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THE PERSISTENCE OF THE CORPORATE FARMS: THEY SURVIVED THE TRANSITION BUT DO THEY HAVE FUTURE UNDER THE CAP

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ABSTRACT

The newly emergent landowners in the 1990s left their land in the corporate farms due to the low level of farm profitability and the high risk in the general economic environment. The accession to the EU and the introduction of the CAP Single Area Payment (SAP) could induce incentives to landowners to withdraw their land if they are not satisfied with the level of rent. The analysis in this paper, based on survey data, has indicated that, although the SAP might induce more landowners to ask for a rent increase, it is unlikely that they would massively withdraw their land from the corporate farms. However, financially constrained farms might quickly loose their capacity to compete for land in the conditions of an increased land demand.

Keywords: Corporate farms, Land rent, Single farm payment, Slovakia

1 INTRODUCTION

On the basis of theoretical arguments concerning the superior efficiency of family farming, many predicted the disappearance of cooperatives and other large corporate farms, as variations in productivity would lead to a wholesale transfer to individual farming (for a summary of the debate, see GORTON AND DAVIDOVA, 2004). Empirical evidence on changing farm structures in Central and Eastern European countries (CEECs) indicates that during the period of transition the corporate sector role in agriculture has shrunk, but in many CEECs the sector has survived and proved to be competitive under market conditions. The uncertainty is to what extent the corporate farms would be resilient to the new policy environment after the accession to the European Union (EU) and the introduction of the Common Agricultural Policy (CAP) decoupled Single Area

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Payment (SAP). The landowners who have left their land within the corporate farms could now cash the SAP themselves, providing they keep their land in good agricultural and environmental conditions (GAEC). They, therefore, have more incentives to withdraw their land from the corporate farms putting the future of those farms, who rent almost 100 percent of their land, at stake. This paper attempts to provide some insights into the future of corporate farming under the CAP payments. The case study country is Slovakia as there the extent of land used by corporate farms is still the highest among the New Member States (NMS). In 2005, the share of corporate farms in the total utilised agricultural area (UAA) was 85 percent (GREEN REPORT, 2006).

Several reasons have been identified as responsible for the persistence of corporate farms in Slovakia during the period of transition. They include low profitability and low level of incomes in agriculture, a decline in domestic demand and a loss of export market share, deteriorating internal terms of trade, a lack of input market infrastructure and output marketing channels for individual producers (BLAAS, 2002). Other reasons were the protracted identification of land titles (still currently about 500,000 ha of land lack clear ownership titles), fragmentation of land ownership and the very slow land consolidation process.

MATHIJS AND SWINNEN (1998) elaborated a series of propositions to explain the decisions of individuals to exit from the corporate farms and start an individual venture. They asserted the assumption that the corporate farms' insiders would be the agents who would undermine the corporate farms and establish a new pattern of family farm structures. According to empirical evidence accumulated during tow decades of transition, more significant actors who established new individual entities were the absentee landowners – the persons who received land in the process of restitution. Among the insiders, only those with skills, e.g. the former cooperative managers, tended towards individual farming. Farm surveys indicated that other "insiders", cooperative farm members, did not possess the proper pre-conditions for starting an individual business (BLAAS, 1995). Only less than one-third of the cooperative members owned land or were expecting to inherit land and only a small share of them owned a land area sufficient for a full-time farming. The majority of those cooperative members who were landowners (57 percent) had only five or less hectares.

2 WHAT COULD CHANGE UNDER CAP SAP?

As mentioned in the previous section, several factors influenced the landowners' decision to leave the land within the corporate farms during the period of transition. However, this situation might change as the landowners can now cash the SAP themselves, providing they keep their land in GAEC. The main conflict that could undermine the long-term existence of corporate farms under the CAP SAP concerns the distributional issues that may arise in relation to the way profit (including the CAP payments) will be distributed between rentals,

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dividends, wages and investment. As noted by BREM AND KIM (2000), a corporate farm can be considered as an economic organisation consisting of different interest groups (the various stakeholders) who bargain on the objectives of this organisation: landowners, capital holders, workers and managers. The separation of ownership and control might induce managers to fulfil objectives that are not the other stakeholders' objectives, such as increasing the farm's size (JENSEN AND MECKLING, 1976; WILLIAMSON, 1983).

In the corporate farms, landowners have three options available concerning the returns on their land. The first option is "no change", which means to keep the land in the farm for the same rent. The second option is to ask for a rent increase and the third one is to withdraw the land from the corporate farms. Landowners will choose option two if they are not happy with the current level of the rent and option three if the rent renegotiations with the farm managers are unsuccessful.

Three propositions are put forward about the frequency with which these options may occur. As the negotiations between corporate farm managers and landowners about the level of rent are at the core of the issue, game theory has been employed as a framework to aid in generating prior expectations. In order to ease the understanding of how the propositions have been generated, a simple game is used (for more details, see LATRUFFE AND DAVIDOVA, 2007).

The game includes two representative players, the manager and a landowner, and is a non-cooperative static one. The negotiation process is one-shot; the manager and the landowner meet together once to decide about the level of the rent and make simultaneous offers. It is assumed that only two offers are possible, a low rent, that is the rent usually paid to the landowners, and a high rent, that includes an increase following the renegotiation. If both players choose the same action, they reach an agreement and the landowner rents the land out to the farm for the specific rent level agreed upon. If the rent is low, the outcome is thus "no change", while if the rent is high, the outcome is "rent increase". If the farm's manager proposes a high rent while the landowner asks for a low rent, it is straightforward to assume that there is an agreement on renting the land at a high rent and the outcome is "rent increase". Finally, if the farm's manager offers a low rent but the landowner asks for a high rent, there is no agreement and the rental contract is ended; the outcome is "land withdrawal".

The landowner's choice of action depends on whether they have a better opportunity elsewhere. For this reason two types of landowners have been introduced. Type 1 is a landowner who has a better opportunity for the land outside the corporate farm and who represents a credible threat of withdrawal, while type 2 does not. There is asymmetric information about the landowners' type. Although managers have information about the plots' characteristics, they are not fully informed about their landowners' values and situation, as most of them are absentee landowners living in cities.

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So far, however, the whole game has been based on the assumption that the corporate farm is able to offer the two levels of rent. If the farm is financially constrained and cannot afford a rent increase, in the case of a type 2 landowner (no credible threat) the solution will still be to rent the land for low rent, but in the case of a type 1 (credible threat) the solution will be withdrawal. In summary, the frequency of each of the three outcomes depends on the type of landowner and of the farm financial constraints.

Proposition 1: Before the implementation of the CAP, the outcome "no change" was more frequent than the outcomes "rent increase" and "land withdrawal".

The outcome "no change" prevailed as many farms were financially constrained due to the low profitability or loss-making (by the same token most landowners had no better alternatives to receive higher returns on their land outside the corporate farm).

Proposition 2: After the implementation of the CAP, the frequency of the outcome "no change" will decrease.

Proposition 3: After the implementation of the CAP, the outcome "withdraw land" will be more frequent than before but not to the extent to undermine the existence of the corporate farms.

It is expected that the frequency of the outcome "no change" might decrease following the CAP implementation, as more landowners might be able to make a credible threat of withdrawal due to an increased demand for land. Also, the SAP delivered without attached requirements to produce might give incentives to landowners to manage their land themselves if the profit from it (taking into consideration the cross-compliance costs) were to exceed the rent they receive in the corporate farms. Hence, it can be expected that more landowners will want to change their situation and renegotiate their rent. However, despite an increase in rent renegotiations, withdrawals are not expected to be massive for two reasons. First, the introduction of the SAP will relax farm financial constraints and thus more farms will be able to offer a higher rent. Second, the overall number of landowners with credible threat of withdrawals will not rise considerably in the next few years. This will be due in part to the typical small scale land ownership in Slovakia and the relatively low direct payments per hectare due to the phasing-in. The other reason is that the landowners, most of whom are absentee, might still prefer to have their land managed by somebody else and often the corporate farm is the obvious choice.

3 DATA

A survey of corporate farms in Slovakia was carried out within the EU FP6 IDEMA project. The questionnaire accounted for the specificity of corporate farms with their complex organisation involving several stakeholders. Face-to-face interviews of 152 corporate farms, including 101 cooperatives and 51

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companies, were carried out. In order to have a better understanding of the structural farm characteristics, the surveyed farms were matched with their Farm Accountancy Data Network (FADN) entries averaged for 2001/2002.

The farms surveyed have hundreds of private landowners who own on average 68 percent of the total land rented by the farm. Another 24 percent of the land is rented from the State and the remaining 8 percent from the Church and municipalities. The average rent indicated by both FADN records and respondents is consistent, about 14 Euro per ha (the cooperatives pay a lower rent than the companies).

4 ANALYSIS OF THE SURVEY RESPONSES

4.1 Relation with the landowners

In the past, about one third of the farms had received requests for a rent increase, but by only 8 percent of their landowners (Table 1). Among these farms, 39 percent increased the rent; the remaining refused, justifying their refusal by financial constraints. On average 3 percent of the sample farms' UAA was withdrawn accounting for about 2 ha per landowner. The large majority of the individuals who withdrew land wanted to start their own farm. The fact that only few landowners asked for a rent increase or withdrew land, as stated by the corporate farms' respondents, supports Proposition 1 concerning the prevalence of the *status quo* in the past. Comparing the legal forms, the main difference is that more companies (63 percent) than cooperatives (25 percent) accepted the requests for a rent increase. This might be explained by the larger returns generated by companies which made them more flexible.

Table 1: Past pressures on privately rented land (% in brackets)

	All farms (152 farms)	Cooperatives (101 farms)	Companies (51 farms)
Requests for a rent increase			
Farms that had requests for a rent increase	51 (34)	32 (32)	19 (37)
Landowners who requested a rent increase	48 (8)	48 (5)	49(12)
Reason given by landowners for the request	Able to get higher rent elsewhere; heard that other landowner had an increase		
Farms that accepted to increase the rent [a]	20 (39)	8 (25)	12 (63)
Land withdrawals			
Farms who experienced withdrawals	89 (59)	62 (61)	27 (53)
Landowners who withdrew	27 (3.5)	27 (3.6)	25 (3.4)
Total UAA withdrawn from the farm; ha (% of UAA)	52 (3)	56 (3.5)	42 (1.9)

[a] In brackets: as a percentage of farms having had requests for a rent increase.

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Corporate farms' respondents were then asked to give their opinion on the possible future pressures. Three quarters of the respondents expect some request for a rent increase, but few of them believe that land withdrawals will take place (Table 2). This also supports Propositions 2 and 3 that the "no change" option will be less frequent in future but those withdrawals of land from the corporate farms will not be massive. However, if this is true on average, financially constrained farms may quickly loose their capacity to compete for land in the conditions of increased demand which has started being observed in the NMS after the EU accession. Therefore, a substantial structural change might be expected within the corporate farm sector with a better allocation of land to the more efficient users.

Table 2: Sample farms' expectations about their landowners' future behaviour (%)

	All farms (152 farms)	Cooperatives (101 farms)	Companies (51 farms)
Share of farms that expect SAP to induce more requests for a rent increase	76	75	77
Share of farms that expect SAP to induce more land withdrawals	20	20	20

Farms whose respondents do not think that the SAP will change their landowners' behaviour have already had a larger share of rentals in their cost of production structure (2.6 percent against 1.9 percent for the remaining sample farms). Farms whose respondents believe that the SAP will give incentives to their landowners to withdraw rather than ask for a rent increase are more often located in unfavourable areas, have already experienced more withdrawals and have a larger share of individual landowners in their land portfolio.

However, landowners are only one of the stakeholders in the corporate farms. The overall profit allocation provides a broader picture as it involves the interests of other stakeholders as well.

4.2 Past and intended future farm profit allocation

In the past the profit was used, first, to finance the current expenses, and second, for investment (Table 3). The increase of rental payments was the least used option. This confirms the above findings that few farms accepted their landowners' requests for a rent increase on the grounds that they could not afford it. This is also consistent with the theoretical argument that when the control and ownership are separated, managers may have an agenda of their own, often different from the one of the factor owners.

The respondents were also asked to rank the same options from the least probable to the most probable in future, taking in consideration the SAP. It appears that there is a strong past dependency; the preferences for the future

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appear to be similar to the past. The most favoured option is to finance the farm current operations, followed by investment. The increasing of the land rent is still the least preferred option.

Table 3: Past and future use of profit by the sample farms

	All farms (152 farms)	Cooperatives (101 farms)	Companies (51 farms)
Profit used for: (% of respondents who answered yes to an option)			
Farm current operations	63	64	61
Investment	50	46	59
Dividends	20	18	24
Land rent increase	5	6	2
Other	18	19	18
Profit will be used for: (% of respondents who ranked an option as most probable)			
Farm current operations	71	71	69
Investment	24	26	22
Land rent increase	1	6	0
Other	4	3	6

ANOVA was carried out to disentangle the farm characteristics that may explain the variations in the farms' decisions regarding the distribution of their profit. The results show that those farms which in the past did not allocate any profit to investment have a higher share of livestock production in their output mix and they are farms that did not benefit much from the investment subsidies. This tends to suggest that some of the variations were induced by policies which might have stimulated investments in certain types of production. These farms are also smaller measured by the land area and pay a lower rent to their landowners. The only significant difference between the cohorts of farms that used part of their profit to increase the land rent and the farms that did not allocate any profit to rent increases, lies in the type of owners (credible threat of land withdrawal) and the managers' information about the type of landowners. Forty three percent of farms that used some profit for rent increases knew that some of their landowners had been offered a higher rent outside the corporate farms (this percentage is only 18 amongst the farms that did not increase the rents). Regarding the intended future use of farm profit, farms that are less likely to reinvest profits have received a smaller amount of investment subsidies in the past (7.1 against 25.4 thousand Euro). Farms that in future intend to allocate some of their profit to rent increases have received in the past more other (i.e. not investment) subsidies per ha, which suggests that they might be less financially constrained.

An interesting policy insight is provided by the study of the relation between the farm intentions for a future use of profit and their trust in the irreversibility of decoupling. It is proposed that farm intentions concerning their future use of

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profit depend on whether farm managers/directors believe that the decoupling is a sustainable policy or they expect another policy switch, either towards coupled payments or a full removal of farm support. First, the farms have been clustered according to three credibility statements that were included in the questionnaire. The respondents were asked to rate these statements. The possible ratings were from 1 "Not probable at all" to 6 "Very probable". The first two statements suggest that the current policy including SAP and GAEC (statement 6.1.1) and a move towards no support (statement 6.1.2) is credible, while the third statement suggests that the current policy is not credible. A two-step cluster analysis based on likelihood was performed on the three credibility statements with the number of clusters restricted to three (Table 4). The Cluster "no payments" includes the farms which consider that the probability of full removal of payments is high - a high rating of the statement 6.1.2. The farms in the other two clusters think that payments are more likely to remain, but as decoupled, Cluster "decoupled payments" (a high rating of the statement 6.1.1), or that policy will revert to coupling, Cluster "coupled payments" (a high rating of the statement 6.1.3).

Table 4: Cluster means according to policy credibility statements

	Cluster "decoupled payments" (88 farms)	**Cluster "no payments" (37 farms)**	**Cluster "coupled payments" (27 farms)**
6.1.1. Payments decoupled from production but conditional on other service provision will be maintained.	4.7	2.9	2.3
6.1.2. Farmers will receive no support payments what so ever.	2.0	4.9	1.6
6.1.3. Payments will be re-coupled to agricultural production.	2.8	3.9	5.2

The use of these clusters to investigate the differences in intended future profit allocation is presented in Table 5. Farms that do not think the decoupled payments are credible are more likely to use their profit for investment and less likely to use it for current operations. This means that they do not intend to change their behaviour as they think that the decoupled payments and the option to receive payments simply by keeping the land in GAEC are temporary policy measures. The expectations for payments linked to production create incentives for investing. Concerning the use of profit for a rent increase, the farms that believe in the irreversibility of the 2003 CAP reform and the continuation of decoupled payments are more likely to give priority to land rentals in comparison with the farms expecting the payments to be re-coupled or to disappear all together. This indicates a perceived danger of landowners' withdrawals under decoupling when they can cash the payment themselves without the need to be engaged in production activities.

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Table 5: Intended future use of profit by the sample farms according to their perception about policy credibility

	Cluster "decoupled payments" (88 farms)	Cluster "no payments" (37 farms)	Cluster "coupled payments" (27 farms)
Share of farms giving priority to (%) [a]			
investment	21	22	41
current operations	74	73	59
rent increase	13	3	0

[a] Farms are classified as giving priority to a particular option if they ranked the option as the most probable (rank 1) for investment and current operations, and the most or relatively probable (ranks 1 and 2) for a rent increase.

5 CONCLUSIONS AND IMPLICATIONS

The widespread existence of corporate farms in the NMS has raised doubts about their viability under the CAP SAP. The preference of the newly emergent landowners in the 1990s to leave their land in the corporate farms was linked to the low level of farm profitability and the high risk in the general economic environment. This was coupled with the fact that many city dwellers received land during the post-communist land reforms but did not have skills and experience in farm production and management. The accession to the EU and the introduction of the CAP support, and in particular the SAP, have improved the market conditions in the NMS and increased farm incomes. The main question analysed in this paper is whether under these circumstances the landowners would still prefer to leave their land in the corporate farms or whether a quick disintegration of these organisations will be witnessed.

There are variations in the corporate farms' attitude toward rent increases. Overall, the corporate farm management rarely puts the land rent increase as a future priority. However, larger farms which are more dependent on numerous landowners give a higher priority to the use of future profits to reward landowners than the smaller farms do. Also, farms that trust the policy drive to decoupling and perceive the 2003 CAP reform as irreversible are keen to use the profit for rent increases. They realise that the decoupled payments that do not require production are easier to be captured by the individual landowners and that they have to share with the factor owners the increase in the value of land resulting from the capitalisation of support. This indicates a perceived danger of landowners' withdrawals under decoupling. Farms that do not think the decoupled payments are credible are more likely to use their profit for investment. They do not intend to change their behaviour as they think that the decoupled payments and GAEC are temporary policy instruments. The expectations for payments linked to production create incentives for investing.

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Overall, the main policy conclusion is that the SAP will induce more landowners to review their situation within the corporate farms and try to capture the capitalisation of the SAP through higher rents. However, it is unlikely that they will massively withdraw their land from the corporate farms. Therefore, the expected behaviour of landowners does not put the very existence of the corporate farms under question, at least within the short- to mid-term horizon. However, if this is true on average, financially constrained farms may quickly loose their capacity to compete for land in the conditions of an increased land demand which has started being observed in Slovakia and the other NMS after the EU accession. Therefore, a substantial structural change might be expected within the corporate farm sector with a better allocation of land to the more efficient users.

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