



Rural Credit Guarantee Schemes

A Financial Instrument for Agriculture and Rural Development

Summary Report

■ Introduction ■

On 12 and 13th January 2006, a seminar on “Rural Credit Guarantee Schemes - A Financial Instrument for Agriculture and Rural Development” took place in the FAO Subregional Office for Central and Eastern Europe. The event was co-organized by the European Mutual Guarantee Association, the Hungarian Rural Credit Guarantee Foundation, EastAgri Network and the FAO Investment Centre.

■ Rationale ■

The aim of the seminar was to discuss the practical experience of rural credit guarantee schemes in the European region, with focus on problems faced by the agricultural sector during the transition to a market economy. The underlying rationale was to exchange best practice and lessons learnt by Western Europe institutions and economic agents with their Central and Eastern Europe (CEE) counterparts.

In CEE transition economies, farmers and small businesses face daily the reluctance of commercial banks to lend. This is mainly due to stagnant agricultural markets, high risk and low profitability of farming, and, last but not least, lack of collateral. As a result, economic entities that in many cases do not qualify for standard bank loans are referred to guarantee schemes. There is increasing interest in transition economies in these schemes and guarantee funds have been used in a number of countries to offset risks from lending to the agricultural sector. They have also been used as an instrument to reduce risk of start up operations through guarantees schemes, which are subsidized. The overall results of the activities of such funds in CEE countries have been assessed as mixed; this experience and ensuing policy recommendations were chosen as the theme of the seminars.

■ Seminar Organizers ■

The European Mutual Guarantee Association (AECM)

AECM is the union of guarantee systems active in the European Union and candidate countries. The Association, established in 1992, active in the European Economic Area, brings together some 29 companies and federations from 17 European countries involved in mutual guarantees business. It is a non-profit association under Belgian Law, acting as an independent body which represents the interests of its members at EU level, and with the aim to enhance their activities by exchanging good practice.

The Hungarian Rural Credit Guarantee Foundation (AVHGA)

AVHGA has extensive experience in providing guarantees as collateral to loans for Hungarian farmers and entrepreneurs. The main goal of the Foundation is to increase the creditworthiness of rural enterprises, promote their financial viability and improve access to lending through credit guarantees. The Foundation provides financial services to agricultural and food processing companies as well as to rural development projects as part of the EU Common Agricultural Policy Second Pillar.

FAO Subregional Office for Central and Eastern Europe, Budapest (FAO SEUR)

In support to the economic transition and reforms in CEE and CIS countries that started in 1990s, FAO has established the Subregional Office for Central and Eastern Europe (SEUR) in Budapest, to provide technical assistance to the subregion. FAO has recently organized and supported a number of meetings and capacity building projects to assist in increasing investment in agriculture and food processing in Central and Eastern Europe, seen as a way to ensure an integrated approach to agricultural and rural development.

EastAgri Network

EastAgri is network of practitioners working in agriculture and agribusiness financing in CEE and Commonwealth of Independent States (CIS). The EastAgri Network is a unique neutral umbrella under which the various funding and technical assistance institutions and organizations come together for constructive dialogue, to share experience and lessons learned and chart future actions and projects.

The above four institutions, sharing common values and covering the same geographical region, have teamed up to discuss key issues related to credit guarantee schemes and create a network for a long-term cooperation among the institutions and professionals in the field.

■ *Participants: countries and sectors* ■

The invitees were stakeholders, key to supporting agriculture and rural development in the subregion: representatives of banks, financial institutions and foundations active in credit guarantee schemes, International Financing Institutions (IFIs) such as the EBRD, and the European Commission. Participants represented Western and Eastern Europe countries: Belgium, Bulgaria, Croatia, Estonia, Hungary, Italy, Lithuania, Portugal, Romania and Slovakia.

■ *Agenda and key topics covered* ■

The main issues discussed focused on causes why farmers and rural businesses face problems when applying for loans and why guarantees are needed, especially during the period of transition to a market economy. Banks and financing institutions are interested in assessing whether credit guarantee funds are really a functional and useful tool to help resolve problems caused by the underdevelopment of rural financial systems. To answer these key points, the seminar agenda included (i) a review of the experience of national rural finance institutions providing credit guarantees, and (ii) technical sessions on relevance and financial additionality of guarantee schemes for rural development and assessment and monitoring of specific risks in agri-business and (iii) public policies for moderation of structural risks in rural development. The seminar participants also analysed the issue of support to credit guarantee schemes from the state budget. Another topic covered was the need to provide financing for diversification of farms and non-farm related activities as well as the creation of new jobs in rural areas, also through the support by the instrument of credit guarantees.

■ *Main discussion points* ■

- As presented and analyzed by both Western and CEE participants, the vulnerability of the agricultural sector frequently results in gaps: communication, institutional, technical between agricultural entities, rural SMEs and the potential creditors. Thus, there is a clear need for an **intermediary**, such as guarantee schemes, between these sides.
- **Beneficiaries of rural credit guarantee schemes** are usually farmers, miscellaneous agricultural entities, processing companies, businesses in rural areas e.g. rural tourism, but also local councils developing rural infrastructure etc. In most cases, the issued guarantee concerns long-term and short-term credits of up to 70% of the unpaid loan amount; (in the case of young farmers this may increase up to 80%).
- **Rural development requires attracting and sustaining rural investment** (Calvin Miller, FAO) which promotes employment, income generation and asset growth. Specific conditions must be fulfilled – a supportive operating environment, suitable financial products and services and attractive returns to investment.
- Guarantee schemes play a key role in boosting entrepreneurship as demonstrated by the region wide experience of AECM. Guarantee schemes encourage entrepreneurship by compensating lack of or insufficient collateral, providing access to longer term loans, and providing advice and coaching to the clients.
- Guarantee schemes are usually a **mix of private and public initiatives** and tend to involve entrepreneurs directly or indirectly in the shareholding, decision and management process.
- **Public support** is necessary since it provides equity and protection in order to reach higher leverage and efficiency. Some schemes are completely public as the case with Istituto di servizi per il Mercato Agricolo Alimentare (ISMEA), a government agency in Italy, whose institutional role is collection of and processing economic data on rural markets, preparing and publication of financial and economic reports on developments in the rural economy in Italy, against a background of sector and macro-economic trends. Its rural credit guarantee scheme activities are supervised by the Ministry of Agriculture and Forestry Policies.
- Other credit guarantee funds have a **mix of shareholders**, including from commercial banks, public entities and entrepreneurs.
- **State aid plays an important role.** The state guarantee is an indirect subsidy from the central budget (Gábor Pósch, the State Audit Office, Hungary) and an efficient financial instrument to fulfil goals of government economic policy. Its principal function is assistance to entrepreneurs, to obtain credit necessary for investments or to restructure the enterprise.
- The Lithuanian Rural Credit Guarantee Fund was chosen as an instrument for business development in rural areas and to foster lending processes (Danguole Cukauskiene, Rural Credit Guarantee Fund, Lithuania) since starting a new business in rural areas without owning property would not be possible. The experience of Lithuania shows that without state aid in the form of credit guarantees, a major part of economic entities would not be able to obtain a bank loan.
- EC Phare and SAPARD have provided funding and technical assistance to a number of rural credit guarantee schemes, such as the Hungarian Rural Credit Guarantee Foundation and Rural Credit Guarantee Fund in Romania.
- **The awareness of banks needs to be increased through information sharing** (Peter Cserfalvi, Hungarian MKB Bank). Since banks view agribusiness as high risk financing, a risk-free collateral base is preferred and strengthening the collateral base through

guarantee schemes is necessary. This point was further strengthened by emphasis of the need for more transparency and cooperation between agriculture enterprises and banks (Mr Piero Crivellaro, Coldiretti). Continuously updated and precise information from enterprises will allow banks to assess the degree of risk and, above all, to provide adequate financial products. On the other hand, agricultural enterprises, through better presentation of their investment plans to banks, will obtain improved credit conditions. Therefore, the proposal to establish a guarantee consortium which would collect information from farmers for presentation to the banks.

- Credit guarantee schemes need good **marketing** to promote and articulate their activities. There is a need to raise awareness of banks and to have **more transparency and cooperation** between agriculture enterprises and banks.
- The sector faces some **major challenges such as the introduction of Basel 2** requirements and EC competition rules, which will require considerable investment time, with focus on cooperation to comply adequately.

■ *Policy conclusions and recommendations* ■

- Rural credit guarantee systems were found to be a functional financial policy instrument to resolve some of the problems faced by farmers and rural entrepreneurs that apply for loans without a credit history and face poor rating by banks. This is in particular true in the transition to market economy period, when emerging private farms lack collateral, among other since land markets do not function. It is to be noted, from a policy point of view, that this niche for support policy will gradually disappear as reforms are implemented, farms accumulate assets and incomes increase.
- While credit guarantees are no substitute for financial reform and building rural financial institutions, they do contribute to reducing the asymmetry of information between the borrower – emerging farms and lender – banks only starting to serve the private sector, additionally reducing high transaction costs. It was noted that credit guarantees are one of the few elements of rural finance well documented, compared to informal credit and limited assessment of the impact of micro lending.
- Rural credit guarantee systems have performed an important role in the period of agricultural markets liberalization, land reform and distribution to create private farms; no less important was their role in financial bridging of support to farm and rural investment under the EC SAPARD and other instruments in support of accession-oriented restructuring. The guarantees have demonstrated important additionality, bringing significantly larger volume of lending to a credit-constrained sector. Measuring additionality remains a problem and challenge for policy evaluation.
- Experience of a number of countries has shown that while state budget support is necessary to start rural credit guarantee systems, a major policy recommendation is that the systems should strive to become sustainable without state support. It was noted that so far there is limited experience of such sustainability. A clear criterion should be the definite time horizon of support offered. Frequent criticism is that guarantee programmes in reality function like income subsidies and distort the agricultural credit market. Credit guarantees should not be used as instrument to rescue bankrupt farms or enterprises.
- Policy makers need to strike a balance between the tasks for the rural credit guarantee systems and operational feasibility and high transaction costs when small, fragmented farms and small entrepreneurs are the main clients. Improvement of the agrarian structure, development of farmer, trader and producer organizations and approximation to common market organisation models may be expected to change the profile of the applicants for guarantees.

- When establishing or expanding rural credit guarantee systems, a recommended orientation is approximation and harmonization with relevant European Commission legislation; this is reflected in the AECM rule of assisting countries that are orienting their economy to European integration. As rural financial institutions are structured for the medium- and long-term, this European orientation and compliance with EC regulations is necessary.

■ *Next steps and follow-up* ■

- Participants have agreed to continue collaboration and contacts to foster exchange of experience, i.a. through the establishment of a network for a long-term collaboration among the professionals in rural credit guarantee schemes in the European region;
- A sub-sector site dedicated to rural credit guarantee schemes will be developed on the EastAgri website. The seminar report and presented material will be posted on the EastAgri network and SEUR websites (www.eastagri.org and www.fao.org/regional/SEUR);
- A survey was proposed to assess the utility and impact of rural credit guarantee schemes, to be prepared and conducted under the EastAgri umbrella and
- Some future workshop topics suggested including: interpretation of EU support and meeting EC criteria on state aid, terminology de-codification, conducted and experienced and transparency of state aid.

■ *Websites of participating institutions and organizations* ■

European Mutual Guarantee Association: <http://www.aecm.be/>

Hungarian Rural Credit Guarantee Foundation: <http://www.avhga.hu/>

EastAgri: <http://www.eastagri.org/>

FAO Subregional Office for Central and Eastern Europe: <http://www.fao.org/regional/SEUR>

Rural Finance Learning Centre: <http://www.ruralfinance.org/>

Hungarian Agricultural Economics Research Institute: <http://www.akii.hu/>

Coldiretti: <http://www.coldiretti.it/>

Croatian Chamber of Economy: <http://www.hgk.hr/>

EBRD: <http://www.ebrd.com/>

EU: <http://europa.eu.int/>

Estonian Rural Development Foundation: www.mesa.ee

Fondo Interbancario: <http://www.fitd.it>

Fonds de Garantie Wallonie: <http://agriculture.wallonie.be>

Hungarian Credit Guarantee Corporation: <http://www.hitelgarancia.hu/>

Hungarian Foreign Trade Bank: <http://www.mkb.hu/>

Hungarian State Audit Office: <http://www.asz.hu/>

Instituto di Servizi per il Mercato Agricolo Alimentare: <http://www.ismea.it/>

Lithuanian Rural Credit Guarantee Fund: <http://www.garfondas.lt/>

Portugal Ministry of Agriculture: <http://www.min-agricultura.pt/>

Slovak Guarantee and Development Bank: <http://www.szrb.sk>

SPGM (Holding of Portuguese Mutual Guarantee Scheme): <http://www.spgm.pt/>

Swiss Agency for Development and Cooperation: <http://www.sdc.admin.ch/>

