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1 Introduction and background

1.1 An outline of rural credit facilities

During the nineties the structure of the banking sector in the Czech Republic (CR) went through a dynamic development. After 1989 there occurred in the CR a change of economic system from central planning towards to an economy based on the market. Banking was the first sector of the economy where far - reaching changes began to be made to bring about a dual-mode banking system.

The Czechoslovak national bank was split into three parts: one part (the Czech National Bank, or CNB) continued to serve the basic function of a central bank, while credit and deposit operations were provided by the Komerční banka a.s. Prague and in Slovakia by the Universal Loan Bank Bratislava. As well as these, Agrobanka Praha initiated activity as well as providing a regional system of Agrobankas that financed agricultural enterprises. The Investment bank IPB (Investiční a poštovní banka, a.s.) undertook the financing and provision of credit for construction, later changing its activities to providing all sorts of banking operations, linked to capital banking.

Gradually private banks were established such as the Credit and Industrial bank Prague, Inc., Pragobanka, Inc., Union bank, Inc. etc. As well as these new banks there were also savings banks operating, such as CSOB (Československá obchodní banka, a.s) and Živnostenská banka a.s. trade bank. On December 31st 1992 there were 37 Czech banks and 8 external banks operating and their number was still increasing. At this time state based specialized banks also arose, including the Consolidation Bank, other state banking institutions, the Bohemian and Moravian Guaranty and Development Bank, Inc. and the Czech Export Bank, Inc.

During this period the banks faced enormous risks, which were connected with a ignorance of economics techniques, especially in particular credit risks. This inevitably led to the gradual bankruptcy of several banks and general economic problems affecting all Czech banks. At this time the regulator of the banking sector in the Czech Republic – the Czech National Bank - began to put in place a Consolidation Programme (CP I) and subsequently in 1996 a second programme was put into place (CP II).

Development of the Czech banking sector 1990 – 2006

	January 1990	December 1992	December 1995	December 1998	31.1.2006
Total number of banks	5	37	55	45	36
of which					
-Foreign banks	-	8	12	13	15
-Affiliates of foreign banks	-	3	10	10	12

Source: CNB

After 1990 in the CR further financial institutions, namely Cooperative loan offices, Credit cooperatives and “Kampelický” were also founded. The CNB announced that in 2002 there were 97 monetary financial institutions (banks, money market funds, saving and credit cooperatives). However, by 2004 the number of banks had declined to 78. On January 28th 2006 there were 64 functioning institutions providing credit services (banks, funds monetary market, that means funds money market or mutual funds, saving and credit cooperatives). This number also includes finance houses providing credit to entrepreneurial clients in

agriculture. At the same time in the CR there coexisted roughly 101 – 105 firms providing insurance credit, but it is not known how many actually helped entrepreneurs in agriculture. The names of significant banks which grant credit to the agricultural sector are Volksbank CZ, GE Money, and GE Capital etc. (note that this is not a full list of banks).

1.2 Major credit and rural policy developments in 2005

In 2005 the financial and income situation of agricultural businesses in the Czech Republic significantly improved. The accession to the CR into the EU and both national and European subsidy policy was of significant importance for the corporate environment. The biggest share of subsidies is concerned with the improvement of entrepreneur economics (roughly 60 %), along with environmental improvement, restructuring and modernising agricultural company production.

Nevertheless it is necessary to stress that the transformation of agricultural economies connected with the extensive shift in the ownership and structure of holdings that began in 1990 is still not finished (for example, complex land adjustments are still in process). A significant break-through in the administration of mortgage credit and agricultural land collateral came with the state programme "SOIL", which was announced by the Czech government at the beginning of the 2004. The aim of this programme was to enable the farmer to purchase the land from private individuals. The programme is now within the framework of the Support and Guarantee Fund for Farmers and Forestry (SGFFF), which finances the interest payments for long - term credits. At the present time 90 % of the land used by agricultural enterprises is rented.

Another significant factor, which indicates the improving situation in Czech agriculture, is the decreasing indebtedness of agricultural entrepreneurs (see the following tables).

Development of entrepreneurial subject indebtedness in agriculture 1995 – 2004 (%)

Year	Cooperatives	Trading companies	Body corporate	Physical person
1995	54.70	64.70	57.60	34.60
1998	59.90	43.40	53.30	20.30
2000	53.00	38.40	46.20	19.26
2002	51.50	40.85	46.33	17.15
2004	48.98	39.86	44.25	15.83

Note: rate of indebtedness = foreign capital/total capital*100

Source: FADN

In 2004 the indebtedness of agricultural enterprises, in all the monitored groups, did not exceed the recommended limit of 50 %. In 2005 economic growth in the CR continued the positive trends of the previous year. In the middle of 2005 the interest rate fell to a historical low of 4.027%. Although in the second half of the year monetary policy was tightened up, there was only a slow increase in interest rate.

Interest rates charged for loans (%)

Indicator	2002	2003	2004	2005
Credits of non financial companies total	6.240	5.306	4.749	4.204
of which	5.180	4.267	4.353	3.845
- short-term (to 1 year inclusive)				
-medium-term from 1 year to the 5 years inclusive	6.830	5.826	4.684	4.175
- long-term (over 5 years)	6.543	5.593	5.386	4.718

Source: CNB, CSO

Favourable conditions in interest rate movements had a significant influence on the utilisation of credit in 2004 as well as in 2005, with the dynamics of credit allocation in agriculture, game keeping and fisheries recording significant growth in 2004 by 12.6 %, while in 2005 moderate growth of 4 % was seen in contrast to the growth of the whole economy in 2005 by 15.2 %. The reason could be seen in significant investment increase in national economy.

1.3 Access to rural credit – uptake and issues

Small and mid-sized entrepreneurs in agriculture face significant problems of obtaining credits from financial institutions. There are many causes for this, from the most important are: a lack of personal capital, the uneconomic management of firms, obsolete production capacity (restitution) with high costs of production, changes in external conditions (accession to the EU). As well as economic problems farm business managers have also to solve the environmental problems of how to limit damage to the environment and nature. In spite of favourable conditions connected with the interest rate the farmers very often are not able to fulfil other criteria which are determined by individual banks.

2 Availability and performance of rural credit facilities

Credit

It is useful to begin by explaining the definition of credit status which is the final balance of a client's account, i.e. opening balance plus utilisation of new credit minus charges for earlier rendered credit.

Since 2002 the status of general credit and claims in agriculture, game keeping and fishing has shown marked growth. In 2005 compared to 2002 the increase reached 26.3 %. In 2002-2005 investment credits composed an average 65 % of the total.

2.1 Assessment of short-term credit sources

In the last four years short-term credits formed on average 22 % of total credits. Despite the favourable conditions in the movement of interest rates having a significant influence on the utilisation of credits in 2004, for 2005 the volume of short - term credit in agriculture, game keeping and fisheries decreased by about 10.0 %. The reason for this decrease can be seen in the optimum results of the cereal harvests in 2004 and 2005 as well as the significant improvement of conditions for the export of animal products to the EU 25 after the CR's accession to the EU. The increase of direct payments, as well as subsidies to the agrarian sector within the framework of the EU structural policy, also had a significant effect.

Status of short - term credits and assets (up to 1 year) in agriculture, game keeping, Forestry and fishing in the CR on December 31st (Million CZK)

Year	Credit on circulating money, export, import	Fixed assets loan	Credit on temporary shortage sources	Other credits	Total short - term credits
2004	2 545.4	528.3	72.8	1 761.9	4 908.4
2005	1 966.4	461.3	62.9	2 490.6	4 418.4

Source: CNB

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

The development of the Czech economy in 2004 and 2005 can be characterised as stable with the exception of the growth in economic efficiency. This exception is shown in the increase in medium term and long - term credits in agriculture. Compared to 2004, medium term credit in 2005 increased by about 9.1 % and long-term credit by about 7.5 %. The increase of general credits is significantly composed of medium and long-term loans for the purchase of fixed assets. Nevertheless it is necessary to state that in 2005 compared to 2004 a significant growth of total credits was not recorded, namely only about 4 %. The same figure in the year 2004/03 was about 12.6 %.

One reason for this was the significant increase of the total cost of CR agri-food sector support in 2005, which includes the growth of direct payments, support within the framework of the EU structural policy on the basis of the Operational Programme for agriculture and further national subsidies and measures.

Status of medium - term credits and assets (1 year – 5 years incl.) in agriculture, game keeping, forestry and fishing in the CR on December 31st (million CZK)

Year	Credit on circulating money, export, import	Fixed assets loan	Credit on temporary shortage sources	Other credits	Total medium - term credits
2004	2 986.2	3 116.2	19.9	256.7	6 379.0
2005	3 017.9	3 617.6	32.1	294.6	6 962.2

Source: CNB

Status of long - term credits and assets (over 5 years) in agriculture, game keeping, forestry and fishing in the CR on December 31st (million CZK)

Year	Credit on circulating money, export, import	Fixed assets loan	Credit on temporary shortage sources	Other credits	Total long - term credits
2004	161.0	9 457.4	-	823.0	10 441.4
2005	183.8	10 627.0	-	415.6	11 226.4

Source: CNB

Total credit in agriculture, game keeping and fishing sectors, as a proportion of total credit in the national economy, was approximately 1.9% in 2005.

2.3 Assessment of the adequacy of credit sources

Basic characteristics (indicator) indices of the Czech financial sector are shown in the following table.

Basic indices of financial sector in period 2001 - 2005

	2001	2002	2003	2004
Adequate capital on risk assets (%)	15.4	14.3	14.5	12.6
Classified credits (% of total credits)	20.8	15.8	11.2	10.8
Outstanding loan (% of total loans)	13.4	8.1	4.9	4.1
Liquid assets (in % of total assets)	20.8	32.5	35.9	32.8
Return of average assets after taxation (%)	0.7	1.2	1.2	1.3

Source: MMF

2.4 Evidence of credit market failure

Since 1st May 2003, there have been some significant developments, which have protected the parties in the Czech credit market. The CNB set up the Central Register of Credits (CRC), with the aim of sharing information about liabilities and the credit worthiness and record of clients that comes from the long term monitoring of credit registers abroad, especially in the EU.

2.5 Overview and prospects

Despite favourable conditions in the last few years with low interest rates and a greater range of possible sources of credit finance, entrepreneurs in the agricultural sector still face impediments when obtaining credit. The problems facing farm business managers are not only concerned with the search for technical solutions in the production process, but also include finding acceptable sources of credit finance, both in volume and structure.

The most important causes of disappointing growth in farm and other rural businesses are as follows: a shortage or total lack of own capital, the uneconomical management of firms, obsolete production capacity due to the restitution process, the high costs of production and significant changes in external conditions. Moreover, farm and rural business managers must try to solve the problem of how to reduce environmental damage caused by farm production and processing, as well as dealing with the economic challenges.

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