

Per aspera ad farmers

Due to the involvement of credit unions to state budget programs small agricultural producers would be able to get government support

One of the priorities of Ukrainian budget policy for 2018 is targeted stimulation of the economy through support of farmers. The state budget for the development of farms provides for the allocation of UAH 1 billion hryvnia. In addition, UAH 66 million is allocated for financial support of agro-industrial complex by reducing the cost of loans. According to experts, partial compensation of loan interest rate can be considered as one of the most effective methods of stimulating small and medium-sized agricultural production. However, a major obstacle to obtaining such an aid from the budget for farmers is the limited choice of financial institutions. Today, the program provides compensation for the part of interest rate only for loans taken at banks. Credit unions, which are the most accessible financial institutions in rural area, remain outside the state program, and therefore, government support will be inaccessible for a significant part of farmers.

Why is it important to support small agriproducers?

The Ukrainian agrarian complex traditionally plays a stabilizing role in the development of national economy. At the same time, small and medium-sized agricultural producers (SMAPs) play a significant role in agricultural production and in ensuring food security of the country, and this role continues to grow. According to the State Statistics Service, more than 80% of vegetable, 77% of milk, 20% of grain and 45% of poultry production are produced by the SMAPs. In addition, their activities contribute to solving social problems of rural area, to establishing sustainable development of rural area, to ensuring employment and supporting income of rural population.

And this trend will continue to grow, because, unlike agriholdings, SMAPs that produce a lion's share of labor-intensive products (especially within the production of fruit, berries, vegetables), create job positions. For example, in the Netherlands, namely SMAPs provides 60% of employment in rural area.

But there is still a long way to go to the full realization of SMAPs potential regarding the stabilization of Ukrainian economy. It is related to existing serious problems that hinder the effective functioning of SMAPs. One of the main issue of SMAPs development is the lack of financial resources.

Unlike Europe, where financial and material resources of EU member states allow agricultural subsidization (in other words, direct financial investments into this industry), Ukraine does not have this opportunity. At the same time, domestic agrarian sector absolutely needs such support. Therefore, almost the only mechanism for financing agricultural production is lending.

The decisive role of credit resources in financial provision of SMAPs is due to the seasonal gap between investing and receiving back money and the continuity of reproduction processes. A

significant need for working capital in case of lack of own funds makes a loan a powerful source of financial resources and leads to the need to find ways of credit support. However, obtaining loans for SMAPs remains problematic.

The problems of lending to SMAPs include the following factors:

- Unavailability of credit resources for agricultural enterprises because of high interest rates.
- Lack of collateral.
- Low creditworthiness of SMAPs.
- Lack of or limited credit products adapted for individual house plots.
- Ignoring the specifics of agricultural production – seasonality of work – when defining conditions for lending.
- Insufficient representation of financial institutions in rural area.

The limited access of SMAPs to lending arises because banking structures focus on large volumes of operations in view of their unwillingness to occupy niches of lesser production, and also considering that entry into these segments is more costly. That is why now the only prospect to obtain financing for small and medium-sized agricultural producers is through credit unions.

Credit unions are the best partners for SMAPs

There are many advantages of credit unions as partners of SMAPs for obtaining credit. The most important advantage of credit unions is that these financial institutions are created for the benefit of their members, who are primarily people from local communities, that is, ultimately, the decision about lending to a farmer or owner of an individual house plot - member of the local community is taken by representatives of the same community, also farmers. And farmers are better aware of risks and needs of farmers than anyone else.

Credit unions are special due to the atmosphere of mutual trust and assistance between borrowers and depositors, deep understanding of local business specifics and flexibility of the terms of cooperation.

That is why loans and terms of their repayment in a credit union are mostly more convenient compared to the practice of cooperation with banking institutions.

High cost of credit resources

A significant obstacle to SMAPs when taking loans in financial institutions is high rates for the use of these loans. This question is especially relevant for individual agricultural producers. The tendency towards high interest rates for using loans is has both objective and subjective factors.

The objective factors include the financial condition of credit institutions themselves, which, in modern conditions, negatively affects the lending to agrarian sector. Inflation processes have a

great influence on the interest rate on using loans. Credit rates are significantly influenced by the cost of credit resources: namely, interest rates on deposits.

It is known that one of the conditions for obtaining a loan is the creditworthiness of the borrower, that is, the guarantee of the loan repayment. Under conditions of low profitability rate, and often loss-making, low assets liquidity, agricultural enterprises are often insolvent. As a result, we have the endless circle: lack of financial resources is a reason for low efficiency of agricultural production, which, in its turn, makes it impossible to obtain credit resources. Taking into account the current economic situation in Ukraine, prospects for decreasing credit rates are unlikely.

How to make loans more accessible for SMAPs?

This problem can be solved by providing financial support to SMAPs at the expense of budget funds. This financial support may take various forms - providing irrecoverable financial assistance, interest-free lending from budget resources, cheapening interest rates on loans received. However, the chronic limitations of such resources do not allow the full application of all these forms of support.

The most economically expedient and progressive direction of financial support is applying the mechanism for cheapening interest rates on the use of loans. Not only does it make loans more affordable, it also ensures the efficient attraction of significant financial flows to agro-industrial production.

According to the "Study on the Effectiveness of Designing and Implementing Regional Programs for Supporting the Financing of SMAPs at the expense of local budgets" conducted by the Institute for Budget and Socioeconomic Research at the request of USAID AgroInvest Project, when implementing such programs, more than UAH 10 of attracted loan resources account for UAH 1 of spent budget funds!

Government support of SMAPs access to finance: how to increase its effectiveness?

The practice of concessional lending of Ukrainian AIC was introduced relatively recently. In 2000, one of the areas of state support was lending to agricultural producers on concessional terms through the mechanism of partial compensation of interest rate on loans of commercial financial institutions from the State Budget. Thus, in 2000, 3853 agricultural enterprises obtained loans under the concessional scheme for the amount of UAH 455 million. In 2003, their number increased to 14075, and the amount of loans - up to UAH 2,847 million. Since 2007, this share has been steadily decreasing and in 2007, 7463 companies obtained loans amounting to UAH 7800 million, and in 2014 the number of borrowers has dropped to several dozen and the amount of lending was only UAH 100 million.

In the state budget of 2018, UAH 66 million were allocated for the development of farms to reduce the cost of loans. As in most cases in previous years, this program provides compensation for part of the interest rate only for loans taken at banks. Credit unions, which are the most accessible

financial institutions in rural area, remain outside the state program, and therefore, for a significant part of farmers, state support will be inaccessible.

Since, as noted above, credit unions have a number of advantages over banks in lending to SMAPs, it would be of great use to involve them in this program. Vast majority of small and medium-sized agricultural producers would have access to the loans with budget reimbursement of interest rates, regardless of the amount of the loan.

The combination of state assistance with know-how of credit unions (knowledge of clients) will significantly improve the efficiency of spending funds intended to support the sector. The fact that such a mechanism will work successfully is evidenced by many years of experience in the implementation of similar programs at the regional level.

Thus, involvement of credit unions to the terms of the program “Financial support of agro-industrial complex by reducing the cost of loans” will allow to solve a number of urgent issues of agrarian sector development. All participants will benefit from this: the state will be able to provide financial support more effectively and with greater benefit, mobilize additional funds, increase agricultural production, strengthen its export potential and increase food security. SMAPs will be able to expand and enhance the sustainability of their business. Credit unions will expand their membership and increase the volume and quality of their services. Local communities will receive new jobs, growth of population income and strengthening of local budgets. Namely, such changes reflect the development of the country and genuine reformation.

Comments

Nataliya Lischytyovych, DCOP of USAID «Credit for Agriculture Producers (CAP)» Project

Credit cooperation needs development in order to fulfill its role - financing of small and medium-sized agricultural producers. The deterrents on this path are: membership in CUs, which is restricted by individuals, complexity of providing finance to farms, and other issues that impede the further development of credit cooperation. CAP Project focuses on addressing these issues, in particular by providing assistance in drafting an updated CU law designed to remove these barriers for credit union development.

Adopting these changes in legislation will allow credit unions to make better use of their benefits, namely: accessibility (they are already located in rural area), deep understanding agricultural producers' specifics that they have received through the technical assistance from the Project, possession of unique agricultural finance technology. The Project aims, in particular, at expanding the capacity of credit unions to assess agrilending risks. For this purpose, the Project attracts technical experts from the Netherlands – a country that is a flagship in the development of agriproduction at the level of small and medium-sized farms. Such new technologies are being introduced into credit union operations through with the Project help, as well as other international organizations, including the IFC (regarding crop receipts, which eliminate another

barrier to increasing agricultural finance and associated with a steady reduction in collateral), developed systems of business planning (such as AgriAnalytica).

The government is aware of the need to increase agriculture finance. But it is economically justifiable not to provide direct funds for production, but to help ensure that the borrowed funds contribute to increasing agricultural efficiency. This can only be done by compensating a part of interest rate.

Government support in compensating a part of interest rate will help attract 10 times more funds per one hryvnia from the budget, and we know that the budget funds are rather limited. But at the same time the area and efficiency of their application is multiplied in many times. Farms receive an opportunity to engage in a normal developed production cycle. And they do not become consumers of gifts, but remain normal producers and get the opportunity to develop. This creates and strengthens the middle class of the country, which is a real reform.

That is why, the role of credit unions is now important in these programs. So far, government programs only involve banking structures. We recommend that credit unions be included as financial organizations as well. The need for this will increase even more when an Updated Law on credit unions is adopted. And credit unions will have full opportunity to work directly with the SMAPs and finance them in significantly expanded volumes.

Lyudmila Goncharenko, Deputy Director of the Department for Agricultural Development of Lviv Regional State Administration:

Lviv region is special because we have many small producers: more than 800 active farmers, many individual house plots. They feel the lack of resources needed for development, but cannot turn to the bank. We have long been running a program for repaying interest on bank loans, and when we began to analyze the effectiveness of using funds, we saw that there were no more than fifty out of 1200 business entities use the program in the region. We began to look for the cause and found out that it is that they can not take a loan from a bank.

We have a very broad network of credit unions: Anisia, Vygoda, Boykivschyna and other credit unions, and they really lend to people. So why not to attract them to lending to agricultural sector? We, together with farmers, were looking for where to get money, credit unions were looking for where to get customers from, seeking to increase the number of CU members – this is a joint work.

Our program condition is not just repayment of interest on loans, but also stimulating loans for development. The main thing for us is the organized commodity production, quality assurance and product safety. We ensure control over the fulfillment of credit conditions. In the first year of Integrated Program for Support and Development of Agro-Industrial Production in Lviv Region, we reimbursed double refinancing rate of the National Bank, and since last year we saw that we have a lot of applications and reimbursed refinancing rate of the National Bank.

We do not provide support to help people, our task is the state food security and development of agrarian sector of the economy. Our priority is diversification of rural economy, and as soon as the rural economy develops, our rural areas will develop. We stimulate loans for development. And we want to see the effect of the invested money in the agrarian sector.

The program develops: if in 2017 we redeemed one million eight hundred hryvnias for reimbursement of interest, this year we already have 2.5 million in our program.

Volodymyr Sidorovskiy, President of Credit Union "Anisia", Lviv region:

Since 2006 our credit union has participated in joint programs with the regional authorities. Initially, it was a program for energy saving (reimbursement of part of interest rate on loans for energy saving measures). Credit unions themselves initiated this program. Now "Anisia" participates in the complex "Program for support and development of agro-industrial production of Lviv region in 2016-2020". We, together with the Department of Agro-Industrial Development, worked out the ways of implementing the program. If there is a desire of the authorities and credit unions – everything is possible. It is necessary to take the experience of Lviv region, to distribute it around Ukraine and to join government programs.

Volodymyr Kazarinov, President of Credit Union "Kredyt-Soyuz", Cherkasy region:

Our credit union actively lends to farmers, and for us, participation in the program of cheaper agricultural loans would be of high importance, because our members - farmers apply for loans and ask for lower interest, but we cannot reduce them. Farmers are very interested in cooperating with credit unions, because we are flexible in lending and have specialized loan products and provide maintenance. Even considering the programs of cheaper loans in banks, farmers still choose credit unions, but they ask for a cheaper loan. Therefore, for us and our members being involved in the program of cheaper loans at the national or regional level would be very useful.

Roland Lampe, Director of Credit Union Association of the Netherlands

In the Netherlands, the agricultural sector's contribution to GDP is about €30 billion, with a total GDP of €700 billion. Traditionally, banks play a significant role in lending to agricultural producers, but in recent years more and more SMAPs are turning for loans to credit unions. It is because of the fact that providing loans to farmers in the amounts they need (up to €260 thousand) is not profitable for banks, and the risks for them are quite significant. Because of lack of knowledge of the specifics of agricultural production when evaluating borrowers, the share of loan non-repayment reaches 8-9%. In addition, the cost of working with small and far-located from the bank borrower is quite high. So farmers in the Netherlands are in the same position as 125 years ago: banks are happy to take deposits, but are not interested in lending. As a result, bank lending to agricultural producers is decreasing. Credit unions in the Netherlands are willing to provide finance lacking to farmers. At the same time, agriproducers' savings return to the credit union and at the expense of these funds they can again grant loans. Farmers know farmers' risks better than

bankers. Besides that, the cooperative structure of credit unions guarantees the customized approach in financing, giving a personal touch to saving and lending again. ACUN helps the small business entrepreneur with financing, and especially with advice and experience.