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## **1 An overview of Bulgarian rural credit and micro-finance**

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Over the transition period the availability of investment and working capital was one of the major constraints in agriculture. This could be attributed to factors both in agriculture and credit system. In agriculture the small-scale semi-subsistence production units which emerged after 1991 with the liquidation of the old structures from the socialist period, had low incomes and were not regarded by the banking system as reliable borrowers. Further, the newly established production co-operatives typically had unclear property rights and an inexperience level of management, so these were in the same position.

The other factor negatively affecting short and long term credit flows in the agricultural sector was the bankrupting of the banking system in 1996-97, which was followed by its slow recovery under the rules of the currency board, and stricter regulation.

To reduce the negative impact of this transition period a state system of credit preferences applying to both short and long term credit sources was used. In the first year of the transition lower interest rates were used, mainly for short term credit although the legal framework that established the mechanisms for this support, the first Law for Protection of Agricultural Producers (LPAP), actually did not impose any restrictions as to the credit period. The main reasons why the mechanism was not used for subsidising investment credits at the beginning of the transition period were (a) the unstable macroeconomic situation and (b) high inflation, which together prevented farmers from getting investment credit. After the new Law for Protection of Agricultural Producers was introduced the mechanism for low interest rate credits was implemented, and also in respect of investment credits.

Under the new LPAP an institution responsible for the application of a support policy for farmers – the State Fund for Agriculture (SFA) – was created. It announced and implemented yearly programmes providing lower interest rate short term credit, as well as its priorities for using the support for investment credits and the requirements for using these programmes. With respect to investment credit these priorities have been as follows: agricultural machinery and equipment, breeding and productive elite animals, construction of buildings for agricultural activities, planting of permanent crops, land purchasing, etc.

Another source of finance for agricultural activities was founded in the beginning of the 1990s as the Federation of Private Rural Mutual Credit Association (PRMCA), established under the PHARE programme project. The financial resources of PRMCA amounted to 10.5 mln. EUR and provided mainly short term credits for working capital for their members.

Another alternative source for short term credits which started its activity during the same period was the System of Warehouse Receipts introduced by the Grain Storage and Trade Act introduced in 1998.

Since 1998 started the process of economic growth in Bulgaria finally began (Table1). The banking system was almost entirely privatized and the majority of the local banks were bought by larger banks and banking groups from EU countries. In this way the banking system in Bulgaria was stabilized in terms of expertise, management and resources.

**Table 1<sup>1</sup> Dynamics of some of the macroeconomic indicators of the Bulgarian economy for the period 2001-2004**

<b>Indicator</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>
GDP- mln.lv	29709	32335	34547	38008
GDP/capita	3754	4109	4416	4885
Unemployment-%	17,9	16,3	13,5	12,2
Inflation	7,4	5,8	2,3	6,1
Investments	6694	7220	8503	8315

The agricultural sector has also stabilized since the end of the 1990s, while the process of accession gradually made agricultural policy more stable and predictable. The structural reforms performed in the first half of the 1990s resulted in a more or less stable dual structure of Bulgarian agricultural sector, with a small number of large farms, which cultivate the majority of land, and a huge number of small semi-subsistence farmers. Agricultural production was stabilized and agricultural and food trade flows were gradually moved towards the EU. As a result of the stabilization of both the agricultural sector and the banking system, credit inflows to the agricultural sector have gradually increased over the last few years.

**Table 2<sup>2</sup> Credit for the agricultural sector provided by the banking system (mln.lv)**

	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>
Credits – leva and foreign currency – mln.lv	164,5	167,4	263,3	376,2
%	100	102	160	227
Credits – leva	137,7	121,2	203,2	258,7
%	100	88	148	188
Credits – foreign currency	26,8	46,1	60,1	117,5
%	100	172	224	438

During the last few years it may be observed also that there has been a substantial increase in the volume of financing with the System of Warehouse Receipts (Table 3).

**Table 3<sup>3</sup> Short-term credit provided by the System of Warehouse Receipts**

<b>Marketing year</b>	<b>Receipts – number</b>	<b>Received credits – mln.lv.</b>
1999	5	0,6
2000	391	7,2
2001	426	7,2
2002	1 036	12
2003	275	5
2004	674	23,4

<sup>1</sup> “Statistical yearbook 2005” – National statistical institute, Sofia 2005

<sup>2</sup> “Annual report 2005” – Ministry of Agriculture and Forestry, Sofia 2006, p.79

<sup>3</sup> Annual report 2005” – Ministry of Agriculture and Forestry, Sofia 2006, p. 80

An important source of long-term (investment) loans is the SFA. Long-term credits from the SFA are structured within three programmes: “Animal breeding”; “Crop production” and “Agricultural machinery”. The numbers of credits advanced to agricultural producers and the value of these credits are given in Table 4.

**Table 4<sup>4</sup> Credits received from the SFA for the period 2002-2004 (in mln.lv.)**

Year	“Animal breeding”		“Crop production”		“Agricultural machinery”	
	Projects	Credits-mln. lv.	Projects	Credits – lv	Project	Credits - lv
2002	44	1,98	37	8,01	29	4,76
2003	442	10,05	123	15,50	223	10,58
2004	298	6,23	119	14,51	132	6,29

The current conditions of the investment loans from the SFA are:

- maturity – 12-96 months
- grace period – 3-48 months
- annual interest rate – 6%

The other credit activity of the SFA is the supply of subsidized short-term credits. These credit lines are of only modest scope and are targeted mainly at grain crops. In 2003, for example, the subsidized credit lines applied to the purchase of fertilizers for wheat, maize and sunflower production. They covered 1694 contracts with subsidy of nearly 9 mln. Leva. In 2004 the short-term credits were 12,389 mln. lv and again are targeted for wheat and maize production, specifically for the purchase of mineral fertilizers and certified seeds. There is a clearly observed tendency for a decrease in short-term subsidized credits and an increase in direct subsidies. The share of credits in the financial resource of the SFA for supporting agricultural producers was 50% in 2002; 21% in 2003 and 17% in 2004.

The other source of short-term credits is credit co-operatives, although the financial resources they have available are very limited. However, credit co-operatives did gain ground in Bulgaria during the 1990s following the financial crisis in 1995-96, and the introduction of the currency board the imposition of strict financial regulations on the country’s banking and financial sectors. One of the consequences of the crisis was that credit co-operatives were very strictly controlled (for example they were not allowed to receive deposits) as they were considered to be easily used as “financial pyramids”. With the stabilizing and activating of the banking system the problem with the shortage of short-term credits is already less severe, and the recent attempt at establishing new credit co-operatives will probably again be unsuccessful.

In the pre-accession period an important source of credits was the SAPARD programme, a specialized programme for supporting agriculture and rural areas in candidate countries. In Bulgaria this started in 2001 and gradually the funds inflow to the agricultural sector and to rural areas in the country from SAPARD increased (Table 5).

<sup>4</sup> “Annual report 2005” – Ministry of Agriculture and Forestry, Sofia 2006, p. 81-83

**Table 5<sup>5</sup> Finalized projects and paid subsidies in Bulgaria from SAPARD for the 2001-2004**

<b>Year</b>	<b>Number of finalized projects</b>	<b>Subsidies - mln. lv</b>
2001	9	1,852
2002	97	26,506
2003	288	70,124
2004	448	135,225

The credit needs, and access to the two categories of credit, for Bulgarian farmers are quite different and the problems they meet in terms of credit supply are also different. For the large farms, operated by farmer-entrepreneurs, access to credit is no different to that available to business units in other sectors. They can easily receive credits from the banking system, and also receive credits from suppliers, especially agricultural machinery suppliers, and they are also winners from the subsidies provided by programmes like SAPARD and the SFA.

The situation with the small but commercially-oriented and semi-subsistence farmers, however, is very different. The recent study by the World Bank<sup>6</sup>, based on a countrywide survey and covering 490 farming households and 71 farmer-entrepreneurs, shows a very different picture. As much as 85% of the surveyed farmers had never taken loans and the proportion in this category for subsistence farming reached 91%. The survey did not distinguish which category of the surveyed had not applied for credits, but it is unlikely to be wrong to guess that they are subsistence and small commercially-oriented farmers. We can find support for this conclusion in the answers given to the question “Size of credit required”, which 89,2% of the interviewed market-oriented farmers answered that they need loans within the size band ‘up to 6500\$’ for long-term credits; this level is obviously insufficient to fund major investment in agricultural production on large units. As concerns the reasons for failure to obtain credit, most of those interviewed stated in first place a lack of collateral (44%) with only 7% citing the difficulties in drawing up a good business plan.

<sup>5</sup> “Annual reports 2001,2002,2003,2004,2005” – Ministry of Agriculture and Forestry, Sofia

<sup>6</sup> “Bulgaria: Survey on Rural Development Needs”, The World Bank, April 2004