

### Pitfalls and challenges

There are cases (such as The Philippines, and partly in Costa Rica) where a range of tax exemption measures for organic operators have been authorized by the government but they have never been effectively implemented due to lack of uptake by the responsible ministries (e.g. custom and finance ministries) and because the administrative procedures involved are too complex to set up.

Even when the measures are effectively implemented, there remain important challenges in their uptake by operators. As with other types of subsidies that require beneficiaries to apply through an administrative process, the main bottleneck in the uptake of such support is the lack of information for potential beneficiaries: often, a significant share of farmers do not benefit because they are not aware. Communication targeted to organic farmers should accompany such schemes.

Aside from the lack of information, beneficiaries may also not apply due to the cumbersome bureaucracy needed to obtain the tax exemption (e.g. in the Philippines, organic food and input producers are exempt from all income taxes levied by the national government for a period of seven years, but in practice very few requests have come from small producers due to bureaucratic application procedures).

Corruption is another risk. The opportunity for corruption is much greater for tax incentives regimes where officials have wide discretion in determining which investors or projects receive favorable treatment. The potential for abuse is great where no clear guidelines exist for qualification. Therefore the qualifying criteria should be simple, specific and objective to minimize the discretion afforded officials that grant the incentives and to provide guidance to tax authorities charged with monitoring and enforcing the tax incentive regime.

## **h. Support for organic farm investment**

### Political justification

For any commercial sector, the quantity of private investments is a decisive factor for sector growth. Organic agriculture is no exception to this economic reality. This is particularly true for the conversion process: conversion to organic farming can be costly in terms of initial investment such as new machinery, adaptation of livestock facilities, integration of on-farm processing facilities, or organizational investments such as setting-up internal control systems for smallholder group certification. Additionally, there is another form of “investment” required during the transition period in the sense of building soil fertility and recovering from the initial yield drop: those absorb much needed financial resources at a time where the other more physical investments are also needed. This makes farm investment support a very important element to facilitate conversion.

Besides the general goal of supporting sector growth, there are several reasons that can justify public support to private investments in the organic sector, especially at the farm level (where farmers are making the individual investment decisions).

First, the acquisition of machinery and other equipment specifically adapted to organic farming is rendered more expensive for farmers than conventional equipment, due to the absence of economies of scale (such machinery is still produced in relatively low numbers). The economic argument of path dependence/technological lock-in<sup>89</sup> is a useful theoretical economic model in this regard, to help understand the economic processes that render a certain technology (in this case, conventional agriculture) more economically accessible, simply because it has historically been adopted as the dominant technology. New organic technologies (e.g. for weed control, organic housing systems, etc.) may not be so well tested as technology for conventional farming, and as the market is considerably smaller, it is hard to convince machinery manufacturers to develop machinery suitable for organic farming. An investment support for the farmers, or product development support for the manufacturer can make it commercially interesting. Ultimately, producing machinery for organic farms can become a lucrative business, and may even include exporting.

Second, farmers' capacity to invest in their farm is often too limited, which prevents them from making investments in favor of organic agriculture, even if these would pay off in the long run. This is particularly true in production sectors that are under economic crisis in the conventional sector: in such situations, although farmers would see the economic benefit of converting to organic (having seen that their organic counterparts are not affected by the crisis), their financial situation is already so bad that without public support, they cannot afford to make the investments needed for the conversion. This was for example the case observed with pig farms in Germany in 2015, or the more general conclusion reached by researchers<sup>90</sup> looking at conversion capabilities in France (concluding that successful farmers in the conventional system were more likely to convert to organic than unsuccessful ones).

Smallholder farmers are also the ones whose production systems are best suited to organic agriculture, but again, their investment capacity is very limited – another reason for public support. The higher diversity in organic production makes it harder to achieve economies of scale for specialized machinery, which is an argument in favor of supporting such investment, possibly for groups of farms together.

### [Suitable contexts](#)

Support for organic farm investment is possible at any stage of development of the organic sector. It is easier in context where there is a clear legal definition of what is organic (i.e. an organic regulation or a legally referenced organic guarantee system), but it is not impossible in other cases: for example, the government may decide to give support for certain types of farm investments which are known to be particularly useful

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<sup>89</sup> [https://en.wikipedia.org/wiki/Path\\_dependence](https://en.wikipedia.org/wiki/Path_dependence)

<sup>90</sup> Latruffe et al (2013)

for organic operators, such as mechanical or thermal weeders, mesh nets, compost turning machines, etc.

Support for farm investments can be obtained under various cultures of government intervention, although it will be more difficult in the case of low interventionism culture.

Support for farm investment is relevant to any of the objectives for policy support to organic agriculture.

### *Possible modalities of implementation*

Farm investments may be incentivized through various policy instruments, including subsidies, grants, loans with reduced interest rates, tax credits (see previous section), etc.

Farm investments can be encouraged on an individual basis (farmers apply for the incentives individually) or on a collective basis (incentives available for farmer groups and cooperatives that share equipment and machinery, for example). Support to groups have the potential to also foster cooperation in other ways, e.g. in marketing.

Governments can offer farm investment incentives specifically for organic farming under a program targeted exclusively for converting and expanding organic operations, as was provided in Germany and Austria.

The government may also offer those incentives under a general agricultural investment program, which may give preference to organic farmers. Examples of the later include:

- Subsidies for installation of young/new farmers, possibly topped up with additional money for organic installations, or for which they have granted additional points to organic farmers in the criteria for access to this support.
- Grants for farm investments and modernization of equipment with higher grants for organic farmers, and/or with additional points to organic farmers in the criteria for access to this support.
- Loans for farm investment with advantageous interests rates and/or higher limits for organic farmers or with priority access for organic farmers. The higher limit may not be the most relevant approach since organic operations are usually smaller. Priority access is more relevant. Such loan programs can be via government partnership with national banks, with the government role in guaranteeing the loan and/or subsidizing the interest.

Governments may also reserve farm investment incentives for certain “sustainability practices”, such as animal welfare in livestock housing investment or investments related to soil conservation. These can end up particularly benefiting organic farmers, since such practices are required in organic production.

### *Country examples*

**Czech Republic** set up organic farming investment grants in 1991 and investment loans in 1992. This was in fact the main focus of their organic support at the time. In the last decade, subsidies for young/new farmers to start-up their business were given, with additional points granted to organic farmers in the criteria for access to the support. This is deemed to have played a very significant role in the growth in the number of organic farms in the country.

Under its National Development Plan 2007-2013, **Ireland** approved a Scheme of Grant Aid for the Development of the Organic Sector, which provided investment support for organic farmers and processors. The scheme still provides grant aid of 40 % of the cost up to a maximum grant of EUR 60,000 for on-farm investments or EUR 500,000 for off-farm investments.

In the **Netherlands**, the National Action Plan 2005-2007 did not have any specific budget to encourage organic farm investment but foresaw that organic operators could seek investment support (in the form of lower or tax-deductible interest rates) from general schemes aimed at encouraging environmentally-friendly investments. Investments in organic farms were eligible under 2 different schemes, namely the MIA (Environmental Investment Rebate) and Vamil (Arbitrary depreciation of environmental investments) schemes. Also, organic projects qualified for the Green Funds Scheme whereby banks, supported by the government green fund, could charge green projects a lower interest rate. Such supports were not enough to encourage conversion but have been used by many organic farmers for scaling up their operations, particularly in the growing sectors of greenhouse production, poultry and pig farming. The Green Fund scheme supported more than 1,600 organic projects between 1995 and 2009, and the fund has supported a total investment of EUR 800 million in organic farming since 2000.

In **Germany**, agricultural investment grants have been one of the main policy instruments to support organic agriculture. Specific conditions vary depending on each *Länder* (region), but essentially the Agrarinvestitionsförderprogramm (AFP) contained special provisions for organic farms from 2002 to 2006, after which the organic provisions were removed. However, since 2014, animal housing investment grants are linked to animal welfare provisions, which is more favorable to organic producers as the animal welfare conditions are close to those in organic regulations. Producers can get up to a 40% grant for this investment. The region of Bavaria had a similar scheme at the regional level from 2001 to 2003, under which 211 organic farms (about 14% of the scheme beneficiaries) received a combined amount of EUR 5 million. Additionally, some German regions have support schemes reserved for organic farm investments. For example, the region of Thüringen has a program – Ökolinvest – reserved for organic farmers, under which eligible investments can receive a subsidy of up to 40% and up to a maximum of EUR 800,000 per farm during the period 2015-2020.

Many other EU countries, or specific regions within countries have given similar forms of support. Some regions of **Italy** and **Spain** have granted additional subsidies for

young/new organic farmers, on top of the general subsidy for starting-up a farming business. The regions of Flanders in **Belgium** and Madeira in **Portugal** have given higher grants to organic farmers than to conventional farmers for farm investments and modernization of equipment. **Cyprus, Latvia, Estonia** and **Slovakia** have given additional points to organic farmers in the criteria for access to the farm investment grants. In **Estonia**, the subsidies for investments into improved performance of agricultural holdings are deemed to have been a very important support measure for organic farmers.

In **Switzerland**, various cantons supported organic farm investments, particularly linked to the conversion to organic farming. This has been done in various ways depending on the cantons. The Jura canton gives financial aid in the form of a **loan without interests** of EUR 36,535 - reimbursable over eight years- for the farming enterprises that begin their business directly as organic or want to convert to organic.

In the province of Quebec in **Canada**, financial support is available to farmers for up to 50% of the cost of building or adapting livestock facilities for organic production, to a maximum of EUR 13,000. Additionally, under a program of support to diversification and regional development, companies opting for organic farming are eligible for reimbursement of interest on a capital loan for a period of 3 years. This support can represent a benefit of up to EUR 10,000 per company.

In **Turkey**, organic farmers can receive credits with 50% interest rate cut.

In **Tunisia**, decades ago the government introduced subsidy packages aimed at increasing farmers' productivity, reducing production costs and enhancing organic product exports. By decree, equipment specific to organic farming has been subsidized by 30% since 1994<sup>91</sup>. The Agricultural Investments Promotion Agency (APIA) also coordinates government investments in the organic sector and helps secure government funding of organic projects in the country. By 2010, at least 52 OA projects, worth more than EUR 42 million had been funded by the government following APIA's endorsement.

In **Brazil**, subsidized credit to support investments for organic farms is one of the actions in the PLANAPO (national plan for organic agriculture). An exclusive credit line for organic agriculture<sup>92</sup> was launched in 2013. Under this program, interest rates are set at 2.5 % whereas rates offered to conventional operations are about 7%. There is a maximum limit of EUR 82,000 per individual farmer or EUR 206,000 for collective projects (machinery in cooperatives, etc.).

In **China**, several local governments have supported organic farm investments. For example, in 2010 Chengdu, the largest city in Southwest China, introduced financial supports for infrastructure investments such as building greenhouse facilities and road

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<sup>91</sup> Article 12 of the decree n°94-427 of February 14, 1994 (amended by the decree of September 13, 1999)

<sup>92</sup> The so-called PRONAF-Agroecologia.

access for organic farms. The local governments of Shanghai and Beijing also have such support. The council of Agriculture of Taiwan also subsidizes green houses investments and the purchase of machinery necessary for organic farming and provides low interest rate loans to organic operators.

### Best practice example(s)

#### **Best Practice Example: Organic Investment Grant Aid in Ireland**

Ireland has been supporting organic farming for more than 2 decades. From 1994 to 2006, organic farmers were supported by way of a Supplementary Measure under the Rural Environment Protection Scheme (REPS).

Under the 2007-2013 Rural Development Programme, there was a stand-alone Organic Farming Scheme. Organic farmers were also entitled to join REPS until it was closed to new applications in July 2009, and after it was launched in March 2010 they were entitled to join the Agri-Environment Options Scheme (AEOS).

The objective of the Organic Farming Scheme was to deliver enhanced environmental and animal welfare benefits and to encourage producers to respond to the market demand for organically produced food. To be eligible for this measure, farmers must have been certified organic and farmed organically for a minimum period of 5 years. The Organic Farming Scheme combined organic area conversion and maintenance payments, and investment grant-aid for organic farmers and processors.

Investment grants were available both to farmers and to processors under the Schemes of Grant Aid for the Development of the Organic Sector, which were approved under the National Development Plan, 2007-2013. The Schemes provided grant aid for new equipment and facilities for production, processing, grading, packing, storage, distribution and sale of organic products. Under these schemes 40% of the investments costs were reimbursed, to a maximum amount of € 60,000 per recipient for on-farm investments and € 500,000 for off-farm investments.

The Organic Support Scheme resulted in significant growth of the organic sector in Ireland: during the period 2007-2013, the organic agricultural area grew by 30%. Investment support is considered to have played an important role in this growth, in combination with area payments.

Support to organic on-farm and off-farm investments continues and the maximum support for on-farm investment was raised to EUR 80,000 per holding. The funding is available under the "Organic Capital Investment Scheme" as part of a broader program cofunded by the EU and the Irish government called "Targeted Agricultural Modernisation Scheme II".

### Pitfalls and challenges

Investment support (especially when in the form of grants/subsidies) means that beneficiaries receive a lot of money at once (or in a short time) for being organic. The main challenge of such support policies is to ensure that the beneficiaries will really stay in the organic sector. There have been cases of some opportunistic behavior of operators becoming organic in order to qualify for the grant aid and reverting to conventional farming once the commitment is over. Options for avoiding this problem

include:

- Restricting preferential treatment to those organic farmers whose farms are wholly converted or who market their product as organic or are willing to do so should their application be successful, linking support to a long-term commitment (e.g. 5 years) and to connecting the producer to the premium organic market.
- Focusing the investment support on machinery and equipment that are specifically needed in organic agriculture, such as mechanical and thermal weeders, grinders and compost-making machinery, compost and manure spreaders, insect proof mesh, etc.

Credit with reduced interest rates lowers the risk of opportunistic behavior because the benefit is less immediately tangible, but it has other disadvantages. Some countries (such as Costa Rica) have authorized such a support measure but did not implement it, due to the lack of cooperation with/by the banks. Unless the government covers the gap in profit by compensating the banks for the reduced interest rates they offer to organic operators (e.g. in the case the Netherlands Green Funds Scheme), those banks hardly see a reason to offer such discounts. The case has even been reported, in Denmark, of banks encouraging meat producers to skip organic production (considered a higher risk) in order to get credits.

Reduced or no-interests credits are particularly beneficial in contexts of high interest rates and in areas where access to finances (for farmers) is difficult (this is, for example, often the case for smallholders in Africa). However, in times and places where interest rates are generally low and access to credit is easy (this is for example the case currently in the EU and USA), the impact of such support measure will be limited. Even when the credit lines are (theoretically) open, it does not guarantee that the benefit will reach the producers; there can be problems in the uptake of those schemes. For example in Brazil's case (see country examples) data for the years 2005 to 2010 shows that the total resources granted by PRONAF - Agroecologia were only EUR 3.1 million, through 979 contracts, and that 40% of the budget allocated went to the Northern Region (mostly to the State of Pará). This represents less than 1% of the total agricultural credit for family farmers granted in the same period, indicating that conventional production systems received more resources through other credit lines. It is likely that this is related to difficulties in accessing credit due to:

- the lack of awareness and preparation from financing institutes (due to the need for a differentiation in the budgets and plans for requesting credits for diversified production systems, which are often also smaller than conventional ones) and
- the lack of awareness on the side of the producers, who do not know about the mechanisms or do not have the capacities to develop the projects to request credit (capacity building for rural projects to request credit has also been an issue).