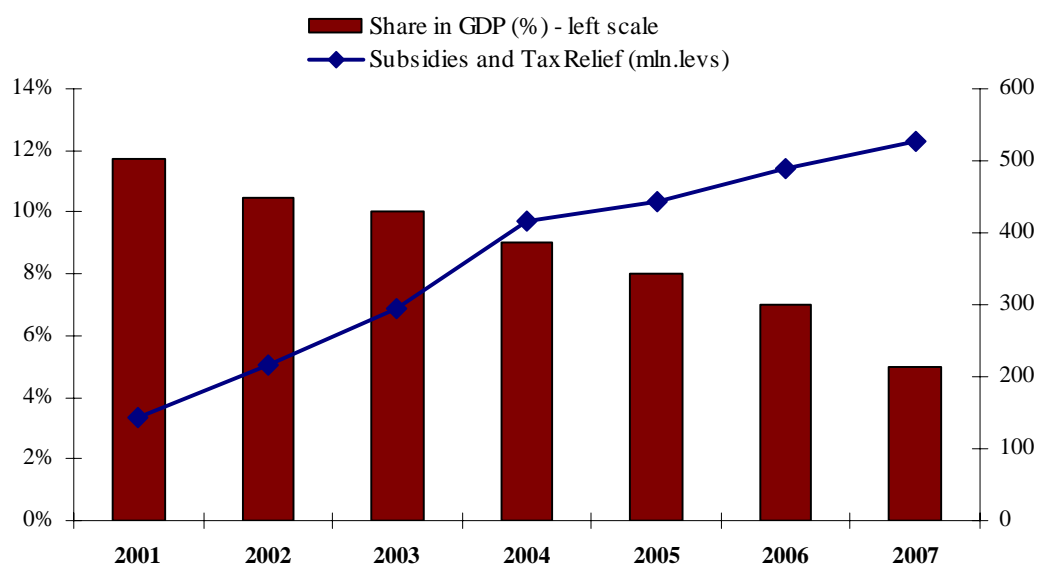
Source: Agrarian reports of MAF and stat.bg

The decrease of the share of agriculture in GDP in those seven years (2001-2007) is more than two times. In addition to that absolute values are also shrinking – the price volume (at current prices) of the agricultural sector in 2001 is 3.5 billion, whereas in 2007 it is only 2.9 billion leva.

Those negative developments contrast starkly with the continued growth of state support for all areas of agriculture.

The research shows main tax relief measures for agricultural producers, giving detailed information for their size on a yearly basis. We look into income and corporate taxes, and the refund of fuel excises. The subsidies include those along the lines of State Fund Agriculture, the Fund Tobacco, and the SAPARD program. We also take into account the Single Area Payment Scheme (SAPS) as well as preferential credits to agricultural producers from SF Agriculture.

Figure 2: Share of agricultural sector in GDP and state



Source: Agrarian reports of MAF, Budget reports of MF

Constants interventions in the sector do not produce the desired results (see figure above).

Even if we do ignore the logical argument for inefficient allocation of resources and their unsuccessful channeling towards a certain “priority” sector there are still more than enough explanations for the condition of Bulgarian agriculture.

The engine of progress in every sector is the people, who, following their self-interest, are willing to take the risk to invest and develop their business. The behavior of these people is

defined by incentives, which are greatly distorted in the case of agriculture. In Bulgaria, business development and profit maximization in agriculture are not leading – the attempts at receiving even more preferential treatment, relief, and direct payments are. **Agricultural producers are no longer focused on the customers (consumers) but rather on the government. The incentives are no longer aimed at creating wealth but rather at redistributing most of it towards some interest groups.**

European subsidies increase this effect and make it even more visible for more and more people. When milk-producers abandon their daily routine and start spilling their products on the roads, this is but one of the proofs that the main goal of entrepreneurs in agriculture is to appropriate as much other people's money as possible (be those Bulgarians or other taxpayers), and not profit as they should – by selling their produce to consumers. The results from those distorted incentives are visible – constant shrinking of the sector despite increasing growth of relief and preferential treatment.

In the period 2001-2007 agricultural producers are **mainly supported through tax relief and subsidies and less through preferential credit lines.**

Our calculations, based on NRA (National Revenue Agency) and customs data show that in the period agricultural producers have **not paid a total of 779 million leva in taxes** – this is the sum they should have paid in the absence of tax preferences.

The main share in this belongs to the income tax, as registered agricultural and tobacco producers are **not subject** to those. The non-taxed income for the period amounts to almost 3 billion leva resulting in tax relief of 656 million leva. Corporate taxes and fuel excises add up to 779 million leva.

The subsidies for this period amount to 1.75 billion leva – again with an upward trend throughout the period. The only exception is 2007 because of delayed Single Area Payment Scheme (SAPS) payments. In 2008 agricultural producers have received 466 million leva pursuant SAPS for Season 2007. This is also the first support farmer receive from SAPS for working a certain area. Taking into account those payments we see that in fact agricultural subsidies increase constantly. Despite this SAPS payments are not included in this research as they were not paid in the calendar year 2007.

Table 1: Support for agricultural and tobacco producers for 2001 - 2007

<i>Millions leva.</i>	2001	2002	2003	2004	2005	2006	2007	TOTAL
Tax relief, including	43.5	48.7	58.8	105.5	92.9	129.1	300.8	779.3
<i>Income tax</i>	36.0	44.1	56.1	99.0	86.6	123.0	211.0	655.8
<i>Corporate tax</i>	7.5	4.6	2.7	6.5	6.3	6.1	21.5	55.2
<i>Excise tax</i>	-	-	-	-	-	-	68.3	68.3
Subsidies, including	99.8	168.3	235.9	311.8	348.9	359.5	225.5	1,749.7
<i>SF "Agriculture"</i>	15.8	24.6	44.0	61.7	58.7	57.1	29.2	291.1
<i>Fund "Tobacco"</i>	59.0	117.2	121.8	114.9	146.8	155.8	108.8	824.3
<i>SAPARD</i>	25.0	26.5	70.1	135.2	143.4	146.6	87.5	634.3

Source: IME based on NRA and budget reports data

The total sum of tax relief for 2007 is greater than half a billion leva, which is almost four times the sum in 2001.

The total sum for the period is over 2.5 billion leva. The growth of tax relief is obvious especially for 2007 when they practically double and reach a sum over 300 million leva. The same can be seen with fuel excises with the only exception being 2007. This decrease is compensated by direct SAPS payments whose importance will increase drastically over the coming years.

Currently state support is much higher than the period which this research analyzes. According to the recently passed budget bill for State Fund Agriculture, the financial resources devoted to supporting agricultural producers amount to almost 2 billion leva for 2009. This can only strengthen our arguments and give additional power to our conclusions and recommendations.

Therefore agricultural reforms are highly needed. Bulgarian agriculture need a change, which would enable producers to make their own decisions (regarding quantity, price, etc.) based on market signals; so that their income depends solely on their customers and not on the state, respectively the taxpayers.

The first step in this direction is abolishing all tax relief and payments from the national budget towards agricultural producers.

II. Farmers' income

All preferences which agricultural producers enjoy naturally focus our attention towards farmers' incomes. In the current research we have utilized two different approaches to analyze incomes in agriculture and their relative distribution.

On the one hand, we have looked into data for average monthly declared income, and on the other, we have investigated data for received support pursuant SAPS and its distribution.

Both approaches lead to similar results – only about **2% of the agricultural producers have declared high income and receive the overwhelming majority of all funding**. The rest, i.e. the majority of farmers do not declare all their income and/or receive additional income, and at the same time receive minimal funding – be it from the national budget or the EU.

1. Farmers' declared incomes

The National Revenue Agency (NRA) has provide us with data on declared average monthly income of agricultural producers according to article 50 of the Income Tax on Natural Persons Act (ITNPA). In 2007 a tax statement was submitted by almost 33 thousand agricultural producers, whereas in 2006 they were only 21.4 thousands - that is growth of over 50% of tax statement submission.

Those 33 thousands agricultural producers who submitted a tax statement are less than half the registered agricultural producers (pursuant Law for Agricultural Produces Support) who amounted to almost 85 thousand in 2007.

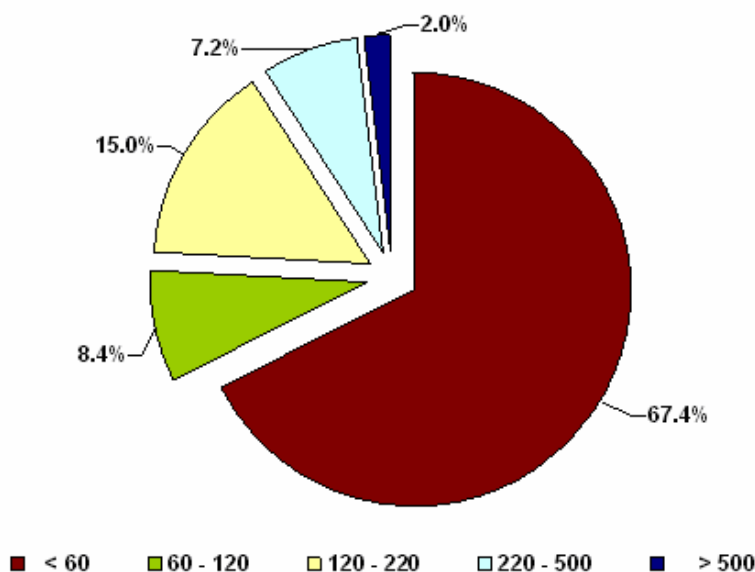
Table 2: Declared monthly income of agricultural producers (leva)

Average monthly income of agricultural producers who submitted a tax statement						
Year	Up to 60	60 - 120	120 - 220	220 - 500	Over 500	Total declared
	(number)					
2006	13 923	1 948	3 965	1 258	348	21 442
2007	22 187	2 759	4 950	2 376	651	32 923

Source: IME based on NRA data

The distribution of declared incomes shows that in 2007 over **67% (or 22 187) of the agricultural producers declared up to 60 leva monthly income**, whereas only 2% (or 651) declared incomes of over 500 leva per month. In 2007, the minimum social security line for agricultural producers was 55 leva per month; and almost 67% (or 21 921) of the agricultural producers paid their social security provisions at this line.

Figure 3: Declared monthly income of agricultural producers (leva)



Source: NRA, IME

Despite all tax relief enjoyed by agricultural producers, the overwhelming majority of them are still paying their social security payments at the very minimum line. It is indeed difficult to imagine that over 20,000 farmers survive on monthly incomes below 700 leva. Data rather point to the conclusion that those people do not declare their full incomes or earn something on the side.

If the first was true, this would mean that the agricultural owner see more the negative than the positive effects of legal compliance. This means that the disadvantages of paying social security installments and interacting with administration far outweigh the advantages of subsidies and tax relief.

If the second were true, this would destroy the myth that farmers can support themselves entirely through agriculture. The presence of additional income would show that even the farmers are flexible enough to adapt relatively painlessly to the new conditions on the market.

2. Direct payments – redistribution

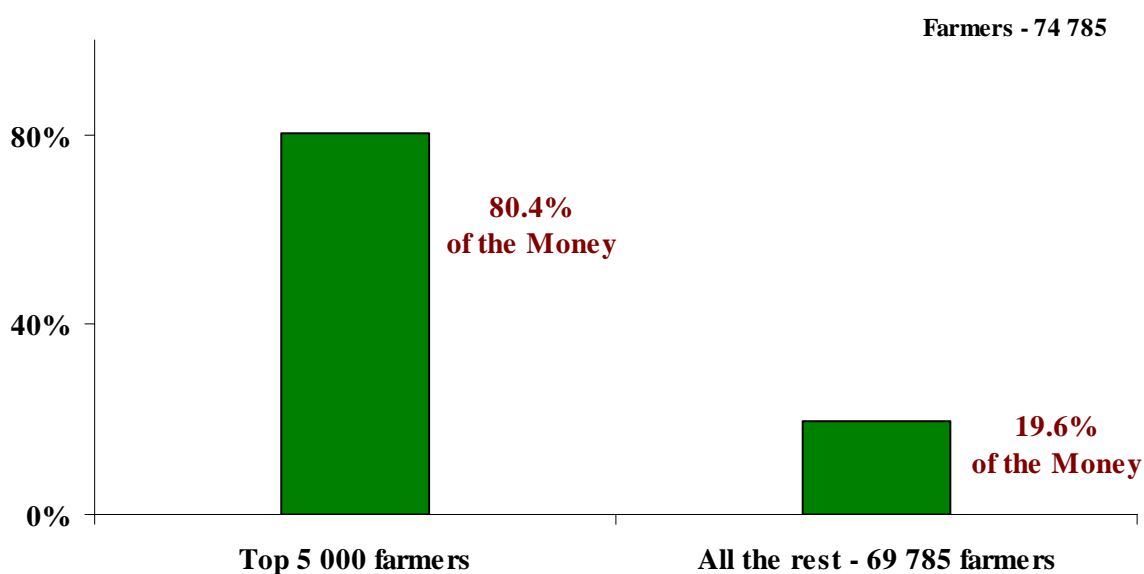
Recently published data by SF Agriculture for support received in 2007 give a very clear picture of the distribution of funding among agricultural producers. In this case we focus on the funding pursuant SAPS, without national financing, as an indicator.

In 2007 SAPS funding was received by 74 785 agricultural producers to a total sum (without national payments) of 326 million leva.

Reports show that less than 2% of beneficiaries have received more than 50% of the total sum – those are 1,500 beneficiaries who have received subsidies amounting to 50,000 to 1.7 million leva. Almost 55,000 beneficiaries received less than 1,000 leva. The differences are really impressive and clearly outline the distribution of subsidies.

The immense differences are also illustrated on the graph below, which shows what percent of the whole sum (326 million leva) was paid to the 5,000 largest beneficiaries in comparison with the rest (almost 70,000 beneficiaries). To put it another way – **80% of all funding (or 262 million leva) went to only 6.7% of the farmers (or 5,000 beneficiaries)**. The rest – almost 70,000 beneficiaries – received less than 20% of the funding.

Figure 4: Distribution of SF Agriculture subsidies among agricultural producers

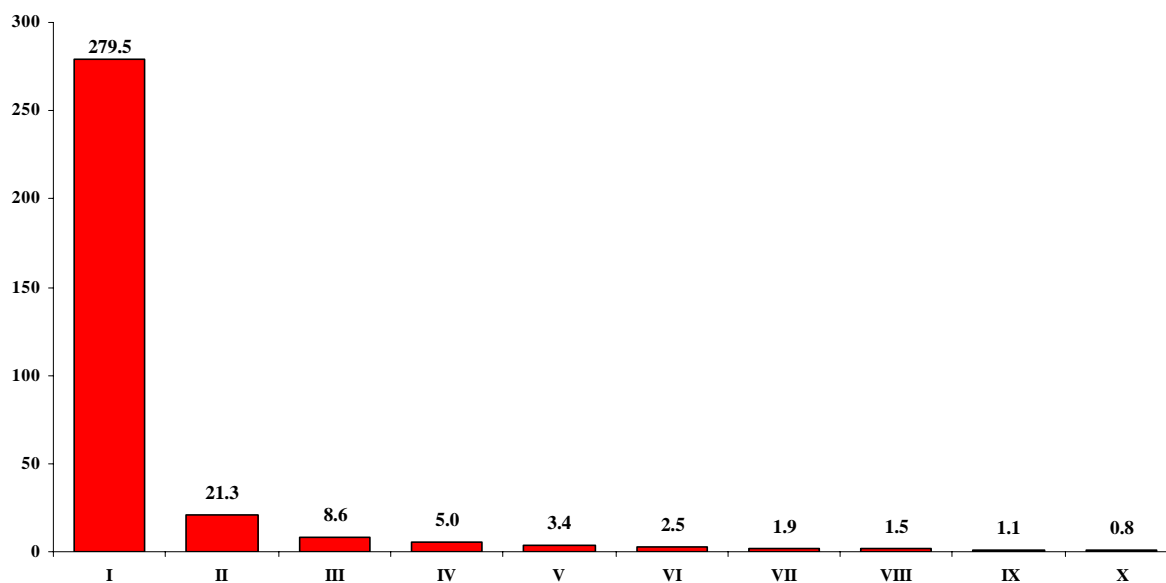


Source: IME

The differences in distribution can be represented in a different way – by dividing beneficiaries into decile groups. This means that all 75 thousand beneficiaries (74,758 in fact) are divided into 10 groups of 7,500 people each, with group I consisting of the 7,500 biggest beneficiaries (those who received most funding) and group X consisting of the 7,500 smallest beneficiaries (those who received least).

The results clearly show that the beneficiaries from group I received almost 280 million leva, which is more than 10 times more than those in group II (second biggest). All other groups (from III to X) received negligibly little funding in comparison with the first.

Figure 5: Distribution of SAPS funding among agricultural producers in decile groups - millions leva.



Source: SF Agriculture, IME

European funding for agriculture, so widely spoken about, in practice goes to only a small share of agricultural producers, whereas the effect for all the rest is extremely limited. This might mean that either there are too many farmers or that funding is distributed inefficiently and concentrated only in specific economic agents. The second proposition is much more likely in the presence of untransparent administration and perception of high corruption in the public sector.

III. Tax relief to agricultural producers

Subsidies coming from the EU and the national budget are not nearly all the support agricultural producers receive.

In fact, agricultural producers are enjoying a number of tax preferences as promulgated in the following tax laws and codes:

1. Corporate Income Tax Act (CITA),

2. Income Taxes on Natural Persons Act (ITNPA),
3. Value Added Tax Act (VATA),
4. Excise Duties and Tax Warehouses Act (EDTWA) and
5. Local Taxes and Fees Act (LTFA).

In the current research we focus only on income and corporate taxes, as well as the refunding of fuel excises. Preferential VAT treatment as well as local taxes and fees are difficult to quantify because of the lack of enough information, which is why they are out of the scope of the current research.

All data used come from official sources, obtained through requests pursuant to the Access to Public Information Act sent to the Ministry of Agriculture and Foods, the National Revenue Agency, and the Customs Agency. The data in question are not freely or easily accessible (internet or published official documents of those institutions) and currently can be obtained only through such requests.

Data, which we have for 2001-2007, show the scale of relief for agricultural producers which can be measured through the sum of the taxes they would have paid if there was not preferential treatment – that is the missed tax revenue.

In 2001-2007, the sum amount to a total of 779 million leva with an upward trend in the last few years. Those are distributed as follows:

- ✓ Income tax relief - 656 million leva
- ✓ Corporate tax relief - 55 million leva
- ✓ Refunded fuel excises tax to farmers - 68 million leva

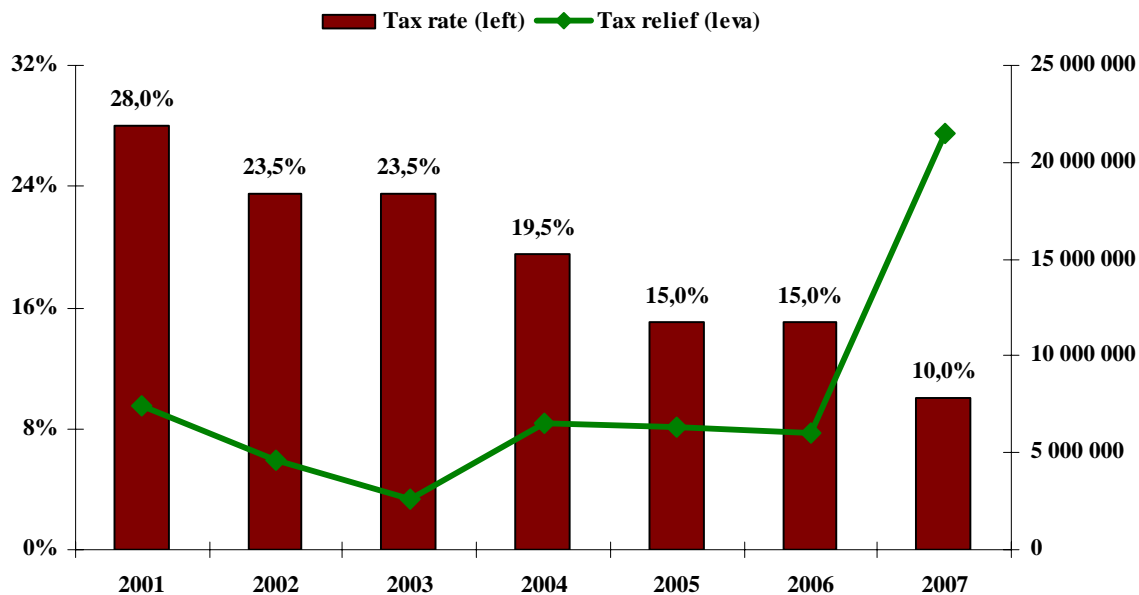
Table 4: Tax relief for agricultural producers (leva)

	2001	2002	2003	2004	2005	2006	2007
Income	35 963 079	44 125 404	56 119 882	98 995 091	86 551 001	122 959 278	211 040 301
Corporate	7 455 977	4 598 187	2 651 516	6 526 482	6 343 990	6 059 520	21 509 678
Excise	-	-	-	-	-	-	68 300 000
TOTAL	43 419 056	48 723 591	58 771 398	105 521 573	92 894 991	129 018 798	300 849 979

Източник: ИПИ

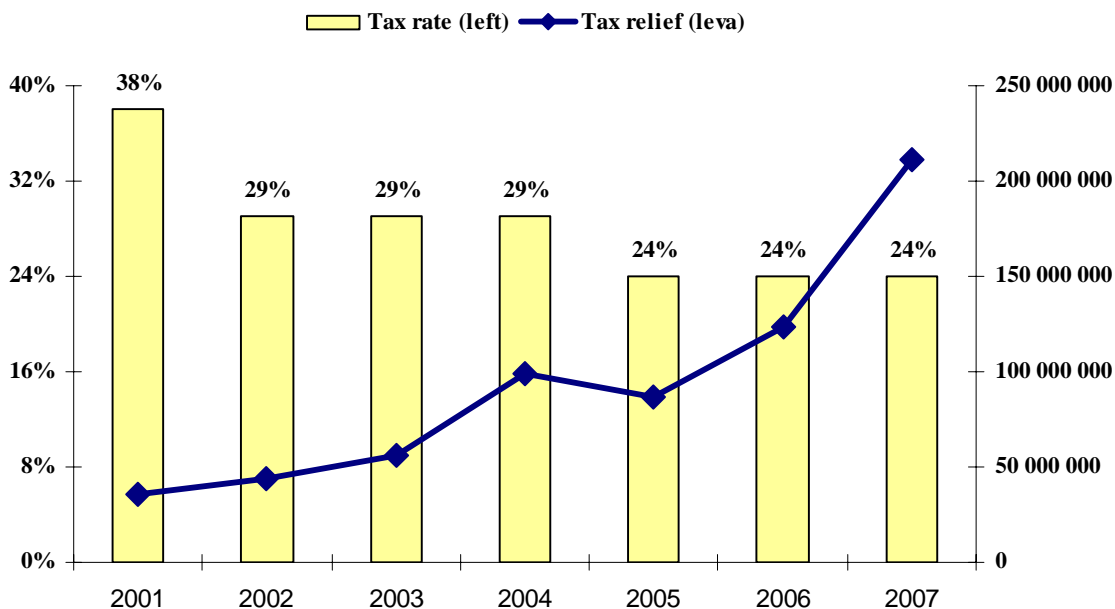
All of this data stands against the background of ever-decreasing tax burden in Bulgaria.

Figure 6: Corporate income tax rate in Bulgaria and tax relief for agricultural producers



Source: IME

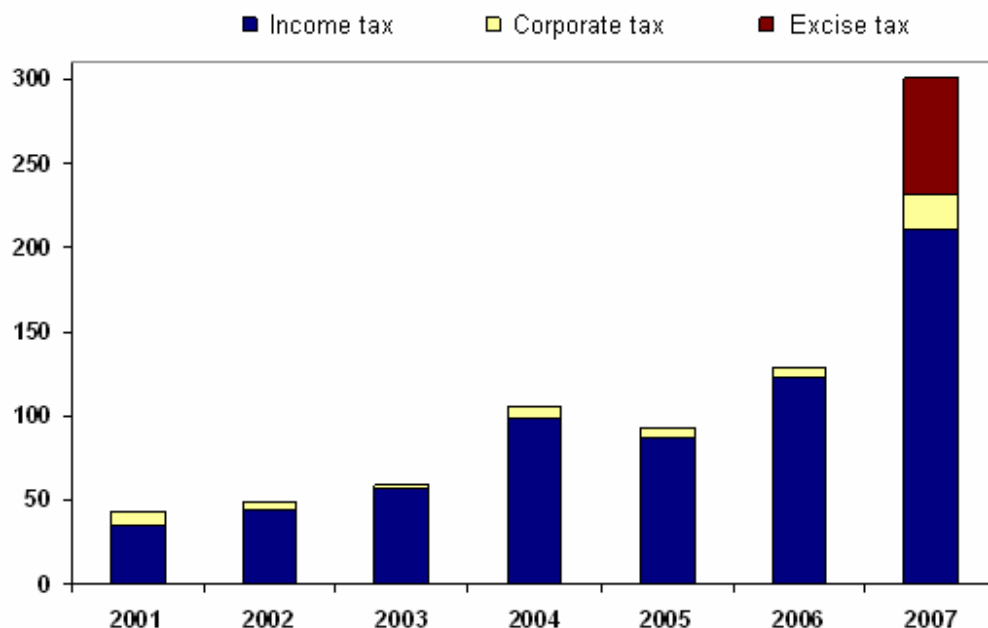
Figure 7: Income tax rates on natural persons in Bulgaria and tax relief for agricultural producers



Source: IME

Year-on-year comparison shows a serious growth of tax relief in 2007 contrasted to previous years. The sum total of all tax relief in 2007 is over 300 million leva which is over two times more than previous year. Even though we do not have data for 2008 we can realistically claim that this trend has continued and the line of 300 million leva is passed yet again.

Figure 8: Tax relief for agricultural producers 2001 - 2007 (in million leva)



Source: IME

1. INCOME TAX

Taxing agricultural producers – natural persons – is pursuant to the Income Taxes on Natural Persons Law (ITNPL).

There are legal clauses postulate that the income of registered agricultural and tobacco producers (including sole traders) is non-taxable, and neither is the income coming from processing of plant or animal production, excluding the production of decorative plants. Neither is the rent or lease of agricultural land taxable.

Income Taxes on Natural Persons law

Art. 13. (1) Taxability shall not apply to:

...

24. any income derived from ground rent, rent charge or from other onerous provision for use of agricultural land;

...

(3) Taxability shall not apply to any income accruing from the activity of

natural persons registered as tobacco producers and agricultural producers, including such carrying out activity in a sole-trader capacity, for unprocessed plant and animal produce, with the exception of any income accruing from growing of ornamental plants.

In the period 2000-2007 the non-taxable income of agricultural producers is almost 3 billion leva with over a billion for 2007 alone. Our calculations show that tax relief amounts to 656 million leva – that is the sum which should have been paid in case of no tax preferences for the agricultural producers in terms of income tax relief. Average tax relief per person amounts to 5,000 leva.

Table 5: Simplified income tax for agricultural producers

Year of report	Number of agricultural producers declared non-taxable income	Average non-taxed income per person	Size of non-taxed income	Tax relief
2001	6 052	19 936	120 650 542	35 963 079
2002	9 398	18 433	173 234 011	44 125 404
2003	12 375	17 914	221 680 626	56 119 882
2004	28 226	14 469	408 403 999	98 995 091
2005	31 918	13 549	432 444 669	86 551 001
2006	36 686	16 615	609 548 224	122 959 278
2007	42 788	23 401	1 001 280 388	211 040 301
SUM TOTAL (2001-2007)			2 967 242 459	655 754 035

Source: IME

The number of agricultural producers who declared non-taxable income grows throughout the period and reaches over 40,000 in 2007.

The average non-taxed income per person reaches over 23,000 in 2007 which differs significantly from the figures of the declared incomes of the agricultural producers who did submit a tax statement.

According to this report, about 98% of the agricultural producers declared annual incomes under 6,000 leva (more at the end of point II). One of the possible explanations for this discrepancy is that a small fraction of the agricultural producers declare very high incomes which notably distort the figures for average non-taxed income. If we trust the reports on those who submitted a tax statement, then those high incomes were declared by less than 2% of the agricultural producers and it is namely those who fully enjoy tax preferences.

2. CORPORATE TAXES

The profits and income of agricultural producers – legal persons – are taxed pursuant the Corporate Income Tax Act.

There are promulgated legal clauses that the taxable legal persons registered as agricultural producers may retain 60% of their corporate income tax on the income stemming from non-processed animal and plant produce, including apiculture, sericulture, freshwater fish-breeding, and greenhouse farming. The retention is admissible only insofar as the retained sum is invested in tax tangible and intangible fixed assets needed for performance of the activities specified not later than before the end of the year next succeeding the year for which the retention is enjoyed.

Corporate Income Tax Law

Чл. 179. (1) Any legal person, which is registered as an agricultural producer, shall be allowed to retain 60 per cent of the corporation tax [due therefrom] in respect of the tax profit derived thereby from unprocessed plant and animal produce, inter alia from apiculture, sericulture, freshwater fisheries in man-made water bodies and hothouse horticulture.
(2) Retention shall be admissible where the tax retained is invested in tax tangible and intangible fixed assets needed for performance of the activities specified in Paragraph (1) not later than before the end of the year next succeeding the year for which the retention is enjoyed.

For the whole period of 2001-2007 the retained taxes pursuant CITA exceeds 55 million leva, and in 2007 alone there is a serious growth and **the retained tax amounts to 21.5 million leva**. One notices that there is on firm logic or tendency in the data with some of them being more than strange. In 2003 the number of people declaring retention pursuant CITA was only 5, and the average retained tax per person was over half a million leva. It would be interesting to look for some sort of explanation of this fact.

Table 6: Retained corporate income tax for agricultural producers

Year of report	Number of people declaring retained tax pursuant CITA	Average per person	Retained tax in leva
2001	920	8 104	7 455 977
2002	939	4 897	4 598 187
2003	5	530 303	2 651 516
2004	971	6 721	6 526 482
2005	888	7 144	6 343 990
2006	907	6 681	6 059 520
2007	1 244	17 291	21 509 678
SUM TOTAL (2001-2007)			55 145 350

Source: NRA, IME

3. FUEL EXCISE TAXES

Refunding of the excise over fuels is in practice since 01.07.2006 and has been in force since the day of promulgation of the Excise Duties and Tax Warehouses Act.

The refund of excise tax rates over motor fuels used to cultivating agricultural land by farmers approved for financial support according to the Agricultural Producers Support Act and is only possible for registered agricultural producers.

The tax rates on motor fuels according to article 32, points 1 and 2 valid at the moment of purchase are used to determine the sum to be refunded. Excises taxes in point 2 are namely for the cultivation of agricultural land by farmers and are significantly lower than the common rates in point 1. The difference between rates per liter is multiplied by the yearly consumption rate and the area of the cultivated arable land.

The yearly consumption rate is determined using technological maps (average for the country), territorial distribution of crops or groups of crops and averaged rates of fuel consumption for mechanized cultivation activities.

In 2007 the Customs Agency refunded **68.3 million leva excise taxes** to the agricultural producers. In comparison, in 2008 this sum is 62.5 million leva – not included here as the period under scrutiny is 2001-2007.

IV. Subsidies

A main element of state support for the agricultural sector is subsidizing agricultural producers. Despite the compelling economic logic behind the idea of developing agriculture through the forces of market competition, subsidizing the sector is conceived as assistance for economic agents. In fact, it is namely subsidies that do not allow the sector to fight on its own means and efforts but instead chooses to focus time and resources on lobbying for bigger state subsidy. In addition, they stop the sector's development and make it dependent on the benevolence of the government. In this way, the effective allocation of economic resources is all but lost and the market is distorted. Moreover, using subsidies as a support tools for a sector distorts both the incentives of the employed there and the price of production.

Another negative effect is the need for a certain number of state officials (meaning expansion of the administrative apparatus) who have to administer and control subsidies for agricultural producers. Practice has shown that this leads to corruption and dishonest practices.

Using tax-payers' money to finance the activity of a group of economic agents contradicts the very principle of market economics and the equality of all economic groups and individual agents.

Short description of main types of subsidies

Direct subsidies, interest rate subsidies and capital subsidies in the agrarian sector are given out by the State Fund Agriculture and the Fund Tobacco.

Table 7: Claimed subsidies by agricultural and tobacco producers in 2001 – 2007 (million leva)

<i>Million leva</i>	2001	2002	2003	2004	2005	2006	2007	TOTAL
SF "Agriculture"	15,8	24,6	44,0	61,7	58,7	57,1	29,2	291,1
Fund "Tobacco", including	59,0	117,2	121,7	114,9	146,8	155,7	108,8	824,1
- premium payments	34,7	91,9	93,2	84,5	111	110,2	86,3	611,8
- financial support	23,6	24,6	27,3	28,1	33,9	43,4	20,8	201,7
- seed supply	0,7	0,7	1,2	2,3	1,9	2,1	1,7	10,6
SAPARD	25,0	26,5	70,1	135,2	143,4	146,6	87,5	634,3
TOTAL	99,8	168,3	235,8	311,8	348,9	359,4	225,5	1749,5

Source: MAF agrarian reports

1. Subsidies through State Fund "Agriculture"

The aim of SF Agriculture is to aid financially agricultural producers to invest in agriculture, the production of agricultural produce for the market, the creation of animal farms, purchase of selected breeds, etc.

To complete those tasks, the Fund grants subsidies, purpose-bound credits, covers partially or in whole the interest rate on bank credits.

State support in agriculture takes place in pursuant a couple or acts:

- Agricultural Producers Support Act
- Application of Common Market Organizations (CMO) in Agriculture Act

Spending by the Fund is in accordance with a revenue-cost bill which is approved by the Council of Ministers annually.

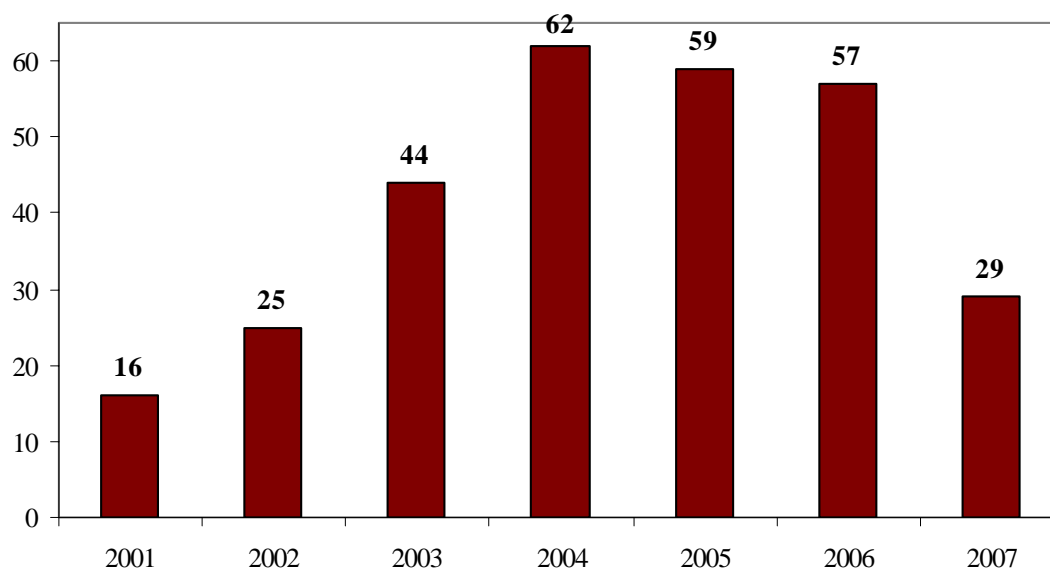
Table 8: Costs of SF "Agriculture" (million leva)

	2001	2002	2003	2004	2005	2006	2007	TOTAL
Total costs	49.2	29.9	54	73.2	116.4	83.2	81.2	487.1
<i>Including subsidies</i>	15.8	24.6	44.0	61.7	58.7	57.1	29.2	291.1

Source: MAF agrarian reports

In the period 2001-2007 the claimed subsidies for agricultural producers granted by the Fund are 291 million leva. For all years under scrutiny over 95% of the allocated by the Council of Ministers financial resource are claimed. The next graph shows claimed subsidies on a yearly basis.

Figure 10: Subsidies through SF "Agriculture" (million leva)



Source: MAF agrarian reports

2. Subsidies through Fund "Tobacco"

Fund Tobacco is charged with regulation of tobacco production, and therefore conducts the following:

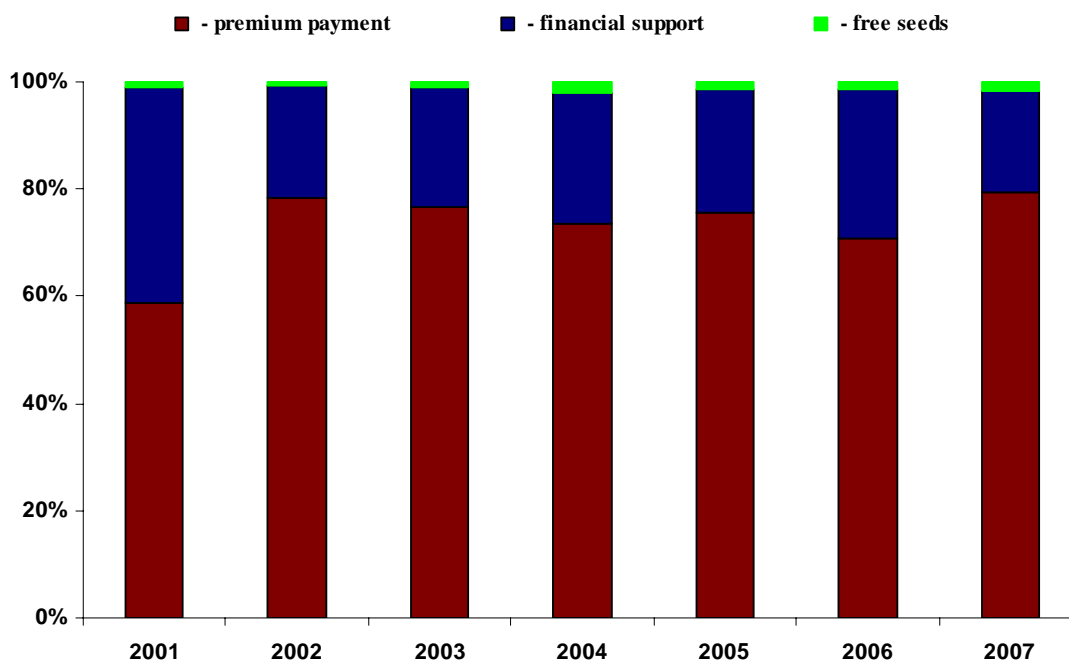
- Partitions tobacco production quotas according to requests of tobacco buyers for demanded quantities and producer's request for supply quotas. Quantity quotas, types, origins, sorts and municipalities are approved by the Minister of agriculture and forests.
- Establishes a price floor for types, origins, and classes of tobacco based on the methodology for tobacco production including all production costs – labor and materials connected to seed production, planting, growing, harvesting, drying and processing
- Heeding minimum prices the Fund allocated purpose-bound financial support per kilogram of purchased tobacco according to types, origins and classes

- Fund Tobacco grants financial premium over each kilogram of produced and purchased tobacco according to types and origins. The idea behind this is the increase of the life standard and incomes of tobacco producers
- The Fund provides tobacco seeds to producers free of charge
- Fund Tobacco can finance buyers, with the approval of the Council of Ministers, to purchase of produced but left over tobacco

For the period of research the Fund has granted tobacco producers **subsidies amounting to 824 millions leva**. The subsidy covers:

- 1) Premium payments to tobacco producers
- 2) Purpose-bound financial support to tobacco producers
- 3) Free tobacco seeds for tobacco producers

Figure 11: Claimed subsidies through Fund "Tobacco" in 2000 – 2007 (million leva)



Source: MAF agrarian reports

3. Subsidies through SAPARD

The SAPARD program is a special accession program in the field of agriculture and rural development (hence the name ("Special Accession Program for Agriculture and Rural Development" - SAPARD). SAPARD program support is aimed at modernization of agricultural farms and the food industry, as well as overall modernization of the rural economy.

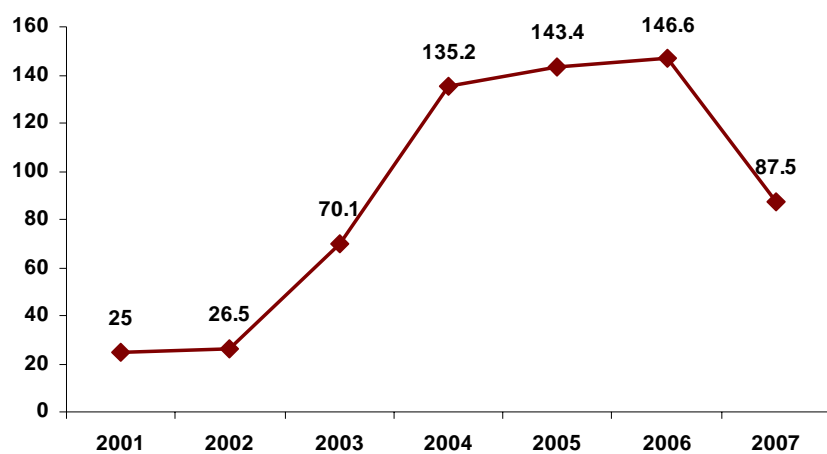
The size of SAPARD program support covers up to 70% of the project value (up to 50% for revenue-generating projects) and the rest is covered by the Bulgarian state. This assistance is solely project-based.

In accordance with the program there are four priority areas for Bulgarian agriculture:

- Improvement of conditions for production, processing, and marketing of agricultural produce, forestry and fish products according to European standards; development of environmentally-friendly agriculture as well as improvement of environment protection activities in agriculture and forestry
- Integrated development of rural regions aiming at preserving and strengthening the local economies and communities and support for reversing the depopulation trend in those regions
- Investment in human resources - increased qualification and training of the employed in the production and processing of agricultural, forestry and fish products
- Technological assistance

For the period studied the program subsidies amount to 635 million leva and are allocated by SF Agriculture.

Figure 12: SAPARD subsidies (million leva)



Source: Ministry of Finance, budget reports

4. Subsidies through the Single Area Payment Scheme (SAPS)

The Single Payment Scheme (SPS) was introduced to cater to old member states (EU15) whereby farmers receive payment based on the funds they received in a given time period (2000-2002). As not all new member states utilized such a method of payment before their accession to the EU (and therefore cannot have a base time period) and as a way to postpone the cross-compatibility requirement, those member states (including Bulgaria and Romania) received in their accession contraction the option of using a Single Area Payment Scheme (SAPA) for a period of three years (including the option of extending twice by 1 year) before moving on to the SPS.

Based on the same principle as the ten new member states, after Bulgaria's accession to the EU, Bulgarian farmers will receive direct financial support in accordance with a certain growth scheme in percentage of current EU payment level as follows: 25% in 2007, 30% in 2008, 35% in 2009, 40% in 2010, 50% in 2011, 60% in 2012, 70% in 2013, 80% in 2014, 90% in 2015, and 100% from 2016 on.

Payment is solely based on hectare of used land and is not dependent on production or number of animals bred. The types of land admissible for these payments are:

- Arable land
- Permanently green areas (pastures and meadows)
- Lands with permanent crops (including vineyards)
- Family gardens

In 2007 direct SAPS payments for Bulgaria are slowed. So in 2008 agricultural producers received their funding for Season 2007 amounting to 466 million leva. And this is precisely the first non-binding assistance farmers receive for land cultivation according to this scheme.

V. Credits

Extending bank credits to agricultural producers through Fund Agriculture can proceed in two different ways. In the first one the fund commits financial resource to a certain bank, which credits the farmer; in the second one the bank credits the farmers and the Fund underwrites the loan.

The main issue with such practices is that production is financed without regard to its market demand. After intensive crediting it can be very well the case that produce abounds and does not correspond to what the market demands. Such a scenario can lead to the bankruptcy of some farmers because of the ensuing price drop.

Another issue with such crediting is that some producers are more advantaged than those who do not enjoy preferences with whom they compete directly on the market. The effects are solely negative and act as a discouragement to the real efficient producers who risked and invested significant sums. The state usually focuses on the financing of such credits irrespective of the their benefits or financial risks. No impact assessment on the whole sector and its economic growth is usually present.

Table 9: Credits to agricultural producers through SF "Agriculture" 2001 - 2007

<i>Million leva</i>	2001	2002	2003	2004	2005	2006	2007	TOTAL
Short-term	26	24.5	12.5	12	24.8	3	2.2	105
Long-term (investment)	36	13.5	94.3	125.7	100.6	109.1	59.1	538.3
Against warehouse stocks of grain	7	12	5	32	20.5	37	48	161.5
TOTAL	69	50	111.8	169.7	145.9	149.1	109.3	804.8

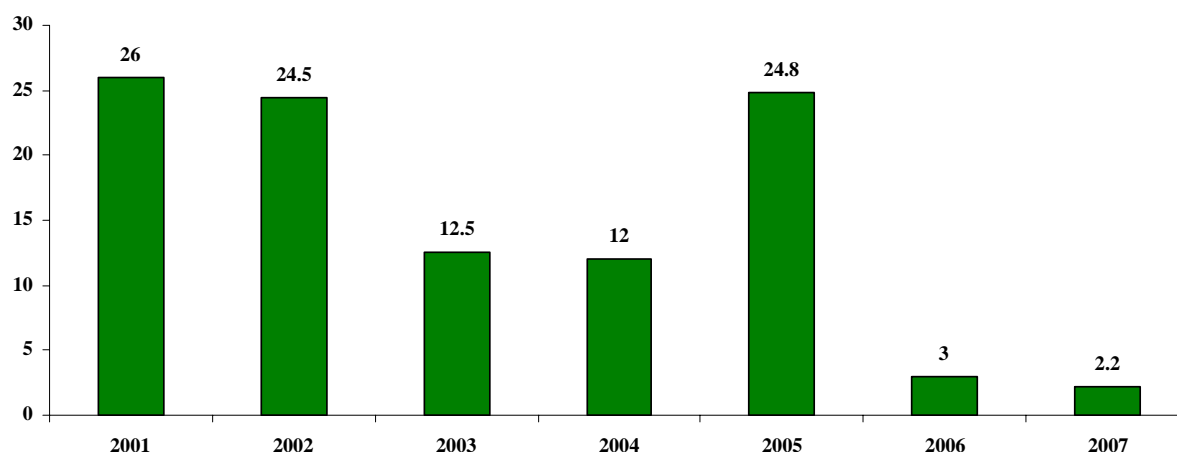
Source: MAF agrarian reports

1. Short-term credits

Short-term financial credit lines aim at stimulating and encouraging the production of certain agricultural products according to SF Agriculture. These credit lines are temporary and are supposed to be phased out in favor of long-term credit lines.

The sum total for the period studied amounts to over 100 million leva, distributed by years as shown in the following graph:

Figure 13: Short-term credits through SF "Agriculture" 2001-2007



Source: Ministry of Finance, budget reports; Ministry of Agriculture and Food, agrarian reports

Short-term credits for agricultural producers go to the sectors of plant-growing and stock-breeding.

2. Long-term (investment) credits

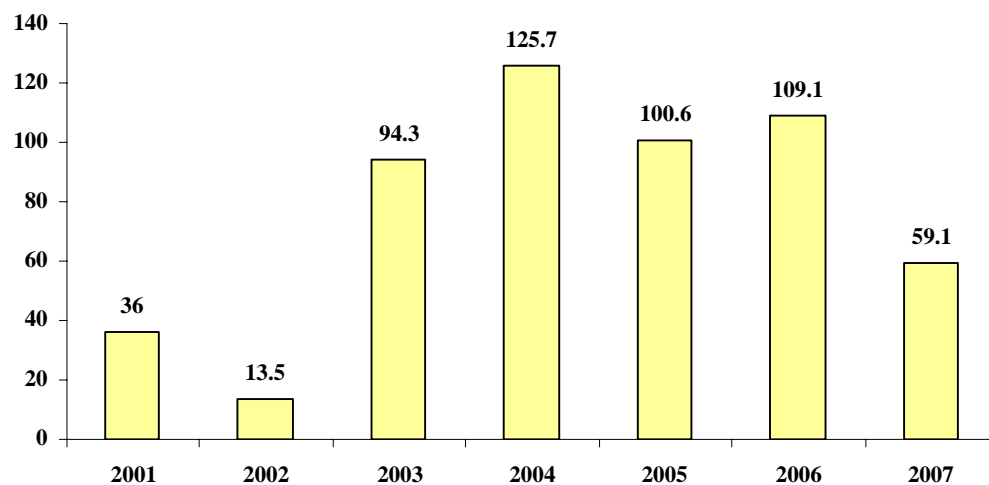
Investment credits through SF Agriculture aim at providing financial resources for long-term investment in agricultural farms, processing of agricultural produce, and rural areas development.

Investment credits in the period studied amount to 538 million leva and comprise three programs:

- Investment program “Stock-breeding”
- Investment program “Plant-growing”
- Investment program “Agricultural machinery”

Those are carried out through non-mediated credits by SF Agriculture and credits by commercial banks.

Figure 14: Long-term credits through SF “Agriculture” (million leva)



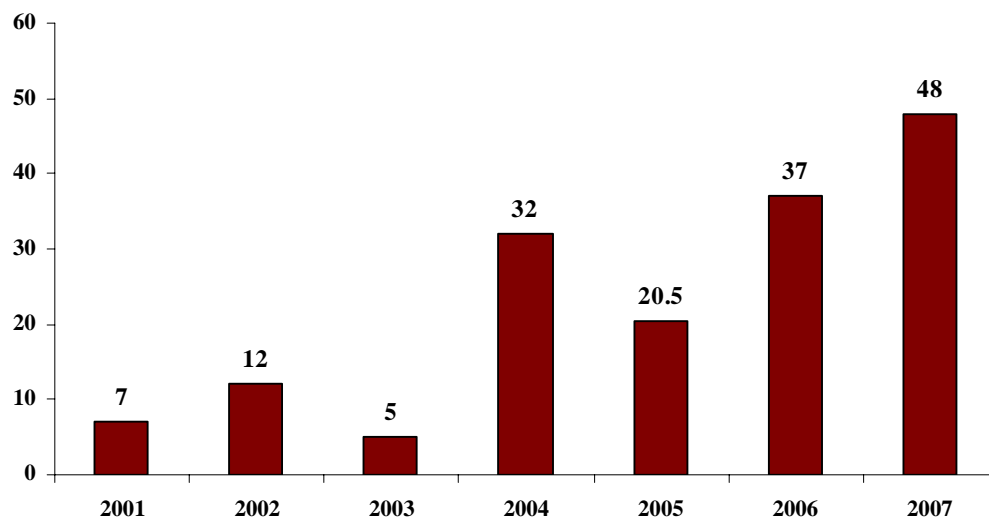
Source: Ministry of Finance, budget reports; Ministry of Agriculture and Food, agrarian reports

3. Credits against warehouse stocks of grain

The introduction of this system allows grain to be traded in stock exchanges as a bond and ensures short-term financing of producers until the autumn sowing with the stocks serving as a credit guarantee.

This system includes the stocks of wheat, barley, corn and sunflower seeds. The sum total of credits under this system for the period studied is 161.5 million leva.

Figure 15: Credits against warehouse stocks of grain (thousand leva)



Source: MAF agrarian reports

VI. Good practice

„The time has come to free ourselves from the political and bureaucratic grip around agriculture and to realize that the labor of farmers should be paid for by those who should pay for it – the consumers, and not a capricious support system which is not immensely popular among tax-payers.”

Eskil Erlandsson, Swedish Minister of Agriculture, 2007

Agricultural support is common practice around the world even though it is often criticized. A lot of OECD analyses (Taxation and Social Security in Agriculture, 2006) alarm that there is no clear idea of the effects of this support. Unsurprisingly, the most common example for good practice in the field of agriculture is New Zealand – a country with no such support for a long time already.

New Zealand

In 1984 the Labor government of New Zealand stopped all subsidies towards agriculture which comprised at that point about 30 different types of payments for production and export incentives – a surprising act, given that New Zealand is very dependent on agriculture, both for production and employment.

A 2001 report by the main agricultural group in the country – the Federated Farmers of New Zealand – shows what ensued after the reform:

- Despite the initial fall of the price of land, it regained its previous levels by 1994 and is high to this very day
- The forecasted farm bankruptcies never happened – only 1% of the farms did go bankrupt
- From the mid-eighties the price of agricultural produce increases by 40% in constant dollars, and the share of agriculture in GDP rose from 14% to 17%
- The sector's productivity increased by 6% per annum after subsidies were abolished, compared to 1% increase before the reforms

New Zealand farmers are still very competitive against subsidized producers around the world on the global market.

Agricultural subsidies in New Zealand form merely 1% of agricultural production and are mainly focused at financing research and development.

The Organization for Economic Cooperation and Development (OECD) confirms that New Zealand boasts the least subsidized agricultural sector in the developed world and reaches the conclusion that their reforms “have lead to a great decrease of market distortion.” This is additionally proved by their Producer Support Estimate (PSE) which shows what share of farmers' incomes is formed as a result of state support. In 1986 PSE for New Zealand was 20%, reaching a low of 2% in the last years.

Australia

After 1988 Australian farmers had to adjust to elimination of all subsidies and free trade barriers in agriculture. Australia has experienced 17 years of economic growth ever since, precisely because of the removal of barriers to free trade and economic reforms (including agriculture) in the country.

In those years the average size of Australian farms has not grown more than that of the Western-European ones under the Common Agricultural Policy of the EU. Over 95% of Australian farms are still family-owned ones and Australian farmers still manage to export 2/3 of their produce.

It is Australian farmer who made the change possible. In the eighties of the past century, the Australian government realized that barriers to free trade and production subsidies put agriculture in a stagnant regulated environment which hinders rather than helps farmers. The reform was carried out by two consecutive governments that despite differing views on other issue reached a consensus in their ideas for reform in agriculture. Those changes continued up to the point when agricultural producers were able to make their own decisions based on market incentives (like price) and to receive their income not from the taxpayers but from their customers.

The decrease of the role of the state in the agrarian sector made Australian farmer much more productive and even more influential. Ever since the reforms they have reached greater flexibility in labor laws, have developed an entrepreneurial spirit and have even turned into leaders in environmental protection.

The Australian experience shows that at least three things are needed so that such a reform could reach the expected and desired results:

- Wide understanding and agreement for the benefits of the reform itself and market-oriented agriculture in general
- Farmers need to be reassured that the reform will reach its conclusion. This conclusion is a situation of free choice (regarding produce, price, etc.) based entirely on market factors, i.e. on a market principle
- If consensus is reached that reform is both wanted and inevitable, government and sector representative should cooperate in the process of change

Sweden

Sweden radically reformed its agricultural policy in 1990. Similar to New Zealand and Australia, the Swedish reform is a part of large-scale process of economic deregulation and structural reforms. Spurred by ideas for economic efficiency, the Ministry of Finance in Sweden played a significant role in the reform. Initially the reform proposal was prepared by a workgroup of seven Members of Parliament. The group proposed radical changes compared to the then-existing policies. Among the reform premises one can mention the inflationary pressures stemming from high food prices, doubts about the legal legitimacy of agricultural policy and wide support for environmental protection aimed against intensive agricultural activities. Civil society also played a significant role in the debate for agricultural policy reform.

Reforms were planned to be conducted fast like the ones in New Zealand and Australia. The main changes included:

- Elimination of all regulations on the internal market
- Maintaining a tiny fraction of compensation payments for producers
- State intervention only in cases of insolvency
- Gradually phasing in a program for environmental protection

It might be due to another radical agricultural policy reform that Sweden embraced in the sixties that the new one was so widely accepted. The implementation process for this policy was significantly distorted when Sweden applied for EY membership, and the policy was completely abolished after the accession. Since then Sweden is one of the member-states

that contributed most to the reform of the Common Agricultural Policy together with Great Britain, Denmark and the Netherlands.

VII. Conclusions and recommendations

The analysis of agricultural support in Bulgaria leads to the following conclusions:

- ✓ Agriculture has declined significantly, as measured by its share in GDP and GVA – by more than two times
- ✓ State help in the form of subsidies and tax relief increase by almost a factor of four
- ✓ The agricultural sector does not develop and slows down the whole economy
- ✓ Agricultural producers are no longer focused on the customers but on the government
- ✓ Distorted incentives harm everyone – producers, consumers, third-parties and the state

This calls for reforms in agriculture that will enable the development of the agrarian sector in Bulgaria with the most efficient production and the most realistic prices of agricultural goods and services.

The main recommendations based on economic logic and good international practices are as follows:

1. Abolish tax relief

The presence of tax preferences in the country effectively discriminates against all non-favored citizens and other types of labor. Tax relief complicates the tax system in Bulgaria and often leads to dishonest practices.

2. Stop state budget subsidies

Support for agricultural producers in the country will reach its peak in the coming years due to EU support schemes. This can be compensated by abolishing some internal support mechanisms like tax relief. In case this does not happen preferential treatment for agriculture will grow exponentially and will result not merely in market distortion but in the lack of a true market.

3. Improve the business environment

Favorable business environment will increase entrepreneurship and efficiency of agents in all sectors, including agriculture. Ease of starting a business, property rights protection, and efficient judicial system will empower Bulgarian entrepreneurs and will attract foreign investors. Improving the business environment is the fundamental base for a developed society and a strong economy.

4. Stop market interventions

State interventions are always more of an obstacle than a solution. Without intervention entrepreneurs will enjoy security instead of the feeling of dependency on the government's next decision. Stopping market interventions will lead to internalizing consequences of mistakes and externalizing the results of success to the benefit of society.

5. Decrease bureaucracy

Bigger bureaucracy always means more regulations and more difficulties for all economic agents. The more the officials and the more power they have, the more likely inadequate decisions, inefficient work and corruption practices are. Decreasing bureaucracy and officials' power will enable further deregulation of the economy.

6. Abolish all subsidies in the medium- to long-run

Granting subsidies affects negatively all parties - citizens, national budget and agricultural producers alike. The main results of this practice are unrealistic prices, distorted incentives and decreased productivity. In addition to that, subsidizing bars from evaluating the sector's and individual producers' efficiency. Abolishing subsidies will free up some financial resource which can be either left to the citizens or be channeled to further improving the business environment in Bulgaria.

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If you want to become part of the spread of ideas of economic and individual freedom in Bulgaria and the region, you can join IME efforts in several ways:

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The payment is made through ePay.bg - Internet based system for card payments.

2. CREDIT CARD PAYMENT



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3. BANC ACCOUNT PAYMENT:

LEVA	USD	EUR
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There are several options:

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