

The Impact of Agricultural Subsidies on the Economic Situation of the State

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Abstract: The agricultural sector plays a pivotal role in global economic development by ensuring food security, contributing to GDP growth, and supporting other industries through resource transfer and trade. However, it is characterized by high volatility due to climatic uncertainty, market fluctuations, and global crises such as the COVID-19 pandemic and the war in Ukraine. These events have triggered significant increases in food prices, intensifying inflationary pressures and reducing welfare, particularly in developing countries. As a result, state intervention in agriculture has regained prominence, with policymakers applying diverse protectionist and redistributive measures, such as subsidies, tax incentives, and direct payments, to stabilize markets and support producers. In the European Union, the Common Agricultural Policy (CAP) remains a cornerstone of this intervention, yet it faces criticism for inefficiency, uneven redistribution, and inadequate targeting of vulnerable groups. Empirical studies demonstrate mixed results: while some confirm the positive effects of agricultural support on productivity and poverty reduction, others reveal inefficiencies, reverse redistribution, and fiscal burdens. This review highlights the complex relationship between agricultural protection, price stability, and social welfare, emphasizing the need for targeted, evidence-based policies that balance economic efficiency, fairness, and sustainability in both developed and developing economies.

Keywords: agricultural policy, subsidies, redistribution, food price inflation, welfare, Common Agricultural Policy

JEL Classification: Q10, Q18

1 Introduction

The agricultural sector, which includes crop cultivation, animal husbandry, fisheries and forestry, is a critical driver of economic growth that cannot be ignored by the economies of industrialised and developing countries (Awokuse & Xie 2015). Furthermore, it makes a significant contribution to the economy, especially in the early stages of economic growth and development, by feeding the population and transferring resources to other sectors (Kuznets 1972). The fact that agricultural products (food) are both a trade commodity and a vital resource for human well-being sustains and deepens the role of the sector in the economy. In particular, the accumulation of capital in the agricultural sector helps in the initial phase of the economic growth process. Agricultural products find consumers in international markets, bring in foreign exchange, and at the same time improve the country's gross domestic product (GDP). In this regard, the agricultural sector helps in the development of other industries (Taylor & Lybbert 2020). Agricultural growth is an important tool for regional development and poverty reduction, as mentioned by Bekun & Akadiri (2019). However, as globalization spreads, increases in income and wealth, population, and life expectancy around the world have led to an increase in food consumption rates. This was particularly evident in the 2000s, when food consumption outpaced production (Abbott et al. 2008), leading to inflationary pressures. Valentina (2020) notes that in recent years, policymakers in national economies have focused on combating inflation as a major concern. However, food price inflation has been rising faster than the consumer price index (CPI) in all regions of the world due to supply disruptions caused by the COVID-19 pandemic (Gruère & Brooks 2021). Various factors, including increased input costs (Algan et al. 2021), global climate change (Singh-Peterson & Lawrence 2015), and losses in agricultural production, have contributed to the global increase in agricultural prices (Edwards et al. 2011).

The significant increase in the prices of agricultural products in recent years has seriously affected low-income consumers. In developing countries in particular, these price increases have a negative impact on the well-being of low-income consumers, as noted by Jomo and Chowdhury (2020). Agriculture plays a key role in reducing poverty and hunger in many developing countries (OECD, 2005). Increases in food prices can trigger social discontent by reducing income per capita in these countries, which spend a significant portion of their income on food.

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The agricultural sector has a fundamental influence on macroeconomic factors such as economic growth, as Gollin (2010) points out, and is a fundamental determinant of the consumer price index and welfare, especially economic growth. Over the last decade, especially after the 2008 crisis, the idea of returning to the ideas of John Maynard Keynes as a means of resolving economic crises has begun to be seriously discussed. This idea, known as "Keynes Resurrected", has led to a renewed interest in fiscal policy as an important and effective tool of economic policy and to the reopening of debates on state interventionism (Alesina 2012). As a result, almost every developed and developing country has adopted interventionist measures in agriculture as part of an active economic policy for economic and social reasons (Searchinger et al. 2020). Policymakers support the agricultural sector through various measures, such as direct support to agriculture, tax incentives, technology and knowledge transfer, market protection measures, non-tariff barriers, quotas and price support (Clapp, 2017). These instruments aim to support agricultural development and expand foreign trade in agricultural products (Vozarova and Kotulic 2016).

One of the main reasons for government intervention in the agricultural sector is to reduce the volatility of agricultural product prices and protect farmers from these effects (Özdemir 1989). Economic development is one of the main goals in both developed and developing countries, and it can only be achieved through stable economic growth. There is consensus that capital accumulation, which can be achieved through the agricultural sector, is a key factor for the initial phase of economic development and a leading factor in economic growth, which in turn contributes to economic development (Taylor & Lybbert 2020).

Recently, there has also been a debate about the role of the agricultural sector in increasing welfare, reducing poverty and hunger, and as a means by which increases in agricultural prices negatively affect household welfare, as mentioned by Bekun and Akdiri (2019). These effects are particularly strongly felt in developing countries. Based on these discussions, some researchers have focused on studying the impact of protection measures applied to the agricultural sector and their impact on economies. Studies on the effects of agricultural support on macroeconomic performance are limited in the literature. For example, Balisacan and Roumasset (1987) conducted research focused on the relationship between protection rates for major cereals and economic development in 68 countries during the period 1979-1981. Their conclusion suggests that there is a strong link between economic development and agricultural protection. In contrast, Köse and Meral (2021) focused on Turkey and found no relationship between agricultural support and economic growth. However, Albers and Peeters (2011) found that agricultural support had a reducing effect on food inflation in their study of nine Mediterranean countries between 2002 and 2010. Caracciolo et al. (2014) examined the links between world and domestic prices of staple crops such as maize, rice and wheat in four developing countries. They found no direct correlation between wheat and rice subsidies and world prices of these crops, but maize seed subsidies had an impact on world prices.

Agricultural support contributes to increasing food supply and reducing food prices, which Oyakhilomena and Zibah (2014) argue helps to reduce poverty. Gollin (2010) emphasizes that increasing agricultural productivity is a key source of economic growth in many developing countries. Several studies have been conducted in this regard. Erdal et al. (2021) and Canbay (2021) found in their studies that government agricultural support policies positively affect agricultural productivity. On the other hand, Uslu and Apaydın (2021) argue that agricultural sector supports have a negative impact on agricultural productivity. Rad-Tüzün and Aslan (2018) also pointed out that agricultural supports have positive effects on some products and negative effects on others. Kalabak and Aslan (2021) found that this effect is limited. Yıldız (2017) concluded in his study that there is a bidirectional causality between variables, while Roe et al. (2002) did not find a statistically significant relationship between variables. The literature shows that there are only a limited number of studies focusing on this issue and their results vary. These differences in results are due to different levels of agricultural support in the countries/groups of countries studied, climatic conditions and insufficient technological infrastructure in the sector. Mistakes in marketing strategies, cyclical developments in input prices, lack of physical and human capital and inconsistent implementation of support plans also contribute to the different results.

The war in Ukraine, which began in early 2022, has fundamentally affected global agricultural commodity markets and has sparked a discussion about the need to protect domestic agricultural producers (Hassen & Hamid, 2022). In the Czech Republic, this protection is manifested mainly in the form of increased support and crisis measures aimed at ensuring stable supplies of key commodities to the domestic market (Aliu et al., 2023).

According to some analyses, protection of agricultural producers in the form of higher subsidies or administrative price restrictions can help stabilize food prices on the domestic market, thereby slowing the rise in inflation that was evident throughout Europe after the outbreak of the conflict in Ukraine. On the other hand, there is a risk that excessive support will reduce competitive pressures and may increase the fiscal costs of the state (Aliu et al., 2023). In this case, there is

pressure on public budgets and the possibility of increasing secondary inflationary pressures, especially if the support is debt-financed.

Increased protection of domestic producers can lead to a decrease in agricultural imports and at the same time to a weakening of exports, for example, if there is an administrative regulation of export prices (Swinen et al., 2024). As a result, the trade balance in the agricultural trade segment may deteriorate, but at the same time the domestic supply of key commodities is stabilized (Hudecová & Rajčániová, 2023). For the Czech Republic, which is dependent on external sources for some commodities, it is crucial to carefully balance protection measures so that they do not undermine trade ties with strategic partners and do not threaten export opportunities.

Economic models suggest that support mechanisms can increase production in a given sector in the short term and contribute to rural job creation (Hassen & Hamid, 2022). However, in the long term, excessive reliance on subsidies can lead to lower competitiveness and limit innovation potential. If protection is provided across the board and without a clear targeting strategy (e.g. for technological modernization or transition to more sustainable forms of farming), it can lead to the so-called “entrenchment” of inefficient enterprises (Swinen et al., 2024).

Protection of agricultural producers is often promoted with the aim of preventing the social impacts of sharp price fluctuations and ensuring food security. In the context of the war in Ukraine, which has affected not only production but also transport capacities and global trade flows, this goal is perceived as a priority. However, as Hudecová and Rajčániová (2023) point out, the long-term burden on public budgets with higher expenditures can limit the government’s ability to invest in other key areas (e.g. education, healthcare, infrastructure). From a social impact perspective, there is also debate about whether support is targeted fairly and whether the most vulnerable groups of the population (e.g. low-income households) benefit from lower food prices, or whether most of the profits go to producers themselves (Aliu et al., 2023).

2 Methods

This paper applies a qualitative analytical approach based on a structured review and synthesis of academic literature and official policy documents. It combines conceptual economic reasoning with comparative policy analysis to assess agricultural support instruments under conditions of “economy under pressure.” The CAP 2023–2027 framework is examined with a particular focus on Pillar I measures and their implementation in the Czech Republic as a contextual case. Alternative instruments used in international trade (export subsidies, tariffs, and quotas) are discussed in terms of their fiscal and welfare implications, using historical and recent shock-related evidence (COVID-19 and the war in Ukraine). The study is interpretative rather than econometric and aims to synthesize existing findings rather than estimate causal effects quantitatively.

3 Agricultural Support Instruments in Times of Economic Pressure

In addition to direct domestic subsidies, international trade traditionally employs policy instruments that states use to protect and support agriculture, in particular export subsidies and import barriers such as tariffs and quotas. Export support measures, or export subsidies, are defined as financial instruments that enable domestic producers to sell goods on international markets at prices lower than domestic prices, often leading to the phenomenon of international dumping (Friedland, 2002; Svoboda, 2010). The key difference between these instruments lies in their fiscal impact. Export subsidies represent a net cost to the state budget and result in a significant increase in public expenditure (Holmann, 1996). Economic analysis shows that in the exporting country these subsidies generate a net welfare loss, referred to as the “deadweight loss effect.” In contrast, import tariffs and quotas, although they raise the price of imported goods on the domestic market, generate revenue for the state budget (Matoušek & Sabelová, 2007).

The authors’ view on the use of these measures in times of “Economy Under Pressure” is ambivalent, reflecting both historical lessons and global commitments. In general, economists agree that protective measures may temporarily bring benefits, such as shielding domestic sectors, wages, and employment, and addressing acute social problems (Rožehnalová et al., 2010). However, experiences from the trade wars of the 1930s demonstrated that the escalation of trade barriers ultimately led to losses for all participating countries (Samuelson & Nordhaus, 2009). The new Strategic Plan of the Common Agricultural Policy for the period 2023–2027 places a strong emphasis on results, performance, and sustainability, thereby aligning with the objectives of the European Green Deal. Within Pillar I, key instruments have been implemented, namely the Complementary Redistributive Income Support for Sustainability and the Schemes for Climate, Environment, and Animal Welfare (eco-schemes).

The Complementary Redistributive Income Support is designed to ensure a fairer distribution of financial resources in favor of small and medium-sized agricultural holdings. Under the Czech CAP, this payment is applied to the first 150 hectares of agricultural land managed by each farm. The Czech Republic has voluntarily allocated 23% of the total direct

payments budget to this intervention, thereby significantly exceeding the minimum EU requirement. The selected model, based on a uniform rate applied to the entire 150 hectares, creates a strong financial incentive, as the total support granted for the first 150 hectares is almost three times higher than the basic income support rate applied to the remaining area. This approach aims to compensate for the competitive disadvantages of smaller farms, which lack economies of scale. Eco-schemes represent a new, voluntary instrument within Pillar I of the CAP, intended to promote agricultural practices that contribute to the protection and enhancement of the environment and the landscape. Member States are required to allocate at least 25% of their direct payments' envelope to eco-schemes, while the Czech Republic allocates more than 30% (Fiala, 2022).

4 Effects of redistribution of political support

Agricultural policy has traditionally focused on redistributing income and supporting public goods. (De Gorter & Swinnen, 2002) Governments intervene in markets to limit price volatility or to restrict imports and promote exports of agricultural commodities. They also provide subsidies and credit for inputs and support rural infrastructure, scientific research, and regulations to ensure food safety and protection from invasive species and animal diseases. However, over the past four decades, rural and trade policy analysts have increasingly focused on the negative welfare impacts and inefficiencies associated with market interventions and price distortions through regulations. Most of the world has gradually moved away from such interventions in agricultural and food markets, thanks to unilateral trade liberalization and the rise of more open economies under the auspices of the GATT and the WTO (Anderson, 2009).

Despite several reform efforts, the Common Agricultural Policy (CAP) of the European Union (EU), especially as regards direct payments, is still considered relatively complex and it is not clear how exactly it contributes to achieving its main objectives. Direct payments can currently support the continuation of agriculture in the EU. However, according to Matthews (2023), farms highly dependent on public support may not be in line with the objective of improving their productivity, although the move to decoupled payments may reduce the efficiency losses associated with the previous partially coupled payments.

Another criticism of the CAP concerns the way subsidies are allocated at the macro level (between Member States) and at the micro level (between farmers). Support based largely on hectares does not take into account local conditions and is therefore not an effective way to incentivise farms to provide public services (Bureau et al., 2012). This redistribution criterion would be appropriate for homogeneous agricultural systems that focus primarily on arable production, but might be inappropriate for highly heterogeneous systems with different production orientations and morphological features. The method of allocating direct payments based on hectares may discriminate and favor farms based on the land they own rather than their actual contribution to income and employment. Alternative methods, such as value added or labor, better capture the heterogeneity that characterizes certain systems (Adinolfi, Little, & Massot, 2011).

Bonfiglio et al. (2020) report that decoupled direct payments have a significant impact on technical efficiency in most specialised farms that have received higher levels of support. However, the impacts are contrasting. In arable crop farms, direct payments are negatively associated with technical efficiency, while in livestock farms, public subsidies have a positive effect.

The redistribution of policy subsidies induces negative changes in technical efficiency in some or all farms. For this reason, the aim is to avoid potential conflicts with other CAP instruments that are specifically designed to increase productivity. Bonfiglio et al. (2020) suggest adopting models of internal convergence that are less redistributive and more targeted. The results presented here may be useful for policymakers to better understand the possible efficiency implications derived from alternative policy options regarding the redistribution of direct payments.

The distribution of subsidies under the CAP is closely linked to the size of farms, whether in terms of physical size or economic indicators. If we compare the distribution of subsidies between two countries, for example country A where the policy is implemented and country B where it is not, any differences may be due to differences in the size structure of farms rather than to the policy itself. If we compare the situation before and after the implementation of the policy within a single country, the results will be partly influenced by "changes in the structure of agricultural holdings". However, this comparison is likely to provide more robust results as changes will generally be gradual and affect the period from year to year (DG AGRI, 2020).

The basic motivation for the current distribution of Single Payment Scheme (SPS) payments is to compensate for historical reductions in agricultural price support (first introduced in 1992 because of the MacSharry reform). One possible justification for the SPS could be capital market imperfections that prevent farmers from borrowing to finance investments

(Shah, 2006). Another justification is environmental externalities that cannot be reflected in market prices (Cong and Wei, 2010). In terms of income redistribution, the current system also has some serious shortcomings.

First, farmers with the highest land productivity, and therefore competitive in the market, receive the highest payments per hectare. Farmers with less fertile land receive lower payments per hectare and therefore their farms face marginalisation and abandonment, which could have irreversible and damaging effects on European agricultural production and its cultural landscape (Brady et al., 2009). Second, because payments are area-based, the largest farms receive the largest total payments. As a result, the current CAP and its single payment scheme may entail reverse redistribution, i.e. redistribution from the poor to the rich (GarciaPenalosa & Wälde, 2000). The single payment scheme should be better targeted at poorer farmers (small farms) and the environment. In principle, high-income households should receive a low subsidy (if any) and low-income households a high subsidy (Ahmed et al., 2001). As public goods, environmental products should be subsidised by the CAP to cover their costs. However, the reality may be more complex. On the one hand, more direct payments to peripheral regions and poorer farmers will affect investment and will not contribute to economies of scale (Dunne and O'Connell, 2002). On the other hand, the current subsidy system harms small farms and poor farmers through inverted distribution, which will be detrimental to social cohesion and environmental protection (Magnani, 2000).

5 Conclusions

The literature clearly demonstrates that agriculture remains a fundamental pillar of economic stability and social welfare, yet it is also one of the most vulnerable sectors to external shocks and market distortions. Global development from the food crises of the 2000s to the COVID-19 pandemic and the war in Ukraine have underscored the strategic importance of ensuring food security and stabilizing agricultural markets through well-designed policy interventions. While state support for agriculture, particularly through mechanisms such as subsidies and price regulation, can mitigate market volatility and protect producers and consumers, its long-term effectiveness depends on precise targeting and fiscal sustainability.

Redistributive policies within frameworks like the EU's CAP illustrate both the potential and pitfalls of government intervention. Although decoupled and redistributive payments have succeeded in sustaining agricultural production and preventing rural decline, they often perpetuate inefficiencies, concentrate benefits among large landowners, and strain public budgets. The empirical evidence remains inconclusive, suggesting that the impact of agricultural support varies according to local conditions, institutional capacity, and the structure of national economies.

Future policy design must therefore balance efficiency, equity, and resilience. Agricultural protection should prioritize productivity-enhancing measures, technological innovation, and environmental sustainability, while avoiding the entrenchment of inefficient enterprises and fiscal dependency. A shift toward targeted, transparent, and conditional support, aligned with broader economic and environmental objectives, is essential to ensure that agricultural policies contribute meaningfully to long-term economic development, food security, and social cohesion.

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