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CONDITIONS AND PERSPECTIVES OF FINANCIAL LENDING IN MACEDONIAN AGRICULTURE AND RURAL DEVELOPMENT

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Abstract

Agriculture is a fundamental economic activity in Macedonia. It constituted 10% of GDP over the past decade. Adding related processing industry increases this share to approximately 15%-16%. During the last period of economic restructuring, agriculture played a critical role in the social and economic stability of the country. As a generator of growth of income and employment (19% of the total employment) agriculture needs a steady stream of funds to increase the competitiveness of the farmers by improving the technological and market infrastructure as well improving quality of life of rural population. Besides the state financial support of agriculture and rural development, the commercial financing - through lending is from utmost importance as well. The pressure for acceleration process for developing competitive and sustainable agriculture and sustainable rural communities requires better access to the funds by farmers. In this regards, the purpose of the research is to explore the existing situation in the lending system in agriculture and further provide analysis and recommendations for improving the commercial form of financing to farmers. Therefore, the desk work and field research through questionnaire and interviews have been conducted in order to collect information about needs and problems of the key actors in the field of lending in the agriculture and rural development. The results have been communicated with the stakeholders at panel discussion and, furthermore, upgraded and distributed to the relevant institutions and organisations. Findings demonstrate that the lending system in agriculture does not operate in an ideal environment and is facing numerous problems and obstacles.

Key words: *lending, agriculture and rural development, financial institutions, farmers.*

Introduction

The main challenges of the agriculture in the Republic of Macedonia in the path of EU accession are to harmonize its legislation with the EU *acquis communautaire*, adapt its institutions and economic policies, strengthen the rule of law and develop market oriented economies. During this integration process, the agro-food sector as a whole faces problems with development of competitiveness, creating market institutions, establishing marketing and distribution chains, meeting EU quality, veterinary and phytosanitary standards.

Credit as a financial instrument is one of the basic tools for vital agricultural development and has a crucial role in the development of profitable production. Lending allows additional accumulation of capital required for investments in the consolidation of agricultural holdings, purchasing of new equipment and machinery, modernization of production and increasing productivity (Kovacev et al., 2013).

Provision of financial services for agriculture and rural development is rather limited. The rural financial system consists of commercial banks, micro-credit banks, savings houses, informal financial channels and considerable credit-oriented programs financed by donors. Lending in agriculture is considered as high risky since its performance depends on many factors such as: climate and nature, marketing, legal, institutional, human factor, technical, financial, macroeconomic and political factor. According to the data from National Bank of Macedonia (NBRM), borrowers in the agricultural sector share is 19.9% in the highest risk groups of credits D and E compared to a share of 8.7% in other sectors. The assessment of credit requirements for investments in agro-industrial complexes is based on certain assumptions about the technical and production parameters, forthcoming demand and prices of products, cost and availability of raw materials and management skills of the borrower. The risk assessment is particularly important in terms of setting an upper limit on borrowing and defines the other terms of the loan. Uncertainty about forthcoming trends of these parameters over a longer period of time and the impact on the viability and profitability of the project on certain external variables complicates the credit analysis.

Specialized Credit lines from the Macedonian Bank for the Development Promotion to support agricultural sector

The Macedonian Bank for Development Promotion (MBDP) is a development and export bank whose strategic goal is to provide support and to incite development of the Macedonian economy through providing finance to small and medium-sized enterprises and export-oriented companies. The Bank which operates in line with the strategic policies, goals and the priorities of the Republic of Macedonia offers two the most favorable credit lines in the agro-food industry.

I) **Agricultural Credit Discount Fund (ACDF)** is a specialized credit line aimed at providing continuous participation in the financial sector in lending to agro-industrial complex by creating a model for refinancing of the loans. The credit line ensures supply of affordable loans to individual farmers and agro-food industry for activities in *primary production*, *processing industry* and *agro-exports*, with opportunity to cover costs for fixed assets and working capital for the above mentioned 3 credit categories. Lending to the target group is made through selected financial institutions that are 10 commercial banks and 2 saving houses. Interest rates of the credits offered by commercial banks amounted to 4% per year for primary production and 5% per year for investments in processing industry and *agro-exports*, while interest rates through saving houses are 6% and 6.5% per year, respectively. Credit terms such as repayment and grace period, fees etc. are identified by financial institutions according to their own credit policy depending on the type, purpose and amount of the loan.

II) **Credit line for production, processing and export of agricultural products.** The goal of this credit line is improving and developing production capabilities of micro, small and medium enterprises whose core business is the production, processing or export of agricultural products. Target group are only micro, small and medium enterprises, unlike the previous credit line for which individual farmers are also eligible applicants. With this credit line both fixed assets and working capital are financed. This credit line offers the best interest rate of the Macedonian capital market with only 3% per year.

Materials and methods

This research was conducted in the period November 2012 - February 2013 and consists of three phases: i) a survey on the farm level, ii) meetings and discussions with financial

institutions and iii) a panel discussion with stakeholders in the agricultural sector for communication of the primary results.
In order to facilitate the data collection for the first phase, a questionnaire was designed and a field survey was conducted in three regions in Macedonia: Kocani, Bitola and Gostivar through organized workshops in each region, structured to be attended by farmers with different farm sizes and agricultural subsectors. Workshops were attended by 100 farmers and qualitative and quantitative data has been collected. Additionally, many farmers were interviewed individually with supplementary set of questions mainly covering the issues of investments and access to finance.
In the second phase meetings with 5 financial institutions were held and discussions about their views and experiences in relation to credit arrangements directed to agriculture, the risks they face, and some recommendations for farmers who have to follow when applying for credit were conducted.
The third and final phase aimed to sit down stakeholders together and the results of this survey were presented in order to bring their postures towards improvement of lending to agriculture which will be of mutual interests for farmers and financial institutions.
Apart from field collection of data, the research is also based on secondary sources of data mainly from Ministry of Agriculture, Forestry and Water Economy, Statistical office, National Bank of the Republic of Macedonia, Macedonian Bank for Development Promotion, Ministry of Finance.

Results and discussion

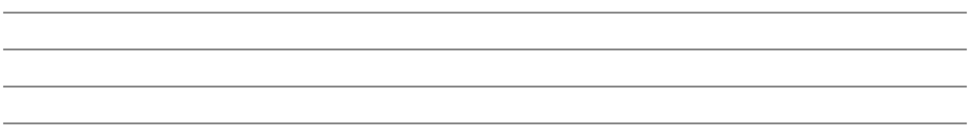
The field research, interviews and discussion with stakeholders gave ground to describe the typical features of the situation with lending to agricultural sector in the Republic of Macedonia. General perception of the stakeholders is that the banking sector is much more oriented towards urban areas where there is a greater concentration of potential customers and industries with higher profit margin (services, trade and heavy industry) than the rural areas that are predominantly oriented to agricultural production.
Credit support from financial institutions as a source of funding covers short-term loans with repayment periods of up to one year offering the financing of working capital (seed, fertilizer, fuel, pesticides, animal feed etc.) and long-term loans with deadlines for returning of more than one year and intended to finance investment projects (production facilities, agricultural land, irrigation systems, establishment of orchards and vineyards, supply of livestock, purchase of equipment and machinery for finalization of agricultural production, introducing new production lines to export). Till end of 2012, through ACDF, 5,501 projects were financed with total amount of € 67 million, of which € 37.2 million were approved in primary agricultural production, € 25.7 million in the processing of agricultural products and € 4.1 million to support the export of agricultural products. The biggest share of credit investments in primary agricultural sector is in livestock production which constitutes 21%, furthermore is the share of investments in establishment of orchards and vineyards makes 14%.

Graph 1: Approved loans breakdown by agro-food subsectors.
Sources: Ministry of Finance, 2013.

Lending in this sector is mostly focused on larger farms so that a number of smaller individual farmers have **limited access to credit**. The majority of farmers (70%) consider that they are not sufficiently respected by financial institutions or are treated as incapable to use credits. Some farmers stated that financial institutions require more documents unlike other applicants who are not dealing in agricultural sector, or sometimes are being manipulated by the banks about the level of interest rates or administrative costs. In terms of awareness, more than half of the interviewed farmers answered, they do not have information on specialized credit lines in agriculture.

Foremost farmers' problem to meet criteria is to provide **collateral**, since the banks rarely accept property in the rural areas such as houses and agricultural land. Other problems farmers face to provide property deeds needed for collateral due to unsolved property rights. Unrealistically assessment of property as subject to the granting of collateral is a supplementary problem that farmers experienced. Additionally farmers mentioned that securing the guarantors becomes problematic because nowadays is getting harder to find them.

Other constraint of lending in agriculture is the **seasonal character** of the agricultural activities and incomes, which basically implies the requirement for adaptation of credit terms depends on seasonal needs for funds and ability to meet obligation to repay the loan corresponding to income flow. Farmers generally have a problem with the payment of annuities, stating that its dynamics should be adapted to the seasonal nature depending on the type of production, that is when the greatest income from agricultural activities. An additional problem that complicates the regularly payment of annuities is the delay of the payment to farmers by buyers. According to the graph 2 which illustrates monthly frequency of the number of requests for credits within ACDF credit line, providing a larger volume of liquid funds for lending by financial institutions in the season (March and December) and relaxation of liquidity out of season (July and August) is required.



Graph 2: Number of requests for credit from ACDF credit line for the period 2004-2012.
Source: Ministry of Finance, 2013.

During the panel discussion, approach of creating a credit policy of banks based on a flexible rate versus fixed interest rate that is applied to all banks was considered. It was assumed that costs for loans with fixed and flexible interest rate are roughly the same but the dynamic amount of payments is in line with the capabilities of the farmers.

Table 1. Comparison of loan disbursement with fixed and flexible interest rates.

Simulation of loan disbursement with fixed interest rate						**Simulation of loan disbursement with flexible interest rate**				
Year	Principal	Interest	Annuity	i (%)		Year	Principal	Interest	Annuity	i (%)
1	0	400	400	4		1	0	200	200	2
2	0	400	400	4		2	0	200	200	2
3	1,250	400	1,650	4		3	1,250	200	1,450	4
4	1,250	350	1,600	4		4	1,250	350	1,600	4
5	1,250	300	1,550	4		5	1,250	300	1,550	6
6	1,250	250	1,500	4		6	1,250	375	1,625	6
7	1,250	200	1,450	4		7	1,250	300	1,550	8
8	1,250	150	1,400	4		8	1,250	300	1,550	8
9	1,250	100	1,350	4		9	1,250	200	1,450	10
10	1,250	50	1,300			10	1,250	125	1,375	
	10,000	2,600	12,600				10,000	2,550	12,550	

Source: Own calculation

According to the responses in the questionnaires, given that agriculture is low profitable sector; favorable **interest rate** should range from 2% to 7%, with most mentioned affordable interest rate (43% of the interviewed farmers) to be equal to 4% (graph 3).

Graph 3: Recommended interest rate by farmers.
Source: Field survey, 2012.

Research shows that another limiting factor for lending to agriculture is the absence of **credit histories** of borrowers since they do not practice running of records of all agricultural activities and costs and incomes on the farm. This situation leads to lack of adequate information which hinders the development of quality business plan or credit analysis by financial institutions.

Conclusion

Access to credit resources for rural and agricultural activities is very limited since the financial institutions are quite reluctant to invest in them as agriculture is viewed as a risky or highly risky sector, where a majority of farmers do not perform bookkeeping, there is lack of secure title deeds to be used as collateral, insurance premiums are expensive and therefore not used regularly, rural enterprises are generally micro and small-scale, with low managerial and administrative skills.

It is of great importance for farmers in order to improve production and market competitiveness to be well informed for availability, terms and conditions of available specialized credit lines in agriculture. Given the nature of the activity performed, and the areas in which they exist which are mostly rural and distant from urban centers, the best way to be better informed and to have influence in creating of national credit policy in agriculture is approaching associations, federations and cooperatives. Financial institutions also may need to intensify the mobility of credit administrators through the implementation of mobile offices on different days and in different rural areas to promote credit lines for farmers and assist in the preparation and collection of credit documentation.

One of the most restrictive factors in terms of lending is unregulated property rights and unregistered properties in the official cadastre, what disable providing collateral for using of loans. Because of that, farmers need to resolve property issues and record their own property in the national cadastre that will lead to increased possibility of getting loans and acquisition of rights to use the program for financial support of agriculture and rural development. We must also make clear that farmers who conduct accounting evidence are in better position to use credit from financial institutions.

Financial institutions need to design credit products for farmers with longer period of repayments and credit packages with variable interest rate (no more than 4% per year on average) and variable repayment terms or flexible repayment schedule. For example, interest on loans for establishment of orchards and vineyards may be lower in a grace period of three years till achieving full productivity, and later in full exploitation of the perennial crops can be offset by a reasonable higher interest rate.

However, the fact is that farmers and financial institutions have the same goal - the maximization of profits, which is not possible without mutual cooperation, understanding and confidence. Additionally, agriculture and rural development should be in focus of national policy makers to assist improving the lending system.

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