



Entrepreneurship Development Foundation (EDF)
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INCREASING THE EFFECTIVENESS OF SUBSIDIES POLICY IN THE AGRICULTURAL SECTOR

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1. SUMMARY

This policy paper has analysed the state support to the development of agricultural sector and the efficiency of allocated subsidies and financial resources in Azerbaijan. The paper is based on the relevant information and data available on annual, quarterly and monthly reports by the State Statistical and State Customs committees of the Republic of Azerbaijan, Ministry of Economy, Ministry of Finance and Ministry of Agriculture, as well as, on legal documents, local, international literature and internet.

The main objectives of this policy paper are to identify major challenges and to design alternative recommendations package to tackle underlying problems, through assessing the state support to the development of agricultural sector and efficiency of allocated subsidies and financial resources.

In this paper the overall situation, the current state of agriculture is analysed based on production, import and export indicators provided by the State Statistical Committee. The paper extensively covers the recently implemented measures and their outcomes. Moreover, the resources of the country and the current potential for their realisation are analysed. This paper also identifies the areas, sectors in need of real state support through evaluating the state of crop and livestock production in Azerbaijan and conducting comparative advantage analysis across subsectors.

The state support to the agricultural sector, the allocation of subsidies and financial resources are analysed in the context of ensuring food security, increasing efficiency in agriculture and producing competitive goods and products.

This paper also reviews the international practice on the support to agricultural sector, especially subsidies.

Recommendations have been designed for improving quantitative and qualitative indicators of crop and livestock production to ensure

efficiency of financial resources and subsidies allocated by the state, for producing competitive products, and in general, for achieving development of agriculture and rural areas.

The policy paper also includes recommendations on the rules of allocation of financial support to agriculture, its distribution across sectors, as well as, on preventing potential problems arising during the allocation of subsidies to rural households, eliminating barriers such as bureaucratic red tape, the collection of documents, establishment of commissions and on other problems.

Recommendations package also takes into consideration the proposals to be made on the status of country during Azerbaijan's accession to the World Trade Organization (WTO), the import quota to be applied to the amount of subsidies allocated to agricultural production.

2. STATE SUPPORT TO AGRICULTURE

Agriculture is the mostly protected sector worldwide. Due to several underlying reasons, producers of agricultural products are not capable to sustain profitability level like industrial enterprises and services sectors. The underlying reasons include: open-air production, technologically disconnected, scattered space, dependence on weather conditions, and the characteristics of market economy. For these reasons, the state support to agricultural sector is an integral part of agricultural policy.

It has been a decade since the introduction of subsidies for the development of agriculture in Azerbaijan. In line with the Order (N° 1907) of the President of the Republic of Azerbaijan dated January 23, 2007, an assistance of 40 manats is allocated from the state budget to fuel and lubricants used in per hectare of cultivated area, on average, 50% of the cost of mineral fertilizers sold to producers is covered by the state, as well as, an additional assistance of 40 man-

ats is allocated for per hectare to promote wheat and rice production. The Cabinet of Ministries of the Republic of Azerbaijan approved a decision dated February 15, 2007 on “Rules on assistance from state budget to the producers of agricultural products for fuel and lubricants used in cultivation” and “Rules on the discounted sale of mineral fertilizers to the producers of agricultural products by Agroleasing Open Joint-Stock Company and by other legal and natural entities”.

However, our analysis shows that, there is a need to improve the mechanisms of subsidy allocation to achieve higher production in agriculture. That is to say, existing rules do not promote productivity growth, product quality improvement, strong competition, by contrast, they encourage extensive agriculture and inefficient businesses. In most cases, allocated subsidies benefitted bureaucrats and swindlers and their close associates, rather than peasants and farmers. The allocation and delivery of these funds to the farmers cannot be considered successful. The document (number-DX-03/01 DSM-14 m) by the Ministry of Finance dated January 13, 2010 reveals that, serious problems were observed concerning the expenditure of assistance allocated from the state budget to the producers of agricultural products¹.

It has been exposed that, those state funds were misused and appropriated. Based on the document, there were violations of rules on a discounted sale of 50% to the purchasers of mineral fertilizers. The names of entrepreneurs were included in the list who do not purchased mineral fertilizers. Moreover, the document reveals that, producers artificially exaggerated the area of cultivated land, and the names of those who do not reside in agricultural land were included in the document about the assistance for wheat and rice production. As a result of examinations, it was found: grain production was reg-

¹<http://www.e-qanun.az/framework/12851>

istered in non-existent areas; barley, spelt areas were presented as wheat areas; wheat production was falsely registered under the names of municipal officials. In addition, illegal amendments were made on the documents about the allocation of fuel and lubricants².

The exemptions and allocated financial resources to agriculture are presented as state support by the government of Azerbaijan. These exemptions and financial support include the followings:

- the producers of agricultural products are exempt from taxes.
- the application of customs privileges to the imported means of production in agriculture and manufacturing.
- payment of 50% of insurance fee of farmers' insurance on farm property and other incidents by state.
- the provision of soft loans at the expense of state budget,
- 50% of the cost of fuel and lubricants used in cultivation of agricultural products is covered by the state budget, a subsidy equal to 50 manats is allocated per hectare, also for re-cultivation.
- allocation of subsidy equal to 0.1 manat per kilogram of cotton sold in manufacturing enterprises
- a subsidy equal to 0.05 manat per kilogram of dry tobacco and per 10 kilograms of moist tobacco sold by manufacturing companies
- 70% of the cost of fertilizers, pesticides, and industrially produced bio humus is covered by the state budget.
- the allocation of subsidies for seed and seedling production,
- a subsidy equal to 100 manats per calf bred through artificial insemination
- to incur infrastructural expenditures on artificial insemination

²<http://apa.az/print/175858>

- 50% of the cost of imported cattle by “Agroleasing” JSC is covered by the state budget and sold to farmers through leasing
- 40% of the cost of agricultural machinery and equipment (sold by “Agroleasing” OJC) is covered by the state budget and are sold through leasing to producers by “Agroleasing” OJC
- state budget covers 40% of the cost of a modern irrigation equipment sold by “Agroleasing” OJC,
- the provision of agro-service at discounted prices by “Agroleasing” JSC.

2.1. A subsidy is allocated for seeds with high reproductive potential

According to the decision (N^o103) of Cabinet of Ministries, dated June 25, 2007, a subsidy from the state budget is allocated to the producers of 1st and 2nd reproduction seeds (as well as seedlings) grown in seed and seedling farms. A subsidy is paid to the applicant if an application includes a copy of the certificate confirming the quality of seeds (or seedling), and a certificate issued by the regional seed inspection committee. In line with the rules, a subsidy in the range of 0.1-21,68 manats (without exceeding 40% of sale price) is allocated per kilogram of 1st reproduction seeds depending on the type of the product (12 types in total). 2nd reproduction seeds are allocated a subsidy in the range of 0.7-14,19 manats (without exceeding 30% of sale price).³

In addition, due to the lack of high reproductive seeds, most of the farmers utilise some of the wheat produced for food as seed material. The products of unknown origin are used in the production of grain and potatoes, which leads to a serious decline in productivity.

³<http://agro.gov.az/231-sn-mayalanma-yolu-l-alinmi-hr-buzova-gr-subsdyanin-verlms-qaydasi.html>

Similar problems are mentioned in “Country Report on the state of Plant Genetic Resources for Food and Agriculture (PGRFA) in Azerbaijan”: “the realisation of imported food products as seeds was making the farmers with low purchasing power to prefer foreign types and species. The lack of experience and knowledge of farmers has undermined growth in the sector. This situation is mostly true for vegetables, industrial crops and grains. So far, there has not been a serious change”⁴

A few years ago, “Azertoxum” JSC, that was certified by the Ministry of Agriculture didn’t germinate after it sold grain seeds to the farmers. Consequently, farmers encountered serious losses. The seed supplied by entrepreneurs, engaged in seed production and import, to farmers are presented as high reproductive seeds. But the absence of independent laboratories leaves farmers no options. The low-quality of purchased seeds is revealed thereafter, when the productivity has been lower. It becomes impossible to prove their seeds to be of low-quality to the enterprises. In this case, a farmer is accused of not following agrotechnical rules. In the end, farmers encounter losses. The farms engaged in seed production in the country have poor material-technical base. Since these farms are not provided with necessary equipment, their seeds do not follow standards. There is no significant improvement in the production of super-elite and elite seeds. The stagnation is also observed in selection activities and in the purchase of new seed types. Since 2007, a subsidy from the state budget is allocated to the producers of 1st and 2nd reproduction seeds, but there is no improvement in this area.

2.2. A subsidy equal to 100 manats is allocated per calf

Based on the resolution of the Cabinet of Ministries dated 22.09.2008, 50% of breeding animals imported are assigned to the

⁴<http://www.pgrfa.org/gpa/aze/azerbaijan2az.pdf>

farmers in the form of subsidies. In addition, “Rule on allocation of a subsidy equal to 100 manats per calf, bred through artificial insemination” has been approved.⁵

The subsidy of 100 manats per calf will increase the number of cattle, which is already massive. On the other hand, considering insufficient feed production in the country, in the context of a lack of pastures and natural hayfields, their low productivity level, and a decline of 100 thousand hectares in the last two years, increasing number of cattle will create serious problems. They include weakening of the cattle due to the lack of fodder, the spread of diseases among animals, increasing number of victims, and a serious loss in productivity.

In Azerbaijan, 70% of large-horned cattle is breed animals. They include Brown Caucasian (24,9%), Black and Hazel (21,6%) Holstein Friesians (11,8%), Simmentals (6,2%). The productivity of breed animals decrease due to low feed base.

3. ENSURING TRANSPARENCY IN THE PROVISION OF SUBSIDIES

Proper utilization of subsidies in line with their purpose has always been a topic of debate. The President of the Republic of Azerbaijan Ilham Aliyev talked about the issue on February 12, 2013 in the conference dedicated to the results of the fourth year of execution of “State Program on the socio-economic development of the regions in the Republic of Azerbaijan during 2009-2013”: “We are allocating these subsidies. But unfortunately, sometimes we cannot ensure transparency in this area. Either subsidies are not delivered to their destination or they are appropriated by someone else. In some cases, some portion of the allocated subsidies is going to the pockets of

⁵<http://agro.gov.az/231-sn-mayalanma-yolu-l-alinmi-hr-buzova-gr-subsdyanin-verlms-qaydasi.html>

public officials. In other cases, the amount of the production and the area of fields are falsely increased to get higher subsidies. Mechanisms need to be improved, to ensure transparency in the allocation of subsidies: “therefore, I consider that, firstly, the international experience on the allocation of subsidies needs to be analysed once more, then recommendations should be designed, and both advantages and disadvantages need to be clarified. I know that, there are problems, transparency is not at a necessary level”⁶

Observations show that, artificial barriers are created for farmers in some regions. Farmers engaged in field-cropping in the lands owned by municipalities, the state, as well as natural persons, do not get assistance at all. Local executive bodies should be blamed for such cases, since they play an intermediary role in receiving and sending the documents to Baku. The main recipients of subsidies in Azerbaijan are wheat producers, but their product is claimed to be of low-quality. Every year around 1,4-1,5 million tonnes of wheat are imported from Kazakhstan and Russia, which is equal to quantity demanded in the country. There is a need for reconsideration of the current policy. An allocation of subsidy should not be based on the area of a land, but on another indicator. For instance, if farmer produces high quality product, State Grain Fund may purchase this product from an entrepreneur. The government instructed the State Grain Fund (SGF) to meet a grain supply of 750 thousand tonnes annually. SGF can purchase grain at higher price from local farmers instead of importing from Russia and Kazakhstan, owing to state funds allocated to the agricultural sector. In this case, farmers will be interested in both increasing the quality and productivity.

⁶http://azertag.az/xeber/Prezident_Ilham_Aliyevin_sedrliyi_ile_Azərbaycan_Republikası_Regionlarının_2009_2013_cü_illərində_sosial_iqtisadi_inkişafı_Dövlət_Proqramının_icrasının_dördüncü_ilinin_yekunlarına_hesr_olunmuş_konfrans_kechirilmişdir-202288

4. AN ALLOCATION OF SUBSIDIES TO AGRICULTURE BY SECTORS AND SUB-SECTORS IN AZERBAIJAN

According to the Order by the President Ilham Aliyev on “State Support to the development of cotton production in the Republic of Azerbaijan” dated September 22, 2016 and on “State Support to the development of tobacco production in the Republic of Azerbaijan” dated October 5, 2016, a subsidy equal to 0,1 manat is allocated per kilogram of cotton sold in manufacturing enterprises; 0,05 manat is allocated per kilogram of dry tobacco and per 10 kilograms of moist tobacco.⁷

A subsidy of 0,1 manat per kilogram of cotton does not encourage the growth of cotton production. Because, currently the price of cotton in international market is 1,7 USD, but our farmers sell a kilogram of cotton for 0,5 manat (0,3 USD). Farmers quite rightly declare that, the amount paid by suppliers do not meet the expenses incurred by them. In Azerbaijan, productivity is low, that is why, the cost of production remains high. In Turkey and Iran, raw cotton is purchased for 90 cents from farmers. Guaranteed price of 1 kilogram of cotton in Iran is 29 thousand and 325 rial, which is equivalent to 1,5 manat. In Turkey, the price of cotton is three times of Azerbaijani price. That is to say, a subsidy of 0,1 manat is insufficient to compensate this difference. High profitability in the sector can be achieved by creating competitive environment in processing and procurement of cotton and by facilitation of the entry to markets. Thus, the state support will not be needed.

As mentioned above, according to the “State Support to the development of cotton production in the Republic of Azerbaijan” dated September 22, 2016 and “State Support to the development of tobacco production in the Republic of Azerbaijan” dated October 5,

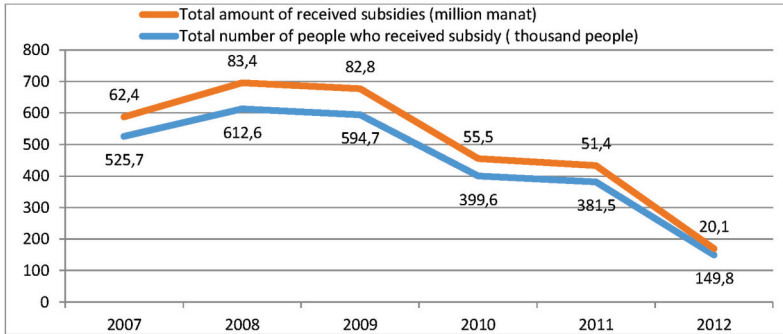
⁷<http://www.president.az/articles/21299>

2016, a subsidy equal to 0,1 manat is allocated per kilogram of cotton sold in manufacturing enterprises; 0,05 manat is allocated per kilogram of dry tobacco and per 10 kilograms of moist tobacco. Based on the data provided by the State Statistical Committee and our research, profitability in this sector is very high. In other words, the profitability level of tobacco producers has been above 30% since 2005.

Although tobacco production in 2000 resulted in a loss, profitability increased in the following years. Even so, the state support was not provided to the sector in 2014, the profitability level exceeded 180%. An allocation of subsidies to the highly profitable sectors should be reconsidered. The development of cotton, tobacco and silkworm (sericulture) production should be regulated via contracts that benefit all parties, including producers, manufacturers and those engaged in procurement. If the conditions of the contract, as well as, the purchase and sale prices of the products are determined on the basis of the experience of neighbouring countries, both parties can benefit.

When subsidies were introduced in 2007, strict control mechanisms were lacking. For this reason, some could take advantage of allocated financial assistance with the help of several civil servants in rural and regional centres. Cultivated areas were artificially exaggerated and barley areas were presented as wheat areas. What is more, some citizens who are not engaged in agricultural sector could get fake documents to benefit from state support. This factor is revealed through statistical data.

In 2013, 20 153 483 manats were allocated to 149 849 producers. Thus, the number of farmers and peasants obtaining subsidies has declined several times compared with previous years. While in 2007, 62 400 000 manats were allocated to 525 700 producers, according to the latest available data, 20 153 483 were allocated to 149 849 producers. As indicated above, decreasing number of both the amount of assistance and the number of producers are due to appropriation of allocated funds.

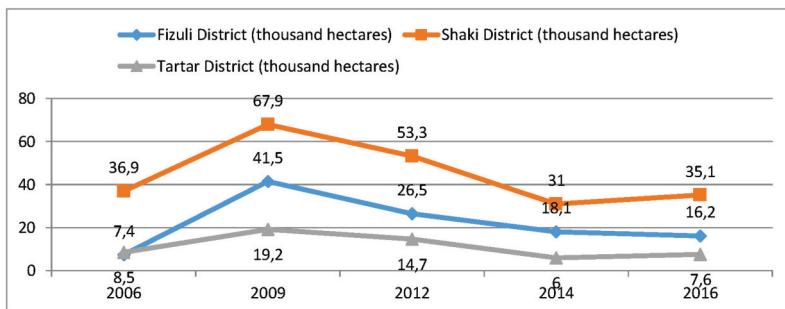


During inspecting the allocation process of subsidies, the Ministry of Finance has found cases of appropriation and misallocation. Additionally, the government officials had already been distracted from illegal activities to some extent, owing to the authority of the Ministry of Finance to conduct inspections at any time. For this reason, recently, the number of people getting state support has declined sharply. However, such inspections are not sufficient to ensure full transparency in the allocation of subsidies.

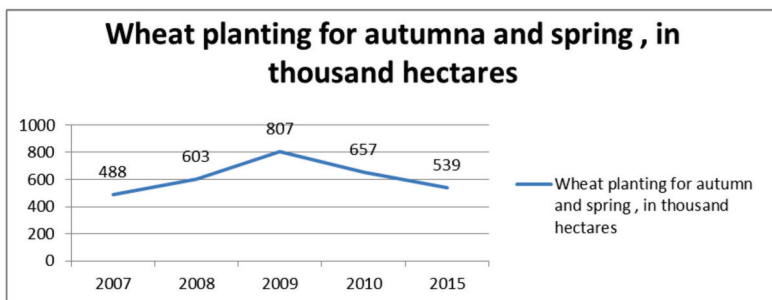
Such forgery cases are recorded in all regions of the country, including Nakhichevan Autonomous Republic. The results of inspections reveal that, there were several cases of violations in many regions.

Statistical indicators show that, there were significant fluctuations in farmland area. While there was 2 times increase in farmland area during the period of allocation of subsidies, after the inspections this number declined by almost 3 times. If we compare farmland area in Fizulu, Shaki and Tartar, we can conclude that the amount of allocated subsidies has created an adverse impact.

Diagram. Grain fields in Fizulu, Shaki and Tartar



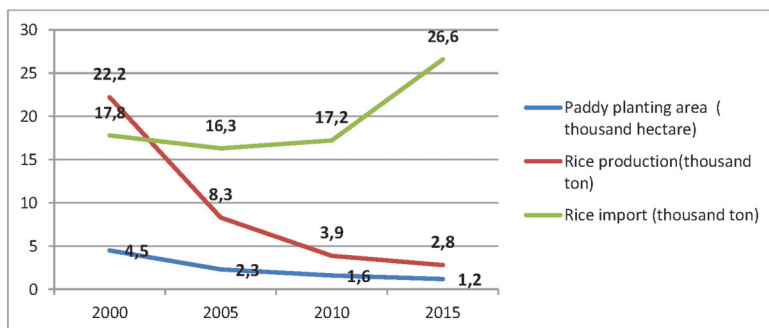
Similar situation is observed in Jalilabad, Shamkir, Tovuz, Ismaili, Aghjabadi, Nakhichevan Autonomous Republic and other regions.



Many farmers who engaged in wheat production were driven away due to inequitable distribution of subsidies, appropriations and forgery. Hence, while until the introduction of subsidies imported wheat in Azerbaijan was equal to 150-300 million USD, last year it rose to 400 million. The interest of some farmers decreased owing to appropriations and misallocations.

Despite the state support provided through the document approved by the Cabinet of Ministries dated November 16, 2007, which intended to increase the interest of producers and encourage production, during this period rice production in Azerbaijan declined significantly. While rice production in 2000 was equal to 22, 2 thou-

sand tonnes, during the following years it fell by 8 times. In 2015, rice production was equal to only 2,8 thousand tonnes and the volume of imported rice grew by 2 times.



As can be seen from diagram above, while rice production in 2000 was equal to 22, 2 thousand tonnes, during the following years it fell by 8 times. In 2005, rice production was equal to only 2,8 thousand tonnes and the volume of imported rice grew by 1,5 times. It is paradoxical that, even though the state support is based on the farmland area, rice planted area shrank by 3,7 times.

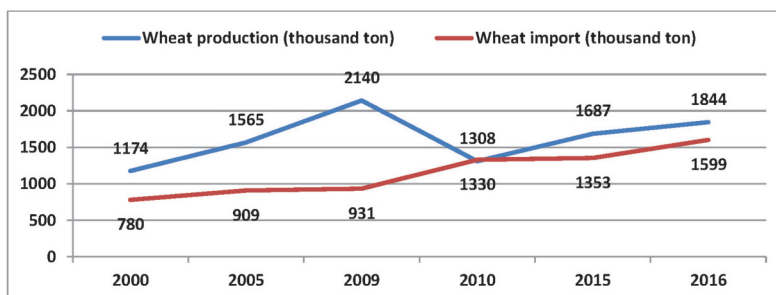
Recently, it has been claimed that the amount of subsidies is insufficient and a need for an increase is underlined. Even the Ministry of Agriculture are making official statements on the issue. But, a thorough research should be conducted before claiming an increase to existing level of assistance. If the price of fuel or factors of production rises, the amount of the state support can be extended to prevent farmers from increasing the price of their products. The main motives should be to maintain interest in production and to facilitate revenue earning. On the other hand, the amount of subsidy can be increased if the costs of production incurred by our farmers is larger compared with those in other countries. The increased subsidy amount is intended to compensate the gap, considering the difference. However, such a research is not conducted by the Ministry of Agriculture or other authorities in Azerbaijan, and the need is growing.

In some cases, subsidized fertilizers are sold to farmers by state-owned “Agroleasing” JSC. 334.65 thousand tonnes of ammonium nitrate (nitrogen), 54.21 thousand tonnes of superphosphate, 7059.5 tonnes of nitroammofoska, 3377.6 tonnes of ammofos, 331.5 tonnes of potassium fertilizers and 301.8 tonnes of pesticides were provided for the producers of agricultural sector since “Agroleasing” JSC started its operations in 2005. These statistical data prove that, only a negligible part of the demand for mineral fertilizers is met in the country. There are limited reserves of fertilizers, farmers experience difficulties in obtaining them, and alternative sources are few. According to our research and calculations, only 10% of the optimal level of fertilizer is used. It should be noted that, based on the calculations by the World Bank, only 4% of the optimum level of fertilizers was used in the past. Agricultural herbicides and pesticides can be obtained through commercial sources; their quality is not approved by the certification procedure of the government. Consequently, farmers heavily rely on chemical means to defend plants from diseases and pests. This, in turn, results in higher costs and negative environmental impact.⁸

2015 was announced to be “Year of Agriculture” by the order of President Ilham Aliyev dated January 12, 2015. At the same time, to ensure rapid development of agricultural sector, several important documents were signed by the President during the year. State Seed Fund (SSF) was created with the order by the President on “Additional measures to strengthen state support to the development of agriculture” dated March 2, 2015. In addition, in April, 2015 President signed an order on “Additional measures to strengthen state support to the development of crop production”. The order intended to extend the volume of exemptions on fuel and motor oils, and to encourage re-cultivation the assistance for fuel and motor

⁸<http://agrolizing.gov.az/az/menu/137/1>

oils used in cultivation of perennial plants per hectare of land, was increased by 25%. On April 16, 2015,



The President of the Republic of Azerbaijan signed an order on “Exemptions for a set and equipment of irrigation systems either offered or sold through leasing by “Agroleasing” JSC. According to the order, an exemption equal to 40% of the initial value of a set and equipment of irrigation systems offered or sold through leasing by “Agroleasing” JSC is intended to be applied to overcome adverse impact of the long-term drought, to improve water supply, as well as, to increase an interest in the sector and promote the flow of investments.

According to the 2016 state budget in Azerbaijan, 596 599 165 manats were allocated to agriculture, forestry, fishery, hunting and environmental protection, and agricultural expenditure accounts to 570 384 822 manats.

Unfortunately, implemented measures and allocated funds throughout these years were not successful. Imported food products has reached unprecedented level. In other words, while the volume of imported food constituted 979 million in 2015, it increased by 35% in the following year by reaching 1,322 billion. The problem is that, in 2016 exports of food products fell by 40%. An increase by 41,6% in fruit and vegetables; 25,3% in sugar; 19% in vegetable and animal fats and oils; and 69% in tea imports were recorded. Compared to the respective period of 2016, imported meat declined by more than

2 times both in terms of volume and value, while imported dairy products; birds' eggs; natural honey; edible products of animal origin rose by 61%. As in previous years, the amount of imported wheat grew sharply. Imported wheat in 2016 was equal to 1, 599 million increasing by 246 thousand. While the amount of most of imported agricultural products increased seriously, the amount of traditional export products fell sharply. In 2016, there were decreases in exported tea, sugar and vegetable and animal fats and oils respectively by 3,8 times, 2 times and 4,7 times.⁹

5. THE MAIN FACTORS ENCOURAGING PRODUCTION

There are several factors encouraging the growth of agricultural production and food in Azerbaijan. Rapid growth of population leads to increasing demand for agricultural products. Moreover, a rise in consumer price of agricultural products and food during last 10 years, in turn, contributed to higher profitability level in agricultural sector.

5.1. Demand in the market is increasing

Efficient use of land can play an important role in providing employment for significant part of peasants and eliminating poverty. These issues are mentioned in "State Program on reducing poverty and achieving sustainable development in Azerbaijan during 2008-2015". "Considering 48% of the population reside in rural areas, agricultural sector plays a crucial role in providing employment and revenues for households. In this sense, it is important to improve the access to credits, agricultural equipment and other necessary resources and services with following ecological sustainability principles in the use of lands"¹⁰.

⁹<http://customs.gov.az/files/arayis201612.pdf>

¹⁰http://sei.az/upload/files/2008-2015-dovlet_programi.pdf

There is a potential of farmers to increase agricultural production more than two times in Azerbaijan. Besides production potential, there is a need for an increasing production in domestic market. Domestic production cannot meet demand for food and agricultural products. The report by the Food and Agriculture Organization of the United Nations (FAO) dated October 16, 2013 includes data on the Central Asia and the Caucasus, as well as on Azerbaijan. It is mentioned that, “significant nutrition risk is observed in The Central Asian and Caucasian countries. The percentage of under-nourished constitute 26%, and poverty rate is around 30-70%, according to the World Bank estimations.

In Azerbaijan, food consumption by population is significantly less than daily and annual averages determined by World Health Organization (WHO), especially, the consumption of high-calorie products falls behind the norm: “the norm for consumption of meat and meat products is 84 kilograms per capita. Notwithstanding, the actual number in the country is only 33 kilograms. Additionally, the consumption of milk and dairy products is 248 (the norm is 360 kilograms) kilograms per capita, of fish and fishery products is 6,8 kilograms (the norm is 20 kilograms), of eggs is 131, below the half of the norm (280)”.

It is underlined in the reports by Food and Agriculture Organization of the United Nations that, daily food consumption level in Azerbaijan is low: “per capita daily average is 2242 kilocalories in Azerbaijan, while in Georgia this indicator is 2249, in Ukraine 2727, in Belarus 3007, and in Kazakhstan 3095”.¹¹

5.2. Rapid growth of population

Along with the shortcomings stated by the international organizations, an annual growth rate of 1,3% population increases demand

¹¹www.agro.gov.az/index.php?cat=188&ses=acflf

for food and agricultural products. These factors, in turn, encourages the farmers to expand agricultural production. These opportunities enable the government to organize an efficient use of financial resources allocated for the sector.

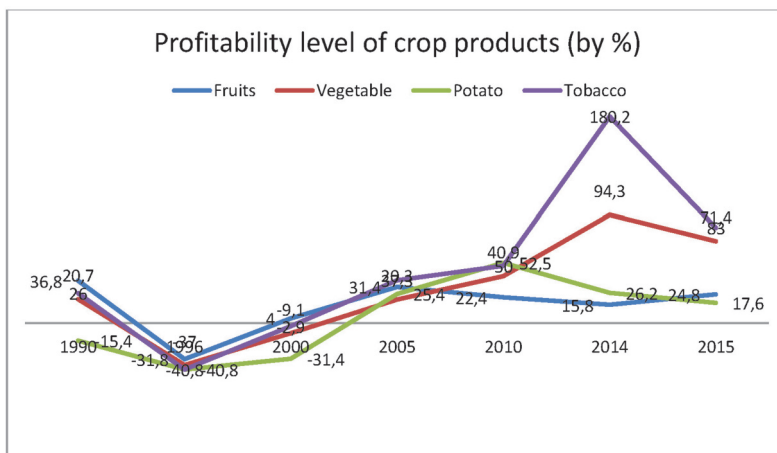
5.3. Specialization across products

Recently, there has been natural specialization process taking place in many regions, following local conditions. The specialization of regions facilitates the work of farms. They, together with several producers can meet their need for seeds, equipment, mineral fertilizers, and easily conduct the sale of the final product. Many entrepreneurs make their way to the regions specialized in the production of specific products earlier in the season. In many cases, entrepreneurs engaged in procurement order as much product as they want, and pay funds to the farmers in the form of a deposit or an advance beforehand. Specialization across products will enable higher profitability via decreasing the costs of production and improves an entry to the market. The formation of production by farmers, based on a voluntary selection is desirable. Nonetheless, the government should also encourage this and undertake several measures in this respect.

5.4. Profitability level is increasing

In the past, the production of certain crops created losses for peasants, farmers. But recently, the profitability level of vegetable products is demonstrating an upward trend. As shown in the graph below, the profitability level of agricultural products in the country is increasing year after year. Due to certain reasons, the profitability of fruit and potato declined to 4.4% in 2013, but it increased in the following year. According to the SSC, profitability level of vegetable products in the country was 94,3% in 2013 and 71,4% in 2015.

5.5. Profitability level of products sold by agricultural enterprises (by %)



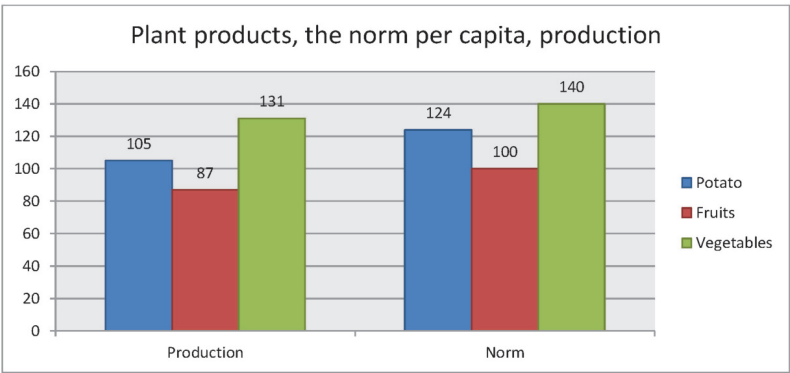
Obviously, the high level of profitability of agricultural products is one of the main and most important factors stimulating rapid development of farms.

5.6. The price of agricultural products has increased by 4 times over the last decade

Data shows that, sale price of agricultural products in world markets over the last decade has increased considerably. During the same period, sale price of crop products in Azerbaijan rose several times. The diagram below demonstrates the sale prices of a centner of agricultural products in individual entrepreneur farms. As can be observed, sale price of a centner of vegetable, potato and fruit increased respectively from 15,4 manats to 40 manats, from 5,71 manats to 21,1 manats, and from 10 manats to 44 manats. Generally, the prices of fruit and vegetables and potatoes, which are considered main crop products, rose nearly by 4 times. This factor increases interest in production of farmers, peasants and promotes production. The development of these sectors can be achieved without state support.

Azerbaijan imports substantial part of the raw grain used in the production of bread. SSC reports that, around 1, 353 million tonnes of grain for food was imported to the country in 2015, which significantly exceeds our consumption demand.

The production of potato, which is considered the second bread, is also low. While per capita norm is 124 kilograms, in 2015 the production of potatoes was equal to 85 kilograms per capita. Not all the produced products are consumed, since the quality can be poor. For this reason, per capita consumption of potatoes in Azerbaijan was below the norm, 88 kilograms in the last year, including imported potatoes. In 2015, the production of vegetables constituted 130 kilograms (the norm is 140 kilograms), while the consumption of population was below the norm (134 kilograms), including imports. Additionally, the norm for fruit and berries is defined to be 100 kilograms per capita annually, while consumption in Azerbaijan constituted 89 kilograms in 2015. The graph below shows the production of potatoes, fruit, vegetable per capita and the norms determined by the WHO.



Farmers can fill the gap, considering that, the level of agricultural production does not meet demand and the volume of imported crop products is huge. There is an opportunity for farms to establish a sustainable supply chain in agricultural production.

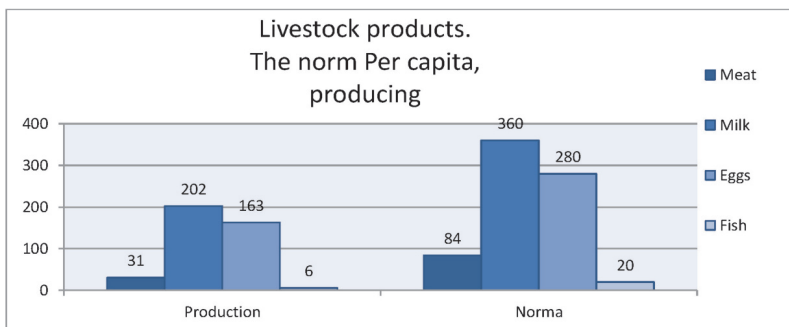
5.7. Demand for livestock production is increasing

Our research shows that, demand for livestock products, and accordingly, opportunities for expanding production are increasing. It should be noted that, there is a recent tendency towards increasing demand and production of dairy products worldwide.

The chief of animal husbandry and veterinary department of FAO, Samuel Yutsin stated “demand for milk is increasing by 15 million tonnes annually in the world, which is mainly attributed to developing countries. This additional demand for milk production involves 3 million people to farms by creating new workplaces”¹².

In 2015, average of 1455 kilograms of milk is obtained from each cow and buffalo during lactation period in the country, which is several times less than the worldwide average. This outcome is not beneficial for farmers either. The farming activities of farmers engaged in milk production and producing at this level can be considered an obstacle to the development of country’s economy.

The graph below presents the production of meat, milk, eggs and the norm on these products determined by the World Health Organization (WHO).

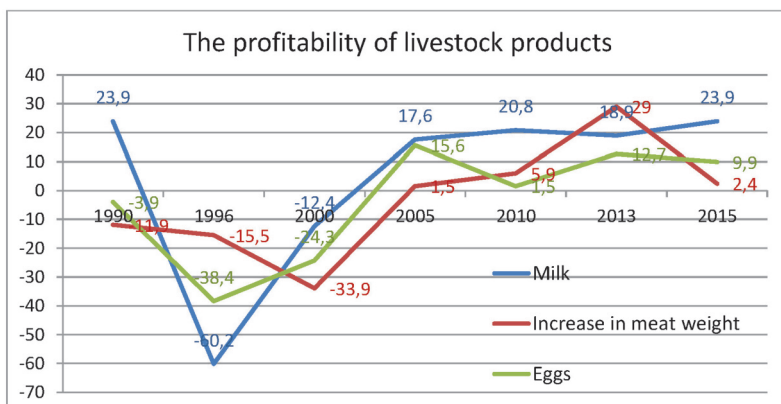


¹²<http://www.fao.org/news/story/ru/item/45828/icode/>

The graph below shows sale prices of a centner of livestock products. As can be seen from the graph, during the period 2000-2015, sale price of livestock products rose by 2-3 times. Increasing sales prices in Azerbaijan were in line with the worldwide tendency. This means that, prices of livestock products will remain profitable for producers.

The production of milk, meat, eggs used to have low profitability level for a long time, but their profitability increased over the last decade. The profitability of livestock production has risen to the level attractive for farmers in 2015.

The graph below demonstrates profitability level of livestock products.



As can be seen from the graph above, there are great opportunities to meet domestic demand for main livestock products. There is a unique opportunity for farmers to establish sustainable production chain to meet increasing consumer demand for meat and dairy products, eggs in Azerbaijan.

Recommendations on the improving the mechanisms of allocating subsidies have constantly been mentioned. It is underlined that, there is a need to design a mechanism of allocating subsidies based

on marketable product. On September 17, 2016, in the conference held in Sabirabad district on the development of cotton production the President, Ilham Aliyev stated that, “I support the claims on the allocation of subsidies based on production rather than cultivated areas for the next period. Relevant authorities should now work on the issue and prepare recommendations.”¹³

6. WTO CONDITIONS REGARDING SUBSIDIES

The recommendations presented in this project takes the conditions put by WTO for Azerbaijan into consideration.

The reason for suspension of the admittance of Azerbaijan into World Trade Organization is that Azerbaijan is demanding special conditions for the membership. Azerbaijani government demand the agreement regarding agricultural subsidies to be on the same level as developing countries, which is 10% of overall agricultural output. Upper limit for agricultural subsidies is 10% for developing countries and 5% for developed countries. However, the membership conditions of WTO gradually change and requirements regarding agricultural subsidies toughen. It is reported that, Azerbaijan is demanding the right to provide 10-15% of direct subsidies, while WTO demands 3-5%. Furthermore, WTO is expected to repeal any subsidies intended for export promotion.

7. COMMISSIONS, REQUIRED DOCUMENTS

In accordance with the rules of allocation of subsidies from the state budget to the producers of agricultural products for fuel and lubricants used in production, as well as, for cultivation of wheat, paddy, cotton and tobacco, a collection of many documents is required from farmers by local commissions. Besides being a waste of time,

²³http://azertag.az/xeber/Sabirabadda_Prezident_Ilham_Aliyevin_sedrliyi_ile_pambiqchiligin_inkisafina_dair_respublika_musaviresi_kechirilib_YENI-LANIB_VIDEO-99315

collecting documents and presenting them to the rural land commissions also require a certain amount of financial resources. The required documents include, an application form, an inspection act on cultivated areas, other acts approved by signatures of a chief and members of rural land commission, documents on farmlands of producers and on confirming the rights owning, renting and using, information on cultivated agricultural crops and perennial plants in owned, rented or used lands and other documents. The Commission has been established to ensure an allocation of state support to the producers of agricultural products and a payment of the amount of exception applied to the mineral fertilizers, bio humus and pesticides sold by legal and natural persons. Experience shows that, despite large numbers of both established commissions in rural, regional, national level and collected documents, an equitable distribution of subsidies has not been achieved. -

Although the area of cultivated lands has increased since the introduction of subsidies, productivity and quality has not been improved. Competitive production has not been achieved. It can be concluded that, allocated subsidies to the agricultural sector failed to promote higher productivity and quality. Instead, these funds improved the financial situation and became means in overcoming the social problems of some government officials and rent-seekers who appropriated the allocated subsidies. Consequently, the farmers who used to be heavily engaged in agricultural production left the sector.

According to the information on the website of the Ministry of Agriculture (<http://agro.gov.az/subsidiyalar>), recently, Shahla Ismayilova (father name-Mammadali) was supposed to receive an assistance amounted to 9900 AZN, but only 5000 AZN was paid by Zardab branch of Kapital Bank JSC. During the inquiries conducted by the Ministry of Agriculture, the list presented by the Commission to Zardab district commission was compared with the list sent by Zardab district commission to Zardab branch of Kapital

Bank JSC. Thus, it was found that, there is a gap amounted to 37185,5 manats between the actual amount paid by bank to 238 producers and the amount defined by the Commission. These funds were subtracted from the amount to be paid to a part of producers and were transferred to the bank accounts of the other producers.

It should be noted that, land commissions, established with an order by the chief of regional executive authority, are responsible for collecting data on cultivated areas and producers receiving assistance in the district and present it to the Commission on the allocation of Assistances. The data on the list of producers receiving assistance, their bank requisites and the amount of assistance are sent by regional commissions to relevant authorized¹⁴.

These and similar factors reveal that, despite a long-standing allocation of subsidies by the government of Azerbaijan to the agricultural production, significant challenges remain.

8. INTERNATIONAL EXPERIENCE

Examination of international data has demonstrated that each country has unique way of managing financial support system to agriculture. United States Department of Agriculture allocates more than 25 billion dollars of subsidies to agriculture annually. The exact amount of subsidies varies depending on market prices and several other factors. Subsidies are mostly allocated to big farms producing wheat, corn, soy, rice and cotton. American experts think that, federal government has ensured a social security system for farmers by this¹⁵.

Main principles of Australian, Canadian, New Zealand and Latin American governments are to liberalize agricultural trade, reduce direct government support and to repeal export subsidies. The ex-

¹⁴<http://www.agro.gov.az/589-knd-tsrrfati-nazrly-trfndn-zrdab-rayonunda-akar-edlm-nqsanlar-bard-materallar-azrbaycan-respublkasi-ba-prokurorluuna-gndrlb.html>

¹⁵<https://www.downsizinggovernment.org/agriculture/subsidies>

perience of the countries which do not allocate direct subsidies have demonstrated that, the elimination of subsidies has increased productivity. Farmers have succeeded to improve quantitative and qualitative indicators, since they attempted to increase productivity and reduce their costs to increase their profit.

Pakistani government has exported 1.2 million tonnes of grain from their state fund in order to promote and facilitate export industry. Overall subsidy expenditure is 60 million dollars. Subsidy per 1 tonne of wheat from Punjab province is 55 dollars, while it is 45 dollars for Sindh province.¹⁶

The practice of allocation of subsidies based on the amount of marketable product have been put into implementation in Hanti-Mansiysk Autonomous District of Russian Federation. State support for agriculture is in form of subsidies allocated based on the volume or weight of the final product. For example, subsidy for every tonne of unprocessed milk is 12 thousand rubles, subsidy for processed milk is 16 thousand rubles, for the weight of live small livestock is 40 thousand rubles, for special breeds of livestock for meat with weight more than 450 kg is 80 thousand rubles per tonne¹⁷.

Russian Federation has pledged to meet a part of cost of production of milk by allocating subsidies to its subjects by the decision of federal government dated 22 December of 2012.¹⁸ The amount of subsidy varies depending on season in most districts. For example, subsidy per tonne of marketable milk in June-July in Volgograd district is 450-1100 rubles, while in August-November it is 1000-3200 rubles¹⁹.

¹⁶<https://www.fas.usda.gov/data/pakistan-pakistan-announces-subsidy-wheat-exports>

¹⁷<http://admhmao.ru/dokumenty/gosudarstvennye-programmy/razvitie-agro-promyshlennogo-kompleksa-i-rynkov-selskokhozyaystvennoy-produktsii-syrya-i-prodovolstvi/postanovlenie-pravitelstva-khanty-mansiyskogo-avtonomnogo-okruga-yugry-322-p-ot-11-sentyabrya-2015-g/>

¹⁸<http://www.garant.ru/products/ipo/prime/doc/70188208/>

¹⁹<http://www.garant.ru/hotlaw/volga/496244/>

The practice of allocating subsidies based on marketable product volume is not widespread across the world. Western countries practicing agricultural subsidies realize that subsidies allocated based on cultivated area do not stimulate increase in production. However, they also realize that allocation based on volume of production also creates many problems. For example, the application of modern technologies in Western countries allows farmers to significantly increase the production if needed. But increase in production would mean increase in supply, which would reduce its price. Therefore, subsidies are allocated based on cultivated land. It should also be noted that, there 12 million farmers in Europe with 15 hectares of land in average, while there are 2 million farmers in USA with 150 hectares of land in average²⁰. Since both production levels and the area of cultivated land is small in Azerbaijan, it is more advisable to allocate subsidies based on production to increase productivity.

New Zealand made a brave decision in 1984: it removed all agricultural subsidies. Although there were certain difficulties at first, eventually New Zealand farmers succeeded to increase profitability and productivity. New Zealand farmers are still successfully operating without government support by decreasing production costs, efficiently utilizing land resources and increasing their non-agricultural profits.²¹

9. RECOMMENDATIONS

9.1. Regarding the efficiency of subsidy policies

Experiences of majority of countries demonstrate that competitiveness of agricultural sector depends on efficient use of domestic resources. Agriculture is in the process of transformation into a high-technology sector. Given this, government of Azerbaijan should revisit and redefine its agricultural policies. Government sup-

²⁰http://europa.eu/rapid/press-release_MEMO-13-631_en.htm&prev=search

²¹<https://www.downsizinggovernment.org/agriculture/subsidies>

port to agriculture should take into consideration the modern needs of the sector. Therefore, government should aim to increase the academic potential of the sector, to employ modern resource-preserving technologies, to train professionals, scientists and experts, to provide greater opportunities for scientific research. As was mentioned above, the allocation of subsidies based on the area of field generates several problems. It leads to exaggeration of relevant indicators through collusion between farmers and local authorities and, thus, to appropriation of state funds, inefficient use of resources and serious law infringements. It is more suitable to allocate subsidies based on the volume of marketable product in Azerbaijan, rather than the area of the field or number of farm animals. Allocation of subsidies based on marketable product would boost overall productivity and stimulates higher quality in products. As was mentioned before, climate and land conditions of Azerbaijan allows production of wide range of agricultural products. This, in turn, creates several options for farmers to generate income. Researches show that the production of fruits, vegetables and industrial crops in Azerbaijan is profitable. Demand for tea, cotton and tobacco products is high in global market, while their prices are also profitable for Azerbaijani producers. Therefore, it would be beneficial to focus the government support to these subsectors on scientific development. Azerbaijan is not self-sufficient in terms of food production according to the WHO criteria. Domestic wheat production meets a negligible portion of domestic demand, meat production meets 38% of domestic demand, egg and dairy production – 55%. Considering the ongoing conflict and complicated international situation, it is essential to devise a strategy to increase domestic food production. Despite the very favourable conditions for wheat production in the country, the yearly import of wheat products is around USD 400-500 million. On the other hand, even though domestic wheat production is mainly used as feed, it doesn't fully meet feed demand either. Thus, development of wheat production can help to ensure

that domestic production can meet demand for wheat both as food and feed. Development of wheat production would drive the development of rice, bread, wheat products, pasta production. High quality feed production, in turn, would stimulate growth of cow, chicken and sheep farming, meat products, dairy and egg production, sweet water fisheries etc. Development of wheat production would also stimulate growth of manufacturing and job-creation. It is possible to increase high-quality, balanced mixed feed production to 2 million tonnes yearly. Providing subsidies based on the wheat production would give farmers more options, they would be able to acquire higher quality and more necessary equipment, quality seed materials, mineral fertilizers, pesticides.

Subsidies are advised to be allocated based on production. Table 1

Nº	The name of the product	Quality	Weight, tons	Subsidy to be given (AZN)
1	Hard wheat	1 st , 2 nd , 3 rd -class	1	50
2	Soft wheat	1 st , 2 nd , 3 rd -class	1	50
4	Rice	Excellent, 1 st grade	1	50
5	Barley	Fodder	1	30
6	Oats	Fodder	1	30
7	Corn	Fodder	1	30

The amount of subsidy per tonne recommended for each product is based on the importance of the crop, its production cost, current amount of subsidy and overall subsidy strategy of government. For example, since wheat production for food has a strategic importance, more subsidy is intended for this crop. Quality wheat is more costly. Farmers need to use seeds with higher reproductive ability to increase the quality of the product and to increase the volume of

production. In order to achieve a normal development of the plants, farmers should follow strict agrotechnical rules during vegetation. It is essential to achieve conditioning dryness, purity and usefulness of the grain. There is a need for additional funds for special equipment and their utilization for this purpose. This and other important factors have been taken into consideration when calculating subsidy amount.

The subsidy amount presented in Table 1 is an optimal option for increasing wheat production and increasing its quality in short term.

9.2. The alternative is the table presented below.

Subsidies are advised to be allocated based on production. Table 2

Nº	The name of the product	Quality	Weight, tons	Subsidy to be given (AZN)
1	Hard wheat	1 st , 2 nd , 3 rd -class	1	30
2	Soft wheat	1 st , 2 nd , 3 rd -class	1	30
4	Rice	Excellent, 1 st grade	1	30
5	Barley	Fodder	1	15
6	Oats	Fodder	1	15
7	Corn	Fodder	1	15

This alternative was formulated based on the current subsidy policies of government. It was prepared considering current productivity of wheat fields and current level of subsidy per hectare (90 AZN per hectare for wheat, 50 AZN for other crops). This is a cost-saving alternative, allowing government to spend the saved resources in other fields, but it will be insufficient for farmers to solve their current problems.

Effectiveness of subsidies in agricultural sector in Azerbaijan depends on resolution of the following issues:

- It is advised to ban the import of wheat of 4th and 5th class with moisture content lower than 23%.
- State grain fund should collect only domestic production.
- VAT should be applied on wheat and floor product imports for 3 years.
- Government should encourage the use of domestic wheat products in milling and production of mixed feed.
- Allowances should be considered for domestic grain producers.
- Operations of recently closed flourmills and mixed feed producers should be revived and supported.
- Establishment of new pasta manufacturers should be encouraged in order to stimulate the production of hard grain.
- Domestic demand for wheat (as food) is 1.2 million tonnes. Required amount of subsidies to produce in this volume is 60 million manats. The adopted State Program encompasses the production of 2 million tonnes of high-quality, balanced mixed feed. The subsidy intended for this purpose is 60 million manats. Thus, the total amount of subsidy needed to meet country's wheat demand is 120 million manats. Furthermore, 50 manats of subsidy per tonne of marketable hard grain and rice will stimulate the growth of these sectors. Total amount of subsidy will thus be 150 million manats, which meets WTO criteria.

It is more suitable to assign the task of the allocation of subsidies to the Ministry of Finance. In this case, the product is documented via cash receipt when sold to processing facility or grain warehouse. Then, producer presents the copy of this receipt to local authorities and eventually allocated amount of subsidies are transferred to farmer's account. It is sufficient to provide cash receipt or financial document specified by Ministry of Taxes to attest that the product is marketable and produced, there is no need to collect additional documentation.

Ensuring the effectiveness of allocated state resources would allow the country to improve coordination in production process, revive the manufacturing sector. Small, household farms will merge their fields and operations, since small-scale wheat farming is not profitable. Wheat production will guarantee the sustainability of local production of bread and other flour products. The production of quality wheat will, in turn, stimulate the production of dairy products, meat, eggs and fisheries.

The creditworthiness of farmers receiving subsidies based on marketed products will improve, thus, developing their access to financing and credit. Therefore, subsidies will increase chances of farmers to receive additional funding for seeds, fertilizers and other means of production.

10. EXPECTED RESULTS OF ALLOCATION OF SUBSIDIES BASED ON MARKETABLE PRODUCT

- Increase the production of grain products
- Improve the quality of the final product
- Ensure the sustainability of grain production
- Dramatically decrease the import of grain products
- Increase the production of certain grains (hard wheat, rice), thus developing new export direction
- Ensure self-sustainability of the country in terms of bread and flour products
- Develop the feed production, which was the weak link in stock raising. Mixed feed production will reach 2 million tonnes.
- Help country save 400 million dollars that were used to import grain products
- Increase farmers' income
- Create jobs and new production facilities.

**INCREASING THE EFFECTIVENESS
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IN THE AGRICULTURAL
SECTOR**

Vahid Maharramov

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