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REPORT**

Second report for CYPRUS

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The project aims to establish a network of experts involved in agricultural policy analysis and rural development in the New Member States, in the Acceding Candidate Countries and in the countries of the Western Balkan. More detailed information on the project can be found at www.agripolicy.net.

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1. Introduction and Background

1.1. An outline of Rural Credit Facilities in Cyprus

Until 2004 the developments in the rural areas of Cyprus were financed by the Government and by the Financial Institutions.

The Government provided grants and low interest loans to local authorities to develop the infrastructure by building roads, erecting dams improving irrigation systems, consolidating land holdings etc. Loans to individual farmers were approved by the Government and were given by the Financial Institutions with Government guarantees and with subsidization of the interest rate.

The Ministry of Agriculture, Natural Resources and Environment introduced at various periods schemes for promoting agricultural and rural development. The schemes were financed by grants and loans. Assistance in the form of grants and subsidies were given to alleviate the consequences of natural calamities (winds, hail, floods, ice) or in order to promote land consolidation.

The financial assistance to farmers was given through the Government Loan Commissioners, the Central Cooperative Bank or the local cooperative credit societies. In those cases where farmers could not provide guarantees, for example the displaced farmers, the Government provided guarantees.

In Cyprus there are four major banks and three smaller banks that provide overdrafts and loans to farmers. The four major banks are:

- Bank of Cyprus
- Cyprus Popular Bank
- Hellenic Bank
- Alpha Bank

The three smaller banks are:

- National Bank of Greece
- Commercial Bank of Greece
- Arab Bank

However, farmers prefer to deal with the Cooperative Banks, which are the Cooperative Central Bank, and the Cooperative Credit Societies that operate in almost every village. The Cooperative Central Bank is solely owned by the Cooperative Credit Societies. At present its membership consists of 428 Credit Societies and Savings Banks, 365 active and 63 non-active due to the Turkish occupation, and 62 non-credit Co-operative Societies, totaling 490 societies. The Cooperative movement's market share for deposits exceeds 30%. It is under the supervision of the Cooperative Societies' Supervision and Development Authority.

The four major banks have trained specialists to deal with the farmers and Agro – businesses. They also have hire-purchase subsidiary companies that offer 2 – 3 years

hire-purchase contracts for agricultural tractors and machinery. The credit given by hire-purchase companies costs 2% - 3% more than other credit given by banks or cooperative credit societies.

A recent study carried out by our own company for one of the major banks showed that about 40% of bank customers do business with more than one bank. Usually farmers, with the exception of some major citrus plantations, do business with the local cooperative credit society and with the Bank of Cyprus.

Agricultural loans statistics are presented in Tables 1, 2 and 3.

1.2. Major Credit and Rural Policy Development after 2004

After accession all Government support measures were incorporated in the Rural Development Plan 2004 – 2006 and the farmers had to apply to the Ministry of Agricultural, Natural Resources and Environment for subsidization of the various measures by 50% - 65% and in some case for environmental control measures by 80% subsidy. Preference was given to applications for farmers who financed the investment from their own funds. In order for the farmers to get the subsidy they had to carry out the investment, pay for it from own or borrowed funds and then apply for the subsidy.

The issue of non-performing agricultural loans has been considered by the government. There has been a political decision to help with the amount of 23 million CYP (40mln EUR). The final decision and a law are expected to be delivered in 2006.

Table 2 provides an insight to the extend of non-performing agricultural loans given by the Cooperative Central Bank. By the end of 2005, the arrears of loans account is more than 4 times the face value of the loans outstanding.

1.3. Access to rural credit – uptake and issues

The Cooperative Central Bank has since 2004 practically stopped issuing loans to farmers. It used to act as an intermediary between the government and the farmers since the money was actually provided by the Ministry of Finance. At present, the Bank acts as a regular commercial bank that also serves agricultural businesses.

Physical access to the Cooperative Credit Societies is not an issue. Their presence covers the whole area of Cyprus and cases of nearby villages each having its own society are not uncommon. A society could turn to the Cooperative Central Bank as ‘a lender of last resort’ if there is an extra demand for loans.

Farmers usually prefer to deal with the cooperatives rather than commercial banks as they can more easily obtain a loan and most often get better terms on their loans. Usually, the rate of interest offered by the cooperatives is somewhat lower than that of the commercial banks and the cooperatives show a greater leniency when farmers happen to fall behind schedule.

According to the Cooperative Central Bank: “The lending operations of the Bank are conducted almost exclusively with its member co-operatives and fall into three main categories:

- Short-term loans repayable within a period of up to 1 year, for the financing of purposes such as crop cultivation, purchase of fertilisers, seeds and other agricultural requisites.
- Medium term loans issued for periods of 2 to 5 years for the financing of such purposes as capital investments in agriculture, construction / maintenance of store buildings, purchase of machinery and equipment.
- Long term loans for periods from 5 years to a maximum of 15 years, granted to co-operatives for erection of office/business premises, purchase of heavy machinery and equipment and other long-term investments or capital expenditure.

In addition to the extension of loans for agricultural development directly to the individual farmers as well as via its member Co-operative Credit Societies, the Bank is also the main provider of long term credit for financing development projects of local authorities, semi-government organisations and other utilities.”

When it comes to the issue of trade credit, farmers are usually at a disadvantage. They usually pay cash either by using their savings or by getting a loan. When it comes to getting paid they are usually “forced” to offer a period of grace that could, in some cases, be significant.

Concerning the issue of subsidies, the farmers are well informed. Both in the case of the Rural Development Plan 2004-2006 and in the case of hectare subsidies paid by the Cyprus Organization of Agricultural Payments, there has been an extended effort by the government to educate and inform them.

2. Availability and performance of rural credit facilities

2.1. Assessment of short-term credit sources

Due to the small size of most farmers’ holdings, the short-term credit needed by each is relatively small. Therefore, they can turn to the cooperatives and obtain the credit without an extended effort and without the need for collateral. In many cases the short-term credit is needed because they cannot secure a trade credit from their suppliers of inputs.

A new kind of demand for short-term credit arose in the past months due to the Rural Development Plan 2004. The handsome subsidies (50-65%) offered by the Plan prompted the farmers to pursue them. Since the subsidies are given after the expenditures are made, the farmers need to apply for loans (unless they have the necessary savings). In many cases the loans approximately amount to the money the farmers get as subsidies, and thus they are repaid within a year.

2.2. Assessment of medium-term and long-term credit sources

Obtaining medium-term trade credit from businesses like machinery traders is even more difficult for farmers (with the rare exception of bigger businesses that are in the agricultural industry). Thus, medium and long-term credit must be sought from the cooperative movement or the commercial banks. This is much more difficult for the farmers to obtain and they have to do so through a mortgage. Once again, they prefer to do business with the cooperative movement. Approximately 70% of agricultural loans nationwide are provided from the cooperative movement.

Local governments do not usually provide any loans to farmers but they are usually borrowing money (mostly from the government or the cooperative movement) for rural development activities.

2.3. Assessment of the adequacy of credit sources

Farmers find it much easier to obtain smaller and short-term loans. They can usually do so at their local cooperative society. Larger and longer-term loans are harder to obtain. They most often require a mortgage and in some case a business plan. Rural businesses that wish to obtain loans from either the Cooperative Central Bank or commercial banks need to present a thorough business plan.

Most cooperative societies have been more like a family business. They were owned by family members or friends. This hampered their development, as the new employees' greater asset would be their relation to the owners or managers. This has gradually begun to change (especially in the larger cooperative societies) and well educated, and in some cases, specialized employees were hired. In these cases, the older employees/managers' experience with agricultural industry coupled with the younger employees' education and specialized knowledge provide for a higher standard of business. Commercial Banks do employ specialized personnel for this sector of their business.

The government aided displaced farmers in obtaining credit by guarantying the loans. In addition cooperative societies did not have to pay any mortgage fees or other fees that had to do with bureaucratic procedures. This has stopped since July 1st 2003. Currently, any part of a cooperative society's profit that comes from transaction between members is exempt from corporate income tax.

2.4. Evidence of credit market failure

As indicated in Table 2 there is an increasing amount in the arrears section of loans of the Cooperative Central Bank. This is despite the fact that the Bank has stopped issuing loans to farmers. This could be interpreted in two ways. The more straightforward

approach is that the farmers can not repay the loans but the second possibility has to do with their willingness to repay them. This unwillingness to repay the loans could come from their belief that the government could step in and repay them (either in part or in full). This demand is likely to be met as explained in section 1.2. Most of the farmers' non-performing loans are from the local Cooperative Credit Societies and from older loans by the Cooperative Central Bank. The non-performing loans to other commercial banks are much less and commercial banks are pressing more for their repayment.

The farmers' need for medium or long-term loans is usually met by collateral. Since the value of land has been appreciating significantly during the past five or six years, they often have enough wealth to get the longer-term loans.

Programs by the Ministry of Agriculture and Natural Resources have been abandoned since the beginning of the Rural Development Plan 2004. All the necessary measures were incorporated in the Plan's Axes. The current debate is on the areas of focus for the 2007-2013 Plan.

The government used to provide loan guarantees for some farmers (mostly the displaced ones). This is no longer the case but more farmers are able to provide collaterals due to the increase in their land's value. Despite this, the demand for loans may be expected to drop in the next years due to the shrinking of some agricultural sectors such as the citrus fruits and banana growers. Cheaper imports lead to farmers exiting the sectors and thus to lower credit demand.

On the other hand there is a trend of a decreasing cost of credit during the past few years. Interest rates in Cyprus have dropped by several percentage points and are expected to decline even more in the following years in an attempt to converge with the ECB's rates. Currently, the rate in Cyprus is 4.25% compared with ECB's 2.5%.

Sources

Public Loans Fund, Ministry of Finance – Loans Officials
 Cooperative Central Bank, Cooperative Central Bank Website
<http://www.coopbank.com.cy/>
 Cooperative Societies' Supervision and Development Authority
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<http://www.cssda.gov.cy/>
 Ministry of Agriculture and Natural Resources – Department of Agro economics

Table 1

PUBLIC LOANS FUND
 Loans issued during the year (in EUR '000)

	1998	1999	2000	2001	2002	2003
Water Development and use	1,114	952	583	416	223	525
Agricultural Development	3,713	1,298	1,013	1,213	562	661
Rural Development	3,111	2,711	2,596	2,377	1,924	1,355
Total	7,938	4,961	4,192	4,005	2,709	2,542

Table 2

Co-operative Central Bank LTD
Outstanding Loans 31/12

	1998	1999	2000	2001	2002	2005
Loans to farmers (in EUR 000)	5,411	5,408	5,404	5,399	5,397	
a) Loans for reactivation of displaced framers	4,865 89.9%	4,862 89.9%	4,858 89.9%	4,856 89.9%	4,856 90.0%	
b) Loans through Local Co-operative Credit Societies	515 9.5%	515 9.5%	515 9.5%	513 9.5%	512 9.5%	
c) Mortgaged Loans	31 0.6%	31 0.6%	31 0.6%	31 0.6%	31 0.6%	
Arrears of loans	17,684	18,931	20,278	20,281	20,278	24,593

Table 3

LOANS OUTSTANDING (Agricultural) at 31/12
EUR '000

	1998	1999	2000	2001	2002	2003	2004	2005
Government								
Water Development and use	17,597	17,477	11,985	11,766	11,566			
Agricultural	38,795	39,246	47,601	44,318	42,131			

Development								
Rural Development	21,338	21,813	25,338	26,074	26,732			
Total	77,729	78,535	84,924	82,158	80,428			
Commercial Banks	168,187	191,929	204,405	208,428	196,364	194,135	203,347	186,617
Co-operatives		87,345	49,646	59,637	58,502	65,288	47,813	52,200
Total	245,916	357,808	338,975	350,222	335,295	259,424	251,160	238,817

Table 4 **AGRICULTURAL CREDIT ACCOUNTS (in EUR 000)**

	1998	1999	2000	2001	2002	2003	2004
Accumulated	3,367	3,414	3,461	3,490	3,504		

Table 5 **INTEREST RATES FOR LOANS ISSUED**

	1998	1999	2000	2001	2002	2003	2004
Self-Employment of Tertiary Education Graduates							
In URBAN areas		6.5%	6.5%	6.5%	6.5%		
In RURAL areas		5.0%	5.0%	5.0%	5.0%		
Public Road Transport Peripheral Companies							
URBAN		5.5%	5.5%	5.5%	5.5%		
RURAL		2.0%	2.0%	2.0%	2.0%		
Infand Transport b/w cities		N/A	N/A	3.0%	3.0%		
Loans to Co-operative Central Bank							
Farmers Scheme		3.0%	3.0%	3.0%	3.0%		
New Farmers Scheme		N/A	N/A	2.5%	2.5%		