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1 Introduction and background

1.1 An outline of rural credit facilities

Before December 1989, the Romanian financial system was a passive one as regards the mobilisation of savings and the allocation of credit finance. The banks were quite few, entirely state owned, each responsible for an economic sector and their role was restricted to providing financial resources for a pre-planned resource allocation. Their autonomy in taking decisions regarding selecting investments and credit granting was almost non-existent. No competitiveness criteria were taken into account when granting credit finance for investments. The level of future credit allocations was mostly independent from past credit repayment history, and therefore there was no incentive for the careful use of money nor for strict repayment discipline by the enterprises concerned. Credit risks were absorbed by the government.

In the agricultural sector and the food industry, the Bank for Agriculture and Food Industry (known as the Agricultural Bank (AB) until 2001 when it was bought by Raiffeisen Bank) had been responsible for performing all types of financial transactions (not only in credit finance). Agricultural production, upstream and downstream activities were all functioning within the structure of large state-owned farms or enterprises. All units received allocations of money for funding current production and for wages and, separately, for capital investments through planned credits. Small rural trade businesses, processing industries and craft businesses either did not exist, or were economically insignificant; and therefore banking operations were limited to a reduced range of relatively few, large units. (*Camelia Șerbănescu, 1999, Agricultural finance and institutional reforms in Romania p.4-5; Gertrud Schrieder, Franz Heidhues, 2000, Transition and rural finance, p.5*).

After 1989 the law of banking activity (1991) allowed the licensing of new banks, including private and foreign ones, but even so the movement of banks into the agricultural credit market has been slow. The reasons for this have been the following: the lack of an extensive network; the unattractiveness of the agricultural sector for the banking system due to its specific features (discontinuity of income, long production cycles, exposure to production fluctuations); and few relevant qualifications and little experience within the banks in the area of agricultural lending, risk evaluation etc. (*Camelia Șerbănescu, 1999, Agricultural finance and institutional reforms in Romania, p.7*). Credit has been highly inaccessible to the private sector due to both the very high interest rates (mainly due to inflation) and the lack of collateral in the sector. Also, the lack of experience of farmers in accessing credit finance has been an important limiting factor. It is important to note that some of these factors are still valid.

In 1993 the state-owned commercial banks still accounted for over 80% of aggregate customer lending, while AB held a 90% share in the market for lending to agro-processors, integrators and farms. (*Joint mission to advise on agricultural and food policy options. Agricultural banking and rural financial markets, March 1993*).

Until 1996, therefore, the state-owned AB was the dominant provider of agricultural credit and also the main bank handling subsidised loans directed to agriculture. The main beneficiaries of the subsidised loans were state-owned agro-processors, integrators and farms

and not the private agricultural sector. It is estimated that between 1993 and 1996 rural households received only 2% of these transfers (Schrieder, Heidhues, 1997). Unfortunately, these cheap credit schemes didn't fulfil their objectives because the main borrowers used them to cover their current operating costs and not for capital investments to increase their efficiency. Moreover, this scheme had other serious adverse effects such as inflation because it was covered by money emission.

Private farmers had very limited access to get subsidised loans directly from the banks because most of them couldn't overcome the collateral constraints. The situation is now different, however, and land can be used to secure loans. But during the 1990's this wasn't possible because even if the land restitution process could be considered to have been generally completed by 1997, the issue of the ownership of titles was not completed; so ownership and user rights relating to the restituted land were still unclear. Buildings could be used as collateral, but their valuation in rural areas was very low and so this was of limited use in practice. As a consequence, a large share of the agricultural sector was forced to resort to the integrators' system. Integrators (such as Romcereal, Semrom and other input suppliers) granted credit by providing inputs to farmers at 0% interest rate and in return the farmers undertook to sell their products at a fixed (lower than market) price to the concerned integrator, which provided for storage and processing facilities. There was, therefore, a real charge for credit finance equal to the difference between the market price for the product and the price actually received.

The Rural Credit Guarantee Fund (RCGF) was set up in 1994 to facilitate access to credit and other financing instruments, by covering a part of the guarantees requested by the commercial banks and other finance providers. The fund guarantees short, medium and long term credits and the amount guaranteed covers up to 100% of the credit.

Beneficiaries of the services provided by this fund are: private farmers, private farmers' associations without legal entity; companies with private or majority private capital, carrying on their activity in agriculture or food industry; Commune Local Councils (for rural infrastructure development, including the SAPARD programme).

In 2005 the Fund concluded Work Conventions with twenty one Commercial Banks.

For private farmers and for private associations of farmers, RCGF gives free guarantees for all kind of credit finance. Companies and Commune Local Councils are charged an annual guarantee fee, which varies between 1,5-2% of the guaranteed amount per year, depending on the type of guarantee granted and the rating category of the credit involved, according to the National Bank of Romania Regulation no. 5/2002. (<http://www.fgcr.ro>).

Since 1997, due to radical changes in the financing of agriculture and new legal provisions stipulating among other things that credit-worthiness is a compulsory condition for accessing credit (at subsidised or commercial interest rate), other commercial banks (both private and state-owned) also got involved in channelling credits to agriculture. (*Camelia Șerbănescu, 1999, Agricultural finance and institutional reforms in Romania, P.6*).

Since 2003, agricultural policy sustains the agricultural production sector through facilities for production credit. Agricultural producers (both natural persons and legal units) who access a production credit and reimburse it within 360 days benefit from a state allocation of a maximum of 30% of the credit volume (Law 150/2003). This scheme

stimulates financial discipline and the fact that these credits can be guaranteed by the RCGF raises their accessibility.

1.2 Major credit and rural policy developments in 2005

The most important rural policy development in 2005 was “The Farmer” programme aiming to stimulate investments in both agriculture and the agri-food sector, and to accelerate the absorption of SAPARD funds.

The programme is implemented through The Agricultural Investment Credits Fund, that for 2006 is set at about 190 million euro.

The Ministry of Agriculture channels the resources of this fund to banks and other credit institutions, who then lend them on to the final beneficiaries (agricultural producers, agricultural products processors) (Law no. 231/2005). Some 90% of the resources of the fund are targeted towards the co-financing of Sapard projects.

These credits are for longer term investment, a maximum of 10 years, with a low interest rate (5%) and are guaranteed by two funds, the RCGF and The National SMEs Credit Guarantee Fund (NSMEGF) (Law no.218/2005). In addition, according to Government Ordinance no.46/2005, the goods purchased with the credit can also be used as collateral.

In 2005, the only bank chosen by the Ministry Of Agriculture to offer these credits was the Romanian Commercial Bank. In 2006, the Romanian Development Bank-Groupe Société Generale, Carpatica Bank and Casa de Economii si Consemnatiuni (CEC) Savings House have won the bid to give out such credits, to date. In April follows another bid, when other banks can also get into the programme.

1.3 Access to rural credit – uptake and issues

Given the experience Romania has had starting with 2000 in the rural finance, the supply side of the agricultural credit market has been quite liquid (World Bank, Report No. 32452, May 2005, *Country Assistance Evaluation*) but commercial banks are “collateral oriented”: loan applications are judged on the collateral offered rather than on their technical merits, on the possibility of servicing the debt. This forms a big obstacle for both farmers and other rural entrepreneurs in accessing credits finance because they can’t overcome the collateral constraints.

High credit costs, the lack of experience of farmers in uptaking of credit finance are also making access to credit difficult in this sector.

The SMEs in Romania appear to rely on mainly on internal sources for funds, such as retained earnings, loans from family and friends and, in some cases, arrears on obligations to non-banks (for example, utilities, government, employees) rather than on credit from financial institutions. Sources of financing new investments were reportedly 72% from internal funds and retained earnings, while another 5% came from loans from family or friends. Borrowings

from banks accounted for only 11%, and equity less than 1%. Working capital financing shows similar patterns (World Bank Working Paper No. 45, 2005, *Capital Markets and Non-bank Financial Institutions in Romania. Assessment of Key Issues and Recommendations for Development*).

Specific features of the agricultural sector (discontinuity of income, long production cycles, exposure to production fluctuations), the low efficacy of juridical institutions when it comes to handling problem borrowers, makes the agricultural sector unattractive for the banking system. (*Camelia Șerbănescu, 1999, Agricultural finance and institutional reforms in Romania, p.7*).

Also the inadequate qualification and experience of banks in lending to the agricultural sector, issues associated with risk evaluation, and the lack of an extensive network of banks in rural areas are all limiting factors in the development of the rural credit market. The Rural Finance Project of the World Bank is trying to address these problems.

The Savings House and CREDITCOOP are financial institutions that target especially the segment of rural clients. They have currently the most developed networks in the rural areas. The Savings House has a network of over 800 units in the rural areas and CREDITCOOP has 137. A few other banks (the most important are RDB-Groupe Societe Generale, and Transylvania Bank) are beginning to develop their networks in rural areas as well but this process is only in the early stages.

2 Availability and performance of rural credit facilities

2.1 Assessment of short-term credit sources

Short term credit finance can be given by the majority of financial institutions, the main being the Saving House, that offers short, medium and long term loans but only to legally constituted units. For a maximum period of one year credit finance can be accessed both for agricultural and other rural businesses to constitute seasonal and periodic stocks.

EBRD funds are channelled through the Savings House that grants them as loans to SMEs, natural persons, and family associations for short and medium-term (maximum 4 years) periods.

The Romanian Commercial Bank (RCB) offers credit finance, for a maximum of one year, to agricultural producers who trade the resulting production for expenditure related to current agricultural production activities and for insurance of crops and livestock. Credits are offered also for financing seasonal and periodic stocks, and for (pre)financing export stocks. (www.bcr.ro).

Credit cooperatives in Romania are autonomous non-governmental associations whose main objective is to provide banking activities for members.

With enforcement of the new legislation (Emergency Ordinance 97/2000 and Law 200/2002), the number of credit cooperatives dropped significantly due to the sector's incapacity to meet the much tougher regulatory requirements. Only one network, CREDITCOOP, has satisfactorily completed all the steps in the licensing process. In December 2005 only 124 credit cooperatives of the CREDITCOOP network held a functioning authorisation issued by the National Bank of Romania.

Although they have proven effective in other countries, so far credit cooperatives have played almost no role in financing rural businesses in Romania and, for the time being at least, they are still not sufficiently well prepared to assume a significant role in rural finance. Their weaknesses include a lack of understanding of the rural sector, limited skills in appraising the business plans of private farmers, insufficient funds to meet the likely demand for credit in rural areas, an emphasis on excessive collateral requirements, and inadequate infrastructural and communication facilities in rural areas. Although in the long run credit cooperatives could play an important role in rural finance, they are not likely to be significant in the next five years.

There are no studies about NGOs that offer rural credit, nor information regarding the allocated sums or the regions served. A selective list comprises seven NGOs that offer micro-credit schemes for people living in rural areas. These offer loans, mostly to community groups, in order to contribute to or otherwise help the development of responsible social communities.

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

CREDITCOOP offers mainly medium term loans. In 2005, 65% of credits lent out by CREDITCOOP went to rural areas to both natural persons and legal units, who used the loans mainly for the development of agricultural production, the trading of products, machinery acquisition, and the development of agro-tourism. The cooperative also offers credits for the co-financing of SAPARD projects.

CREDITCOOPs market share was 0.41% in 2005, ranking it in 28th place in the banking system. As the targeted population have modest incomes, the typical credit offered are relatively small (in average 400-550 euro). The reimbursement period has grown from three to five years in order to help their clients with low incomes.

The Savings House offers credit for personal needs, specially designed for people living in rural areas, and with variable interest rate (typically 13.75%). The maximum amount that can be contracted is 680 euro, with a reimbursement period of five years.

For the moment the Romanian Development Bank-Groupe Soci t  Generale, Carpatica Bank and Savings House (CEC) are entitled to give out credit eligible from "The Farmer" programme to help the co-financing of SAPARD projects (Measure 1.1 - Improving processing and marketing of agricultural and fishery products; Measure 3.1 - Investments in agricultural holdings; Measure 3.4 - Development and diversification of economic activities,

providing for multiple activities and alternative incomes). These credits are for longer terms (a maximum of 10 years) and come with a low interest rate of 5%.

The RDB-Groupe Société Generale offers rural credit for investments based on sales contracts for milk (five years), and through the Romanian-German Fund gives credit to agricultural producers for cash flow (two years) and for investments (four years).

The rural credit service packages of the Romanian Commercial Bank for natural persons offers financing for investments in agriculture for 5-7 years such as: purchasing animals, the acquisition of machinery, and investment in orchards or vineyards. With a 20 years reimbursement period credits are guaranteed for the purchase of land for agricultural purposes. The advance payment is a minimum of 25% of the land purchased. This latter type of credit for legal units is available for short, medium and long term.

Credit is given to help to support the 25% national contribution when applying for measure 2.1 of SAPARD programme for “Development and improvement of the rural infrastructure”.

The ROMCOM Society for Microfinance offers credits for agricultural SME’s for a maximum period of five years. Beneficiaries have to be between 20-50 years, and at least 50% of their income has to come from agriculture. The credits can be used for modernising the infrastructure, extending the production capacities, and the purchase of agricultural machinery and equipment.

“The Apuseni Mountains rural development project” grants credits for short and medium-term for investments in agriculture, agro-tourism, rural industry in this area. The interest rate is determined annually. There are three types of credits granted:

- for individual farmers (maximum 4000 USD) for small investments, primary production and tourism;
- agricultural credits (between 4000 - 10000 USD) for primary production, for small processing companies, as well as for commercial activities and tourism;
- for commercial/industrial activities (between 10000 - 100000 USD) for those processing and commercial activities that generate support for the above mentioned credit categories.

The “Rural Financing Programme” financed by the World Bank and the Romanian government grants credits, through banks and leasing companies for investments and working capital. The reimbursement period depends on the nature of the economic activity being financed and is maximum 8 years.

2.3 Assessment of the adequacy of credit sources

Most small farmers and other rural entrepreneurs find it difficult to get loans. Collateral constraints are the main problem. Even if, according to the legal framework, banks can accept moveable guarantees (i.e. stocks, business plan, personal property etc.) for the credits, they are reluctant to accept them and prefer real estate guarantees. Some moveable

guarantees are accepted but this tends to be from legal units rather than from natural persons (and most farmers or farmer associations are not legal units).

Business plans are required, especially when applying for an investment loan. Farmers and other rural entrepreneurs have difficulties in building up a business plan, but government provisions for aiding farmers and other rural entrepreneurs to draw up business plans were made through "The Farmer" programme. This includes consulting and assistance for building up business plans and is freely available to the programme's beneficiaries at the Agricultural Consulting Centers.

Regarding the terms of loans, interest rates applied in the financial sector for agricultural and rural credits vary between 5% and 18%. We can say that "The Farmer" programme is trying to make them more "friendly".

For production necessities short term loans are available. Farmers have to repay them within the maximum of 360 days according to law no. 150/2003.

Medium and long term credits are available for investments. Due to the still unstable economic environment, banks prefer to grant credits for medium term periods instead of long term.

2.4 Evidence of credit market failure

Among natural persons the amount of problem borrowers in 2005 was less than 1%. Among legal units who take up a loan the percentage involvement is greater, but not significantly. According to experts, there is no evidence for credit market failure. The potential danger period for this to happen existed until a few years ago, but it has now passed as the economic environment has become more stable.

2.5 Overview and prospects

- Beginning with 1998 modest progress can be noticed in several important factors: the development of rural financial services, the raising of financial flows, and access to credit finance at the level of rural borrowers.
- Banks are beginning to develop their networks in rural areas. Privatization of the Savings House, the bank with the most developed territorial network, will result in increased competition in the rural financing business. In this way financial services will become more accessible to people living in rural areas.
- Bankers consider that granting credits for the financing of the agricultural sector will be the next step in the development of the banking sector, but for that to happen growth in the retail segment has to reach a "sufficient" level. This point is expected to be reached in the next 12-18 months.
- The SAPARD programme has effected an increase in the demand for rural credit (World Bank, 2005, *Romanian Food and Agriculture from a European Perspective*)

and there are big expectations from "The Farmer" programme. Also, in the near future, it is expected that the co-financing necessary to access Structural Funds, available after accession to the EU, will be an important factor in the development of rural credit.

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