

THE ROLE OF EU FUNDS IN DIVERSIFICATION OF RURAL ECONOMY IN LATVIA

Jānis Ozoliņš¹, Armands Vēveris², Elita Benga²

¹Corporate Management Experts Bureau, Latvia

²Latvian State Institute of Agrarian Economics

armands@lvaei.lv

Abstract

Promotion of non-agricultural activities in Latvian rural areas is highly important for diversification of rural economy due to decrease in agricultural and forestry employment. So far too little attention has been paid to this aspect. Although EAFRD is the only EU fund directly supporting rural development, only 14% of its public financing for projects in 2007-2013 was invested in non-agricultural entrepreneurship, half of this in financially demanding energy production projects. By total eligible accepted project expenses, approximately 60% of rural entrepreneurship projects were financed by EAFRD. ERDF was also important in which a smaller number of higher value investment projects was implemented. Although EU funds have some importance in activating rural entrepreneurship, so far the direct impact on creation of jobs and value added has been small. The impact could be increased by setting forth specific job creation requirements for the beneficiaries. It is also suggested to avoid supporting expensive projects which do not create a substantial number of jobs. In view of rural entrepreneurs improvements in entrepreneurial environment, including taxing policy are more important than direct support. It especially concerns operation of small companies. Development of small companies in rural areas is of high importance because in many territories there is no capacity and rationale to develop large projects.

Key words: entrepreneurship, support, rural areas, diversification.

Introduction

Economic development in Latvia is increasingly territorially unequal. Such situation promotes not only depopulation of broad territories but also of the whole country. Furthermore, depopulation is associated with increased infrastructure costs and lower attractiveness for entrepreneurship in the future.

Survey of Latvian rural population indicates that one of the most important factors to promote population density is employment possibility (Zobena and Lāce, 2011). Just 26% of rural respondents consider their territory a good place to work. Statistical analysis reveals that agriculture and forestry are still key branches of economy in Latvian rural areas. The branches create 22% of rural jobs which are rapidly decreasing in number: by 14 thousand or 19% within 2008-2013 time period according to the data of Central Statistics Bureau of Latvia (CSB). The traditional branches of economy are especially significant in places distant to development centres. For example, in municipalities whose centres are in excess of 50 km from Riga and 20 km from other large towns, 50% of economically active market sector statistical units work in primary branches and their number shows a decreasing trend. It means that promotion of entrepreneurship is critically important to avoid further depopulation of rural territories. In addition, the priority should be creation of new jobs with a goal to attract people who are forced to leave primary sectors (agriculture, forestry and fisheries) due to increases in production efficiency.

As indicated in the discussion material prepared by several institutions (Latvijas lauku..., 2012), the productivity in agriculture and food processing is

still low, but it is gradually increasing concurrently with decreases in the number of jobs in the respective areas. In the absence of considerable investments in improving employment possibilities a more unfavourable situation can be expected. The discussion material forecasts that within a decade 60% of primary sector employees of agrarian branches will leave anyway and without a purposeful activity on the part of the state the number will reach 70%. According to calculations made by authors of the discussion material, each employee in the real production of goods or services creates a basis for an additional employee in services, government or trade. Thus, the total depopulation risk reaches 40%. It follows that the effect of decreased employment in Latvian rural areas can be severe, because the territories will not be able to fulfil even 2 of the 3 basic functions – place of work and place for socialisation.

Research carried out in the EU and other countries points out that it is possible to considerably improve the entrepreneurial environment, even in territories located remotely to larger urban centres (Esparcia, 2014; Horlings, 2014; McAreavey and McDonagh, 2011; Čingule-Vinogradova, 2011; Rural entrepreneurship..., 2011; Smallbone, 2009; Stimulating the..., 2010; Study on..., 2010; The future..., 2003). It is supported by observations in Latvia because, especially at the level of rural territories, the situation varies highly. For example, from 2006 to 2013 the total number of employees decreased by 11.8%. However, according to the data of Latvian State Revenue Service in 168 of 584 Latvian rural territories (parishes) and towns, the number of employees increased (in 35 rural territories even by

more than 50%). These rural territories are located in all regions of Latvia.

Latvian sustainable development strategy Latvia 2030 sets a goal to create equal life and work conditions for all inhabitants irrespectively of their location of living by promoting entrepreneurship in regions, developing quality transports and communication infrastructure and public services (Sustainable development..., 2010). Several support programmes promote entrepreneurship both in the previous (2007-2013) and current (2014-2020) EU budget planning period.

The aim of the paper is to evaluate the effect of the most important EU funds on rural economy diversification in Latvia. The following tasks have been carried out to achieve this aim: (1) analysis of Latvian 2007-2013 RDP rural entrepreneurship diversification measure characteristics and results; (2) evaluation of availability and use of ERDF and other EU funds for development of rural entrepreneurship. Due to format limitations the paper includes concise analysis of results of the respective funds and measures, including only the key indicators and refrains from detailed reviews of supported branches.

Materials and Methods

Results of research carried out in OECD, Latvia and other EU countries on development of non-agricultural entrepreneurship in rural territories, data of Central Statistics Bureau of Latvia, Rural Support Service (RSS), State Revenue Service (SRS), Latvian Investment and Development Agency (LIDA) and a focus group discussion have been used in the paper.

Correlation, synthesis, constructive calculations, graphical analysis, focus group discussion and monographic analysis methods have been used to carry out research tasks.

EAFRD RDP 2007-2013 impact assessment is comprised of analysis of measure 3.1.2. (3.1.1.) Business creation and development (including diversification into non-agricultural activities) and measure 3.1.3. Encouragement of tourism activities. The analysis is based on RSS data on 1474 projects of 1308 beneficiaries (data as of 28.03.2014). The economic impact has been evaluated for those projects which have received public support payments and which have submitted annual reports to SRS.

In line with EU evaluation guidelines (Guidelines for..., 2014), the main economic indicators being evaluated for the 3rd axis of the RDP were gross value added (GVA) and number of jobs created. Data on creation of jobs have been obtained from RSS database and have been subjected to logical control.

GVA cannot be calculated directly from the RSS database information. Several approaches to calculate the GVA from annual report data were considered.

The chosen approach includes annual report data from profit and loss statements, information on the number, remuneration and taxes of employees from SRS as well as information from company income tax statements. ERDF support data was obtained from LIDA and is limited to information on eligible expenses of contracted projects, branch and implementation address. Due to space limitations only the most important fund by amount of investments, the ERDF has been analysed.

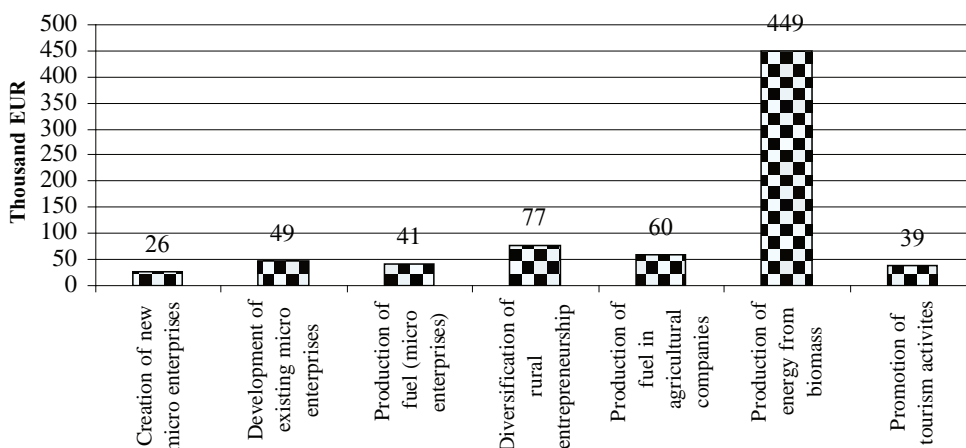
A focus group discussion was conducted involving existing and potential rural entrepreneurs from various regions of Latvia. This allowed obtaining direct insights and opinion about possibilities to develop non-agricultural entrepreneurship in the rural territories of Latvia. Cartographic material was prepared to demonstrate and analyse several key indicators at levels of municipalities and rural territories.

Results and Discussion

Characteristics and results of Latvian RDP 2007-2013 entrepreneurship diversification measures

Just a part of RDP 2007-2013 3rd axis support was directed at activities, which are not related to agriculture and forestry. They include measure 3.1.2. (3.1.1.) Support to creation and development of enterprises (including diversification of activities not connected to agriculture) and measure 3.1.3. Promotion of tourism activities. By the end of 2013, public financing of 96 million EUR was disbursed in these measures which was only 14% of the total RDP financing for investment projects. It means that entrepreneurship diversification was not an RDP priority. The measure 3.1.2. (3.1.1.) pursued several aims: creation and development of rural micro enterprises; diversification of agricultural enterprises; energy production from agricultural and forestry origin biomass. The aim of the measure 3.1.3. was to support and improve the existing Latvian rural tourist facilities. Measure 3.1.2. (3.1.1.) was separated into creating new microenterprises and development of existing ones, but both first and second sub-measure included a separate activity – production of fuel. As a result, in measure 3.1.2. (3.1.1.) there were 6 activities and only one in measure 3.1.3.

The public financing for energy production from biomass activity comprises 45% of total public financing while the number of projects (41) was the smallest. The part of financing directed at development of existing microenterprises (538 implemented projects) formed 24% of total, whereas 11% (359 projects) were received by newly created micro enterprises. The share of other activities did not exceed 10% of total. Data on mean public financing per newly created job has been summarised in Figure 1.



Source: Calculations of authors based on RSS data.

Figure 1. Mean public financing per newly created job, 2007-2014.

The highest number of newly created jobs (501 and 420, respectively) is in the activities of development of existing microenterprises and creation of new microenterprises. It must be noted that the mean financing per newly created job at level of EUR 25.7 thousand is the lowest in the creation of new microenterprises. To the opposite the highest public financing amounting to EUR 449.4 thousand per newly created job is in the energy production from biomass. Only 101 jobs were created in this activity.

The investment of such a considerable part of financing in large biomass energy production projects (the average project and public support amount in the activity is respectively EUR 3 and 1.1

million) contradicts rationale of the measure. The substantiation states that the support is needed for small rural farms in order to maintain rural population, allow for starting an alternative business as well as to increase the quality of services for rural population (Latvijas lauku..., 2014). The substantiation of submeasure 3.1.2. (3.1.1.)/3 states that the need to develop processing of biomass stems from utilisation needs of animal husbandry by-products (manure). It means that support should have been provided only to such projects as opposed to those in which energy is produced from specially grown agricultural products (grain, corn etc.).

The second financially largest activity (in relation to the number of newly created jobs) was

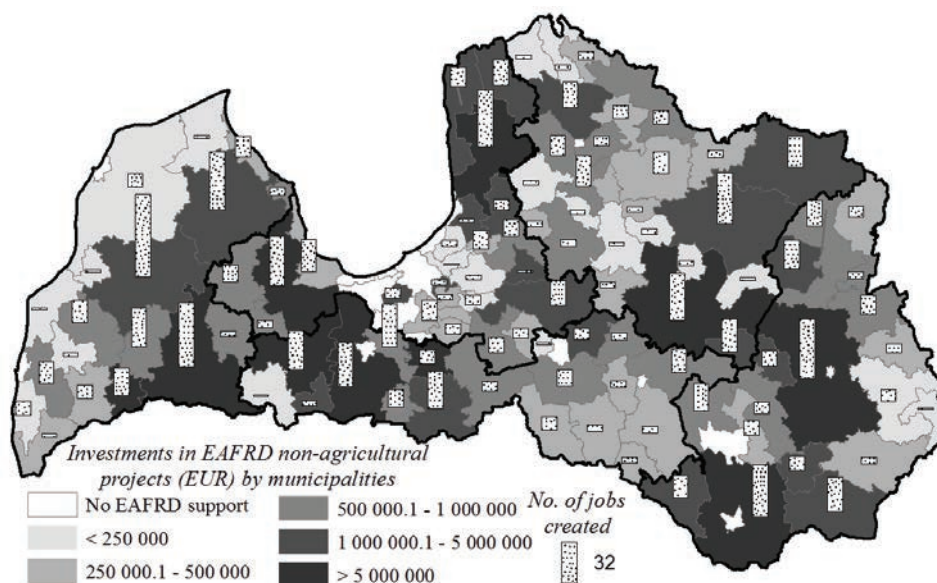


Figure 2. Support and newly created jobs in RDP measures 3.1.2. (3.1.1.) and 3.1.3. in Latvian municipalities, 2007-2014.

diversification of agricultural enterprises. It is suggested by the authors that further support to such activities must be more tightly connected to the number of jobs created and their sustainability. The discussion with entrepreneurs supports a conclusion that entrepreneurs are not inclined to increase the number of jobs – it is in their interest to produce higher value with the same or smaller number of employees. Therefore, support can be an important stimulus to attract new employees.

According to RDP 2007-2013, the measure 3.1.2. (3.1.1.) implementation territory is whole Latvia except large cities and territorial units of municipalities – towns with more than 5 thousand inhabitants. In measure 3.1.3., in addition to the above-mentioned, projects from municipalities bordering with the city of Riga were not eligible. Moreover, the selection criteria favoured projects from territories with lower development indices.

Graphic analysis of support at the level of municipalities (Figure 2) shows higher concentration of support in Pierīga and the central part of Zemgale, whereas much smaller financing has reached territories further from Riga – eastern part of the country and western Kurzeme. Largely it is determined by dependency of entrepreneurship development on the local market demand – focus group discussion showed that one of the main factors is position within 100 km from Riga. However, research carried out in other countries indicates that successful entrepreneurship is possible elsewhere further from major urban areas (Study on..., 2010).

Correlation analysis for connection between the number of jobs created and financing was carried

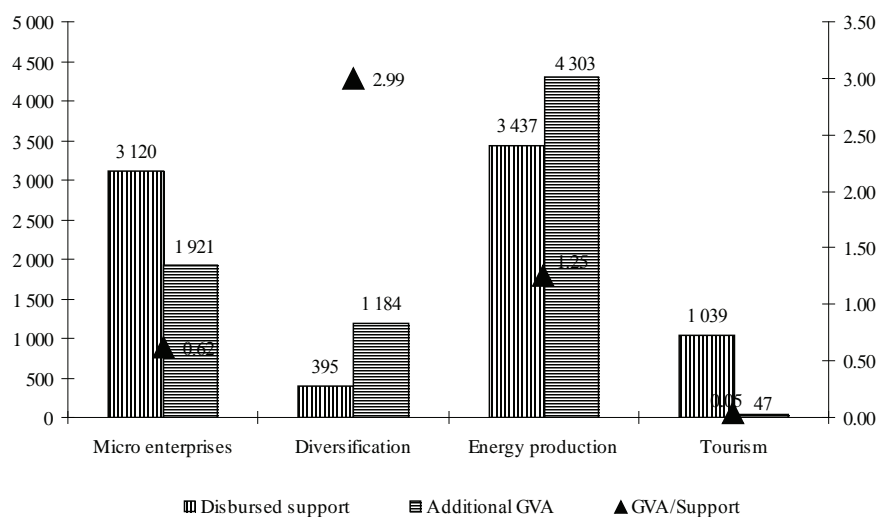
out. A panel of 584 Latvian territories and cities with variables newly created jobs and financing of 3rd axis received was used for calculations. The results show that funding and new jobs are moderately positively correlated ($r = 0.44$). Correlation is significant at 0.01 level (2-tailed).

Although the intensity of job creation in various activities obviously varies, statistical analysis shows that the support is connected to increases in employment. At the same time it can be seen that the connection is not very strong, thus other factors such as branch of implementation are important.

Additional GVA during the whole period was calculated as a total of annual GVAs starting from 2008, by subtracting the result of 2007 (thus the additional GVA of each year was calculated). The additional GVA created in the analysed period (2008-2012) was estimated at EUR 7.4 million for measure 3.1.2. (3.1.1.) and EUR 0.05 million for measure 3.1.3. (Figure 3).

It should be emphasized that the results refer only to the projects included in the evaluation. It can be calculated that in the period of 2008-2012 each euro of support has increased the GVA on average by 1.1 EUR in measure 3.1.2. (3.1.1.) and only by EUR 0.05 in measure 3.1.3. The submeasure analysis reveals that the most effective has been 3.1.2. (3.1.1.)/2 (diversification), which has brought 2.99 EUR per each euro of public support although this activity is the smallest by the amount of financing.

Assuming that the same results would be reached by the other companies which receive support in the abovementioned measures, each euro of public support would yield EUR 0.93 additional GVA. Thus, the total



Source: Calculations of authors using SRS data.

Figure 3. Additional GVA in 2008-2012 period and paid public support comparison (thousand EUR), additional GVA per euro of paid public support by submeasures in beneficiaries which have received support by the end of 2010.

additional GVA in both measures would exceed EUR 100 million which exceeds the initially expected EUR 35.9 million several times. It is not much though when compared to the total amount of investment in these measures (almost EUR 300 million).

The impact potential of EAFRD on the unique set of factors determining development of rural economy and entrepreneurial environment is not substantial. The focus group discussion indicated that entrepreneurial environment is of highest importance to rural entrepreneurs. Road infrastructure quality, workforce availability, administrative and tax burden related to any legal entrepreneurial activity were mentioned as the key aspects. The focus group participants, Latvian rural entrepreneurs, unanimously expressed an opinion that even a very high support rate would not help to create sustainable rural companies in territories with adverse entrepreneurial environment. RDP 2007-2013 financing was not sufficient to ensure entrepreneurial environment appropriate for starting new business. Furthermore, many factors such as natural resources, position relative to major urban centres and transport routes, set of local population attitudes and values cannot be changed or it may be complicated and costly.

Availability and use of other EU funds for rural entrepreneurship development

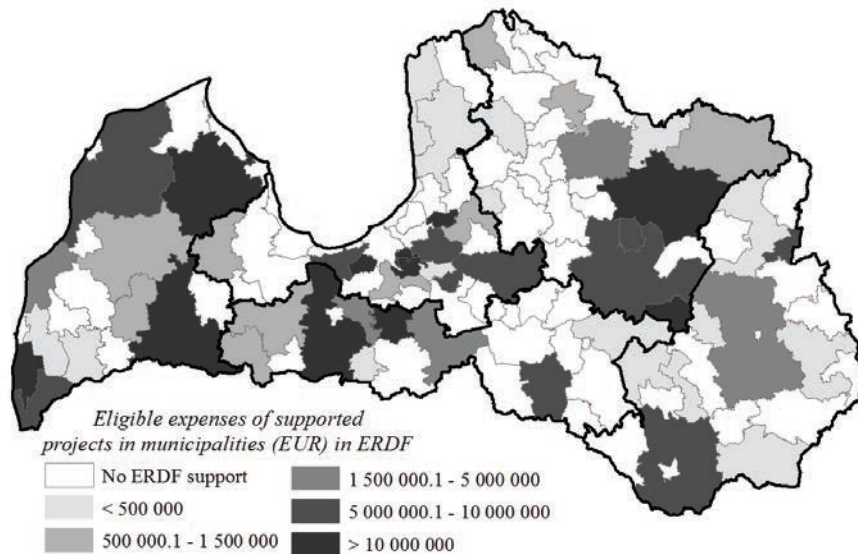
Apart from EAFRD the most important EU fund for promotion of non-agricultural entrepreneurship in Latvia in 2007-2013 was European Regional Development Fund (ERDF). The aim of ERDF was to promote social and economic cohesion by decreasing regional disparities. The most important measures by the amount of financing for rural territories were high value investment (HVI), development of new products and technologies – support for introduction of new products and technologies (NPT) and support to development of micro and small companies in specially supported territories (SST). The territorial spread of ERDF support of the three measures is shown in Figure 4. Most of support has been attracted in municipalities, which have one or several economically strong, viable companies which have implemented large projects in the HVI programme. Companies from approximately 50% of the municipalities did not receive any support at all because in a large part of Latvia there were no strong applicants to qualify. There were no specific privileges to rural companies; therefore, in HVI and NPT they had to compete for project financing with the most advanced and largest companies located in urban areas.

The support of SST measure was more available to rural areas because it was intended for companies located in specially supported territories, which are mostly rural. The eligible expenses included

preparation of construction projects, purchase of equipment, construction costs, software, licences and patents. The required financing exceeded the available financing almost tenfold and 101 projects were implemented, EUR 7.6 million in public support was disbursed. Approximately 52% of the eligible expenses were in projects implemented in rural areas, in 29 municipalities. Lower territorial development index provided a major advantage in project competition.

HVI support has been granted to investment in fixed assets (construction, equipment) and credit institution guarantee costs, the rate of support being at 35-45% level. Advantage in project selection was to companies in which high value added per employee is created, there is an adequate capital supply, who work in prioritised sectors of economy, are able to export, can prove their economic viability and research and development capacity. The application and implementation process in the measure was time-consuming and complicated, but it allowed receiving substantial support for large projects, part of them in rural territory. The total planned financing for this activity was EUR 201 million. According to the eligible expenses of contracted projects, 33% of the financing in the measure was intended for rural territories. Contracts with 30 companies have been signed who have implemented or are still implementing projects in 19 rural municipalities. A considerable part of these projects by the share of eligible expenses (45%) are being implemented in the municipalities close to the capital city of Latvia - Riga (Stopini, Salaspils and Marupe). The projects are mostly implemented in various branches of processing industry: wood, fuel, construction materials, meat, vegetables, chemicals and production of electronic components. A relatively large share of investment in rural territories can be a result of availability of land for developing medium or large projects outside boundaries of cities or towns.

NPT was a financially important measure in which support was provided to initial investment in equipment as well as in patents and licences necessary to start production of a new product or to implement a new technology. The maximum rate of support was 35%. Project selection criteria provided advantage to projects with higher level of innovation, those in prioritised sectors of economy, in which the company together with related persons has high turnover or provable sales network as well as in cases of high export intensity in the branch of project implementation. Similarly to HVI, the administrative burden in the project life-cycle was high. Minimum and maximum public financing for projects in this activity was considerably lower – beneficiaries with smaller projects could take part. Therefore, mostly small or medium sized projects were implemented



Source: Calculations of authors using LIDA data

Figure 4. Eligible expenses of supported projects implemented in Latvian rural territory in HVI, NPT and SST measures of ERDF, 2007-2014.

in urban territories to improve existing production infrastructure.

A part (26%) of contracted project eligible costs in NPT measure was intended for implementation of projects in rural territories in branches of construction materials, furniture, vegetable processing, metal processing and chemicals. In total, 31 contracts on project implementation in rural territories with 30 beneficiaries were signed. Project implementation takes place in 19 municipalities, 25% of planned investment being in those which directly border the territory of Riga city.

Support in SST measure was received by companies of various traditional rural non-agricultural branches because no high-level requirements were set forth for applicants and expected project results. In HVI and NPT activities, to the contrary, the requirements for project applicants, project quality and results predetermined that support was received by the economically and technologically strongest, most promising companies. Although some beneficiaries implemented projects both in HVI and NPT measures, in the latter case rural projects were implemented to a larger extent by local capital small and medium enterprises.

The total eligible contracted rural project expenses of the analysed ERDF measures exceed EUR 176 million. It is close to 40% of the total eligible expenses of projects implemented to develop rural economy in EAFRD and ERDF. A conclusion can be made that the ERDF and EAFRD support is mutually complementary. Nevertheless, ERDF activities were not specifically targeted at development of rural territories but rather whole regions. Although no data

for evaluation of support impact is available, it can be assumed that the ERDF measures analysed had a considerable positive impact on development of non-agricultural entrepreneurship in Latvian rural areas. It can be substantiated by relative to EAFRD strict requirements for reaching project results in HVI and NPT activities and amount of public financing. It should be noted that in HVI measure support was given to projects with higher value added per employee. The beneficiaries of NPT measure were not motivated to create additional jobs either. Thus, the support applicants were encouraged to develop highly productive, internationally competitive production with a minimal number of employees while the provision of rural jobs is of key importance in countering rural depopulation.

Conclusions

1. Whereas EAFRD is the most important EU fund for development of rural entrepreneurship, diversification of rural economy is not its priority because only 14% of its public financing has been paid in projects directly promoting this goal.
2. Almost one-half of EAFRD resources intended for rural entrepreneurship diversification were invested in one activity – energy production from renewable energy resources in which a small number of expensive projects were implemented, resulting in very high costs per newly created job.
3. Creation of new microenterprises has been the most successful activity from job creation viewpoint while the most effective in the value added formation was diversification of rural entrepreneurship.

4. Creation of new jobs, as a result of RDP 3rd axis measures in Latvian municipalities and towns, depends on the amount of financing.
5. Support of the ERDF promoted development of the economically strongest rural non-agricultural companies but it was not specifically targeted at increasing rural employment.
6. The financing of both EAFRD and ERDF was more actively attracted in the central part of Latvia. However, it is positive that in case of EAFRD the support was rather equally territorially distributed which was achieved by project selection criteria.
7. Entrepreneurial environment aspects such as availability of road infrastructure, workforce, administrative and tax burden are more important to rural entrepreneurs than direct support.
8. EAFRD projects whose implementers have assumed responsibility to create new and to preserve existing jobs should be prioritised in the future in order to achieve the goal of increasing support efficiency in maintenance of rural population and employment.

Acknowledgements

The paper has been supported by the project "Elaboration of innovative diagnostic instruments for regional development". Agreement No. 2013/0057/1DP/1.1.1.2.0/13/APIA/VIAA/065, co-funded by European Social Fund.

References

1. Čingule-Vinogradova S. (2011) Dienvidlatgales potenciāla izvērtējums un attīstības virzieni (Evaluation of Dienvidlatgale Potential and its Development Directions). Available at: http://lufb.llu.lv/dissertation-summary/economics/Sanda-CinguleVinogradova_promocijas_d_kopsavilkums_2011_LLU_EF.pdf, 23 February 2015. (in Latvian).
2. Esparcia J. (2014) Innovation and networks in rural areas. An analysis from European innovative projects. *Journal of Rural Studies*. Vol. 34, pp. 1-14.
3. Guidelines for the ex-post evaluation of 2007-2013 RDPs (2014) Available at: http://enrd.ec.europa.eu/enrd-static/app_templates/enrd_assets/pdf/evaluation/epe_master.pdf, 07 March 2015.
4. Horlings L. (2014) Exploring the "New Rural Paradigm" in Europe: Eco-economic strategies as a counterforce to the global competitiveness agenda. *European Urban and Regional Studies*, Vol. 21, no. 1, pp. 4-20.
5. Latvijas lauku attīstības programma 2007.-2013. gads 12. versija (Latvian Rural Development Programme 2007-2013. Version 12). (2014) Available at: https://www.zm.gov.lv/public/files/CMS_Static_Page_Doc/00/00/00/37/56/LAP_12_versija_13012014.pdf, 25 February 2015. (in Latvian).
6. Latvijas lauku telpas attīstība un tās iespējamie nākotnes scenāriji. Informatīvs materiāls diskusijām. (Development of Latvian Rural Space and Its Possible Future Scenarios. Informative Discussion Material). (2012) Available at: http://www.laukutikls.lv/sites/laukutikls.lv/files/informativie_materiali/latvijaslaukutelpasattistibauntasiespejamienakotnesscenarijipetijumslr.pdf, 06 March 2015. (in Latvian).
7. McAreavey R., McDonagh J. (2011) Sustainable Rural Tourism: Lessons for Rural Development. *Sociologia Ruralis*. Vol. 51, Issue 2, pp. 175-194.
8. Rural Entrepreneurship in Selected EU Member States (2011) Available at: <http://enrd.ec.europa.eu/enrd-static/fms/pdf/A502C17B-B074-2913-E9E0-F1AC79AE55C0.pdf>, 25 February 2015.
9. Smallbone D. (2009) Fostering entrepreneurship in rural areas. In: Potter J. and Hofer, Andrea R., (eds.) Strengthening entrepreneurship and economic development in East Germany: lessons from local approaches. Paris, Organisation for Economic Co-operation and Development. pp. 161-187.
10. Stimulating the Agricultural and Rural Economy Through the Rural Development Programme. (2010) Available at: <http://www.nrn.ie/wp-content/uploads/2010/12/stimulatingtheagriculturalandruraleconomythroughtherdp1.pdf>, 19 February 2015.
11. Study on Employment, Growth and Innovation in Rural Areas (SEGIRA) (2010) Available at: http://ec.europa.eu/agriculture/analysis/external/employment/full-text_en.pdf, 28 February 2015.
12. Sustainable Development Strategy of Latvia until 2030 (2010) Available at: http://www.varam.gov.lv/in_site/tools/download.php?file=files/text/dokumenti/pol_doc//LIAS_2030_en.pdf, 20 February 2015.
13. Zobena A., Lāce I. (2011) Lauku attīstības programmas 2007.-2013. gadam 3. un 4. ass pasākumu ietekme uz Latvijas lauku iedzīvotāju dzīves kvalitāti (Impact of Latvian Rural Development Programme 3rd and 4th Axis Measures on the Quality of Life of Latvian Rural Inhabitants). Available at: http://www.lvaei.lv/images/Nacionalie_projekti/2011/Petijums%20par%20soc_datiem.pdf, 06 March 2015. (in Latvian).
14. The Future of Europe's Rural Periphery, the Role of Entrepreneurship in Responding to Employment Problems and Social Marginalization. (2003) Available at: <http://cordis.europa.eu/documents/documentlibrary/100124141EN6.pdf>, 20 February 2015.