FINANCING AGRIBUSINESS BY STATE DEVELOPMENT BANKS - THE CASE OF MACEDONIA

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Abstract

In countries where agriculture has substantial role in generating domestic product, sustainable agro-finance can seriously increase economic development. It is well known that agriculture is perceived as risky to be financed by commercial banks. Therefore, creating specific agro-credit lines within state development banks is key element in enhancing agricultural activities. These state development banks, operating in close collaboration with the Government have a significant role in accelerating economic welfare of farmers and rural poor. This study tends to emphasize the importance of creating special lending products targeted towards agriculture. The focus will be put on comparison between the first pillar – direct lending to agriculture and second pillar – lending to agriculture through commercial banks showing the better viability of the later.

Keywords: Sustainable Agro-Finance, Agriculture, Risky, Economic Welfare, Rural Development, State Development Banks, Agribusiness, Direct Lending, Indirect Lending

JEL classification: E5, G2, H8, Q1

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1. Introduction

The eruption of the global financial and economic crisis in 2008 caught the governments, international financial institutions, banks and agribusinesses unprepared. Although, sensing that some problems might occur, few expected the intensity of the crisis will be that strong. After the initial shock which has totally contracted the supply of loans to agriculture and related industries, the financial consolidation commenced first, followed by the real sector and agriculture as well.

In small-scale economies as Macedonia, development banks (DB's) have the main role in this consolidation. They are commonly owned by the Government and are generally designed to support the economic development of the country by performing specific financial services which private-owned commercial banks are not interested to pursue due to high credit risk. For a state bank to be designated as development, certain conditions must be fulfilled:

- The bank should credit certain targeted sectors of major importance to the national economy (agriculture, exports, infrastructure etc.);
- The bank should operate in a strictly defined legal framework not distorting free capital market and competition;
- The bank should be self-sustainable.

Nevertheless, the opinion that DB's are only correlated to small-scale, transition or development countries is misinterpreted. State-owned financial institutions (SFIs) on average account for 25% of total assets in banking systems around the world. In the European Union, for example, SFIs represent 30% of the total financial system.[1]

One of the key questions often raised among banking circles is: *What is and what should be the role of DB's in lending to agriculture?* It is commonly avoided by banks because the agriculture is exposed to specific risks, not immanent to other economic sectors: weather conditions, poor profitability, high transaction costs, lack of collateral etc. Operating in high risk environment with narrow margin is not a 'dream come true' for profit-based financial institutions. Every Government tends to overcome this vacuum in supporting agro-beneficiaries, mainly farmers and rural poor by lending on soft-terms. But, there is practically a consensus in the financial sector that this support should not be at a cost of direct, often unfair competition to commercial banks. DB's have

[1] Thought Leader, 2012. Mail & Guardian [online] Available at: http://www.thoughtleader.co.za/leeroychetty/2012/09/26/the-role-of-development-banks-in-times-of-crisis/ [Accessed 25 May 2013]

countercyclical role by filling the gap that occurs in funding agriculture by private owned commercial banks. They should be here to help whenever commercial banks restrain to lend, i.e. in times of crisis and when 'market failure' occurs in agriculture (unstable prices, unfair weather conditions, pestilences etc.)

Macedonian Bank for Development Promotion (MBDP) is the Macedonian DB. It is a state-owned development bank of the Republic of Macedonia established by law.[2] MBDP is a pioneer in implementation financial instruments that have great support to agriculture and agro-industrial complex in general. MBDP first initiated guarantee mechanisms for lending and currently it is the only Macedonian financial institution providing credit insurance and factoring. The lending to agribusiness by MBDP is realized through:

- *direct lending* (or 'first pillar of DB's') by offering a product called **Credit line for production, processing and exports of agricultural products - Compensation Funds (CF)** that targets agro-SMEs directly and
- *lending through commercial banks* (or 'second pillar of DB's') by offering a product called **Agricultural Credit Discount Fund (ACDF)** that targets individual farmers and agro-SMEs indirectly with mediation of the commercial banks.

2. Objectives and Target Groups of Lending Products

The main objective of the CF credit line is to provide improvement of the production capabilities of micro, small and medium-sized enterprises (as defined under the Law on State Aid Control[3]) with principal activity - production, processing or export of agricultural products and their manufactured goods. MBDP disburses the funds of this credit line to final beneficiaries in a manner that the enterprises shall improve their capacity for appearance at the domestic and foreign markets and the investments, employment and competition shall increase.

The ACDF credit line is specifically targeted to smaller agribusinesses, i.e. individual farmers, rural households, agricultural, agro-processing and agro-export SMEs as well as European Instrument for Pre-Accession Rural Development Program (IPARD) beneficiaries. ACDF's main objectives are:

- to create a framework for a sustainable agricultural finance sector within the Macedonian banking system;
- to integrate the smallholder agricultural SMEs and rural population in the banking system, both as depositors and borrowers and
- to reduce the risk to beneficiaries through institutional and capacity building programs in support of sustainable commercial lending.

3. Operations

CF credit line is transferred to beneficiaries directly. As a state-owned bank, MBDP on behalf and for account of the Macedonian Government manages Funds and approves loans to legal entities registered in the Republic of Macedonia under terms and conditions set. Potential beneficiaries are submitting credit applications accompanied by other necessary documentation to MBDP premises. The Credit department, according to the Bank's credit policy processes the credit application and prepares a credit resume, stating a proposal whether the application should be accepted or declined. The final decision is with the Bank's Credit Committee for loans higher than EUR 150,000 and Special Credit Commission for loans up to EUR 150,000. The credit risk in on-lending operations is with MBDP, i.e. the Government in a manner that CF funds shall diminish whether beneficiaries should not repay.

CF is transferred to beneficiaries directly and the credit risk is with the MBDP.

ACDF is transferred to beneficiaries through PFIs and the credit risk is with the PFIs.

ACDF on the other hand is a discount or refinancing facility. Its refinancing operations are co-financing activities undertaken by both MBDP and selected participating financial institutions (PFIs). Twelve privately owned commercial PFIs (ten banks and two saving houses) are utilizing ACDF revolving fund for their agro-lending at the moment. PFIs are eligible to draw down refinancing for a percentage of a sub-loan to qualifying beneficiaries at a rate of no more than 80% that is set by the MBDP. PFIs are required to pre-qualify loans with the ACDF. They pay interest for the discounted amount at a level of only 0.5% annually that serves as a financial incentive for them to expand agricultural lending activity. The credit risk in on-lending operations is with the PFIs and there are absolutely none fiscal implications to the state budget. PFIs also provide a portion of the investment capital from their own funds (at least 20% of the loan amount) which is huge incentive for them to insist on-time repayment by their ACDF beneficiaries. Beneficiaries are also required to contribute a minimum of 20% to the cost

[2] *Law on Establishing Macedonian Bank for Development Promotion,* Official Gazette of the Republic of Macedonia No. 24/1998

[3] *Law on State Aid Control,* Official Gazette of the Republic of Macedonia No. 145/2010

of investment. The contribution is not mandatory to be in financial assets but in assets correlated to the investment credited. PFIs then repay the discounted portion of the sub-loan to the MBDP in constant EUR terms and in accordance with the repayment schedule set for each sub-loan. Individual sub-loans may also be indexed in foreign currency.

4. Lending Policies

Credit Categories:

Both CF and ACDF have three major lending categories:

- *Primary production* loans for investments in primary agricultural production (viticulture, horticulture, floriculture, livestock etc.);
- *Agro-processing* loans for investments in agro-processing industry (dairies, mills, wineries, fruit, vegetables and meat processing capacities etc.) and
- *Agro-export* loans for investments supporting agro-exports.

The differences between two credit lines are in the lending amount. While lending limit for primary production with ACDF is set on EUR 100,000 per borrower, with CF is set on EUR 300,000. The lending limit for agro-processing and agro-export is set on EUR 300,000 per borrower for both credit lines with an exception of CF where beneficiaries borrowing for working capital needed in processing wheat, grapes, milk, fruit and vegetables can borrow up to EUR 500,000.

Interest rates:

The best competitive advantage of both CF and ACDF credit lines is the interest rate cap for the final beneficiaries. The former has fixed interest rate set on 3% annually as stipulated in the Decision for the Terms and Conditions for Redeployment of Funds from the Compensation Funds from Foreign Aid.[4]

CF lending is concessional while ACDF lending is commercial.

The interest rate of the later is fixed and set to 4% annually (for borrowing through banks) and 6% annually (for borrowing through saving houses) for the first credit category and 5% annually (through banks) and 6.5% annually (through saving houses) for the second and third credit categories as stipulated in the Subsidiary Loan Agreement signed between each PFI and MBDP.

Considering that the latest yield on Macedonian state bonds is 3.5%[5], it is clearly evident that CF interest rate is subsidized by the Government and CF lending is concessional. ACDF on the other hand provides quality agro-lending by continuously promoting it as commercial, not Government subsidized under the circumstances. The ceiling on interest rates is a voluntary concession by the PFIs negotiated with the Government. They receive funds from ACDF under much favorable terms than the capital markets regime, which allows them a reasonable margin.

Other lending conditions:

The application fee for CF is set to 0.8% of the loan. The repayment period is up to 60 months for investments and up to 18 months for working capital and the grace period is up to 12 months for investments and up to 3 months for working capital. Beneficiaries should also meet certain specific criteria:

- at least 20% own participation in the total investment;
- satisfactory liquidity level and ability to repay the loan;
- positive financial results in the last fiscal year and
- to have settled all due liabilities to the Government (tax, allowances, etc.)

With ACDF, each PFI is allowed to apply their own lending policies; collateral requirements, documentation, repayment period, fees (except for the interest rates) to sub-loans. For example, the application fees vary between 0.5% and 3% of the loan depending PFI, loan amount or investment type. Repayment period varies between 6 months and 7 years, and the grace period between none and 3 years.

5. Performance Indicators[6]

CF credit line is active for only a year now, while ACDF for almost 10 straight years. In order to make an adequate, complementary comparative analysis, the performance indicators of both CF and ACDF credit lines will be analyzed only for the last year or the period between July 1st, 2012 and June 30th, 2013.

By Credit Category:

A total of 16 loans in amount of EUR 4.7 m. from CF and 211 loans in almost equal amount from ACDF have been approved in the analyzed period *(Table 1)*.[7] This capital injection into the nation's rural economy represents a substantial contribution to agricultural development. The overall amount of loans underestimates the total value of induced investments, since borrowers' own equity contributions to the associated businesses are not included.

[4] *Decision for the Terms and Conditions for Redeployment of Funds from the Compensation Funds from Foreign Aid,* Official Gazette of the Republic of Macedonia No. 76/2012

[5] National Bank of the Republic of Macedonia (NBRM)

[6] The data presented in this subtitle are from internal sources of the Macedonian Bank for Development Promotion.

[7] For comparisons and ratios see Appendix at the end of the text.

Table 1. Loans Disbursement by Credit Category

Credit Category	Amount (EUR)		%		Average Loan (EUR)	
	CF	ACDF	CF	ACDF	CF	ACDF
Primary Production	460,000	2,733,522	10	58	230,000	15,500
Agro-processing	4,273,205	1,359,958	90	29	305,229	52,306
Agro-exports	0	627,362	0	13	0	69,707
Total	**4,733,205**	**4,720,842**	**100**	**100**	**295,825**	**22,380**

It is evident that CF lending is predominantly oriented towards large scale agro-processing enterprises while ACDF lending towards individual farmers and small- scale primary production enterprises. This is no wonder considering the differences in the credit policy where beneficiaries of CF could only be SMEs, on contrary to ACDF where individual farmers are also included.

By Gender:

Even though MBDP strongly supports equal opportunities in funds availability to beneficiaries, CF shows deep gender imbalances. Only 1 credit was disbursed to a SME managed by a female manager amounting EUR 300,000 or 6%.

ACDF lending is far more balanced to this manner. Exactly 150 loans amounting EUR 2.8 m. (59%) were disbursed to male beneficiaries and 61 loans amounting EUR 1.9 m. (41%) were disbursed to women (*Note: the analysis also includes SMEs managed by both men and women*). The average loan size (EUR 18,374 for male and EUR 32,397 for female beneficiaries) indicates that women have 'more courage' when deciding to borrow and they perform better when lending and repaying. MBDP continuously informs PFIs that lending to women borrowers should be prioritized and increased to the satisfactory extent, having in mind that in some cases they are carriers of the households' rural and agricultural activities.

By Loan Amount:

Macedonian agribusiness is generally small and fractious in European terms. Individual farmers who are allowed to use ACDF funds consist large proportion of up to EUR 50,000 loans. Therefore, it's not surprising that a share of 89% of the disbursed ACDF loans and a share of 59% of the disbursed ACDF amount are loans amounting EUR 50,000 and less *(Table 2).*

Credit policy of CF on a contrary is oriented exclusively towards larger-scale agro-producers, agro-processors and agro-exporters utilizing therefore loans higher than EUR 100,000 or EUR 295,825 on average.

Table 2. Loans Disbursement by Individual Loan Amount

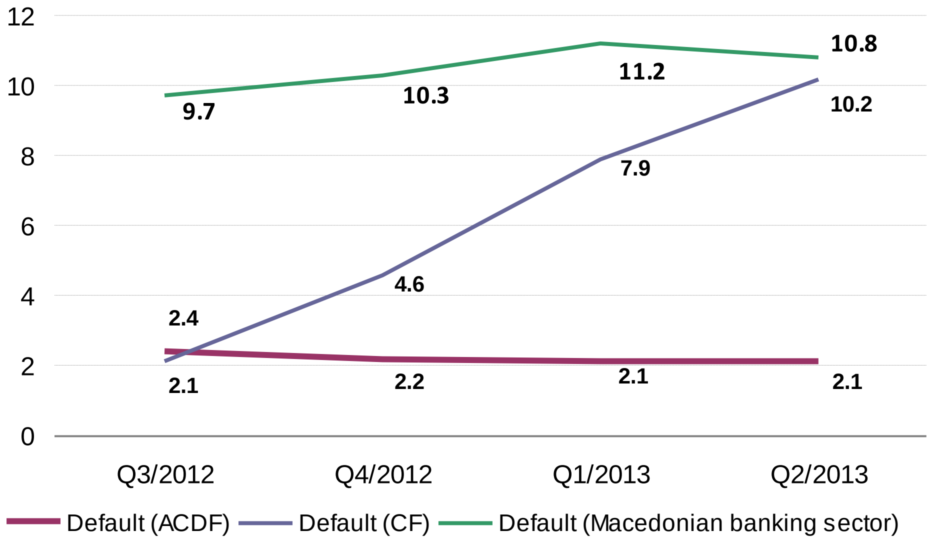
Individual Loan Amount (EUR)	Number of Loans		%		Amount (EUR)		%		Average Loan (EUR)	
	CF	ACDF	CF	ACDF	CF	ACDF	CF	ACDF	CF	ACDF
up to 10,000	0	103	0	49	0	544,823	0	12	na	5,289
10,001-50,000	0	84	0	40	0	2,227,265	0	47	na	26,515
50,001-100,000	1	22	6	10	85,000	1,709,754	2	36	85,000	77,716
over 100,000	15	2	94	1	4,648,205	239,000	98	5	309,880	119,500
Total	**16**	**211**	**100**	**100**	**4,733,205**	**4,720,842**	**100**	**100**	**295,825**	**22,380**

Cumulative Repayment Rate:

As said before, the credit risk in lending CF funds to beneficiaries is fully with the MBDP, thus with the Government. Therefore, if occur high default and a number of nonperforming loans can severe diminish CF revolving fund and can cause financial troubles in MBDP lending performance.

On the other side, the full credit risk of all ACDF-refinanced loans is with the PFIs. Their obligation is to fully repay the refinanced principal plus interest back to ACDF revolving fund at MBDP even in cases when the final borrowers delay their repayments or default. While the credit risk of individual loans is with the PFIs, it is of interest for MBDP to follow-up the actual repayment by clients. The repayment performance for both CF and ACDF is shown on *Chart 1*.

Chart 1. CF and ACDF Loans Repayment Performance (%)



Sources: Macedonian Bank for Development Promotion for CF and ACDF and National Bank of the Republic of Macedonia for the Macedonian banking sector

Chart 1 shows permanent worsening of CF credit portfolio through quarters. At the end of Q2/2013 it was brought close to average default of the whole Macedonian banking sector. Having on sight the chart trends, it is highly expectable that default of CF beneficiaries will break above banking sector's average in very near future. Several reasons are noticed to be influencing this situation:

- CF funds are disbursed directly to the beneficiaries by a state-owned bank. In practice, state-owned banks are often perceived as 'state agencies' that disburse grant money, not to be repaid back. This 'opinion' causes permanent diminishing of repayment performances causing high default.
- Risk management sectors in state development banks often are not on a quality level of their counterparts at commercial banks. The 'protection' of capital is far more extended in privately-owned than in state-owned banks. At the former there is a clear nomination of owners (shareholders) who expect high return on equity and assets. At the later, the owner is the state, i.e. 'nobody and everybody' and the protection of capital is not that strong.
- The human and technical resources in state-owned banks are often insufficient to cope with the credit risk and lending volume and quality.

Compared to CF, ACDF portfolio cumulative repayment rate (disbursed through commercial banks) is more than satisfactory and above all expectations. The worst, but still bearable result was noticed in Q3/2012. Fortunately, in 2013 only 2.1% of ACDF loans were in default. This near excellence was partly as a result of PFIs' accelerated recovering or writing off. Considering that default in whole Macedonian banking sector at the end of Q2/2013 was 10.8% (National Bank of Republic of Macedonia, 2013, Quarterly Report [online], in Macedonian language. Available at: http://nbrm.mk/WBStorage/Files/Istrazuvanje_Kvartalen_izvestaj_april2013.pdf [Accessed 4 May 2013]) it is clearly evident that ACDF beneficiaries are far more sustainable and serious in fulfilling their repayment obligations than CF beneficiaries and the rest of economic operators in the country.

ACDF beneficiaries are more serious in fulfilling their repayment obligations than CF beneficiaries and the rest of economic operators in the country.

Portfolio Quality:

In addition to cumulative repayment rate, MBDP also analyses the portfolio quality of CF and ACDF loans disbursed *(Table 3)*.

Table 3. Portfolio Quality Progress (%)

Days in Arrears	Q3/2012		Q4/2012		Q1/2013		Q2/2013	
	CF	ACDF	CF	ACDF	CF	ACDF	CF	ACDF
Up to 30	98.7	94.7	92.6	94.7	86.1	94.5	82.3	95.1
31-180	1.3	3.0	5.1	3.5	8.4	3.2	9.7	3.7
181-365	0.0	0.9	2.3	0.3	5.5	0.2	7.2	0.2
Over 365	0.0	1.4	0.0	1.5	0.0	2.1	0.8	1.0
Total Outstanding	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

The portfolio quality progress only confirms the previous statement. Arrears of CF portfolio are longer from quarter to quarter, while arrears of ACDF are pretty much constant. Anyway, the outstanding portfolio with up to 30 days in arrears with both credit lines is over 80%. This is considered to be highly satisfactory. Namely, due to the specific nature of agriculture and agro-processing industry, up to 30 days delay in agro-lending is not considered risky. Furthermore, it is commonly known that financial institutions not always follow the sector's specific inflows and outflows when creating repayment schedules. Therefore, an up to 30 days repayment delay in agribusiness should practically be considered as unnoticeable.

Collateral:

The collateral with CF could only be mortgage on intangible assets or a bank guarantee as defined by the Government decision (Official Gazette of the Republic of Macedonia No. 76/2012).

With ACDF, PFIs have full discretion in collateralization according to their own policies and procedures, since they carry the risk of loans repayment to MBDP. All available instruments provided by law: tangible collateral (mortgages and pledges) and soft collateral (personal guarantees, cash cover, insurance policies, bills of exchange etc.) are used *(Table 4)*.

Table 4. Collateral requirements (%)

Type of Collateral	CF	ACDF
Personal guarantees (guarantors)	0.0	59.5
Mortgage on housing and production facilities	81.2	31.3
-urban	50.0	19.2
- rural	31.2	12.1
Bills of exchange or other securities	0.0	29.4
Mortgage on agricultural land	12.5	18.9
Pledge on tangible assets (equipment, mechanization, herds, vehicles)	0.0	5.9
Cash cover, banks/guarantee funds guarantees, insurance policies	25.0	4.7

*(**Note**: Some loans were covered by two or more collateral instruments).*

Applications Rejection:

The risk of default requires a specific in-depth analysis of credit applications mainly articulated by both quantitative and qualitative parameters. Unfortunately, sometimes one, several or all of these required performances are not fulfilled by the applicants, creating therefore grounds for rejection.

As said before, decision making for CF loan applications is on MBDP's Credit Committee/Special Credit Commission. As of end of June, 2013 exactly 41 applications were decided of which 16 approved and 25 declined or 60.9% rejection rate.

The decision making for ACDF loan applications is bi-leveled - on PFIs' credit decision bodies and later on the ACDF Credit Committee consisted of representatives of MBDP, Ministry of Finance and Macedonian IPARD Agency. The cumulative loan applications' rejection analysis for the analyzed period indicates that 20 out of 231 loan applications received have been rejected by the PFIs' credit committees, which is 8.7% rejection rate.

The most common reasons for rejection of the loan applications by credit decision bodies are presented in *Table 5*. It is noticeable that indebtedness and insufficient collateral are still an "open wound" for potential agricultural investors.

Table 5. Reasons for Loan Applications Rejection (%)

Reason for Rejection	CF	ACDF
Indebtedness	52	35
Insufficient Collateral	20	15
Insufficient Business Volume	13	10
Incomplete Documentation	15	10
Cancelation by Applicants	0	30
Total	**100**	**100**

6. Findings

Implications on beneficiaries:
MBDP agribusiness credit lines' most obvious impact on beneficiaries is *decrease of rural poverty*. The financing operation successfully reached large-scale enterprises as well as small-scale, asset poor households. The outcomes from the regular monitoring and assessment show that these borrowers develop their businesses and become economically stronger and viable with the realized investments.

The MBDP beneficiaries *improved their competitiveness* by modernization of equipment and production technologies as well as higher products' quality and value added. Over EUR 5.5 m. were spent by agro-processors for working capital, production equipment and restructuring production techniques in order to keep pace with the modern technologies.

MBDP operations *decreased the unemployment rate in agriculture* by engaging labor on farms and agro-processing companies. Individuals are engaged on longer term basis in agriculture, having larger income and feeling more secured. The number of employees in agro-processing companies has permanently risen also. The very poor, including those without agricultural assets, gained access to seasonal employment arising from higher production, enhanced marketing and increased employment requirements for product handling, sorting and packaging at the processor level.

Last, but not least, crucial importance of MBDP agro-credit lines is *increased income to beneficiaries*. Considering 5% agricultural BDP growth in 2012, these investments resulted in total value added of about EUR 1 m. in the last year.

MBDP succeeded in decreasing rural poverty and unemployment, improving competitiveness and increasing income to its beneficiaries.

While CF strategy is predominantly oriented towards financing agro-processors, ACDF strategy was recognition of the family farm as core entrepreneurial unit in the emerging market-oriented rural economy in Macedonia. By directing agricultural financial support to such, it was expected not only to improve the standard of living of farm families, but also to impact favorably on other rural poor with no access to agricultural assets. Farmers and other rural entrepreneurs have become increasingly connected to the formal financial sector on a systematic and commercially viable basis. Greater production entailed an increased labor requirement and contributes to absorbing new entrants to the labor force. Intensification of production has increased the demand for on-farm labor and suppliers of inputs, while increased output offered scope for private investments in processing and trading enterprises, thereby creating further employment opportunity and means to enhance linkages in the rural economy. The appropriateness and success of the ACDF approach can be measured not only in terms of the absolute number and amount of loans refinanced, but also in terms of the wider effects induced among PFIs and the target population.[1]

Impact on MBDP operations:

Comparing the results of the outreach, recovery rate and aging portfolio analysis between CF and ACDF portfolio it is evident that for state-owned development banks when lending, 'second pillar' operations, i.e. indirect lending through commercial financial institutions is much more successful than the 'first pillar' operations, i.e. direct lending to beneficiaries. General reasons for this are:[2]

- *Large-scale subsidized programs generally do not reach low-income households*. Because of capital constraints, subsidized loans are effectively rationed. When interest rates are subsidized, rent-seeking behavior by borrowers, combined with the relatively high costs to lenders of making small loans, ensures that institutional loans are routinely channeled to larger borrowers.
- *Subsidized credit programs, especially in state-owned institutions, often have high default rates*. Subsidized loan programs have been widely reported to experience high default rates. This shortcoming is especially pronounced in subsidized rural credit programs in state-owned financial institutions. Partly because borrowers tend to be

[1] Efimija Dimovska, 2010. *Bringing Finance to Rural People-Macedonia's Case*; EastAgri Annual Meeting; Istanbul [pdf] Available at: http://www.docstoc.com/docs/68827478/Bringing-finance-to-rural-people [Accessed 18 May2013]

[2] Marguerite S. Robinson, 2001. *The Microfinance Revolution, Sustainable Finance for the Poor.* The World Bank, Washington D.C. pp. 142-147

locally influential individuals (rather than the poor) and because lending is often seen as a political entitlement rather than a business transaction, lending institutions typically put little effort into collection and usually do not foreclose on collateral in case of default.

- Subsidized credit, channeled to local elites, buys political support for governments. Once offered it is difficult to dislodge. The difference between credit as agricultural input and credit as finance is well understood by borrowers around the world - if not always by their creditors. Influential borrowers, quickly learn to take advantage of the below-market financing available to them (especially desirable because of the high probability of avoiding repayment altogether). In many countries such low-interest credit is used for a wide range of business and household expenses, as well as for on-lending or saving at higher interest rates.
- *Borrowers bear high transaction costs*. Lending institutions providing subsidized credit typically impose time-consuming and cumbersome procedures that can result in high transaction costs for borrowers as well as in significant opportunity costs of the borrowers' time spent waiting in line and in making return visits.
- *Loan products are inappropriate for borrowers' needs*. Loan products in subsidized credit programs are usually rigidly determined; the purposes, amounts, and terms of loans are prescribed with little or no regard to borrowers' needs and income flows generating therefore defaults.
- *Bank staff time is used unproductively*. Banks' staff working on subsidized credit programs typically spends their time in unproductive ways. For example, they may engage in futile monitoring of the end use of loans-which cannot be effectively monitored because credit is fungible.
- *Subsidized credit prevents the development of sustainable financial institutions*. Large-scale subsidized credit programs depress, in one way or the other, the development of sustainable financial intermediation at the local level. The low interest rates of subsidized loan programs discourage deposit mobilization, Credit subsidies often depress savings because revenues are too low to cover the operating costs of effective savings mobilization. Far from being sustainable, many institutions providing subsidized credit programs, especially state-owned agricultural credit institutions suffer from political interference, unmotivated staff, unwanted products, low repayments, high costs and high losses.

Free of these restraints on the other hand, ACDF operations have managed:

- *To create a framework of a sustainable agricultural finance sector within the Macedonian banking system*, through establishment an agricultural refinancing facility. After ten years of operation, ACDF has undoubtedly achieved it. All PFIs now actively use the ACDF scheme to start their lending operations to small rural clients from their branch offices and have started to compete of clients by offering ACDF-refinanced loans.

ACDF lending strengthened the competition and created a framework for sustainable agro-finance, hence expanded rural lending of its financial partners.

- *To increase competition among PFIs* in attracting new clients and made the loans more available to individual farmers, i.e. the loan terms (interest rates, repayment periods, collateral requirements, fees etc.) became more favorable. While there is a voluntary interest rate cup for ACDF loans, the repayment periods finally followed the specific needs in agriculture. The collateral policy was further relaxed by accepting mortgages on rural housing/production facilities, agricultural land and pledge on agricultural mechanization/equipment. Fees have also been decreased in some cases by more than 50%. This "positive transfer" of appropriate approaches to service delivery and products between banks is among the key measures originally identified for ACDF success.
- To convince PFIs to notice the financial potential of agriculture. As a result, *the PFIs agribusiness credit portfolio has dramatically expanded*. The share of agricultural credit portfolio in their total credit portfolio had risen from 13.4% to 35.9% and the agricultural credit portfolio had increased by 168%.

7. Conclusions & Recommendations

For Beneficiaries:

MBDP as a development bank has the most favorable credit lines for agriculture and agro-industry on Macedonian capital market. Nevertheless, during the analyzed period, small portion of farmers and agro-enterprises has applied, thus financed. This appoints

It is of great importance for farmers and agro-SMEs to be in constant search of improvement their competitiveness. One of these efforts is permanent and on-time information about availability, criteria, preconditions and innovative concepts of financing. Once these finances are located, next is doing all the best to meet their prerequisites in order to obtain them easily.

to certain lack of information among stakeholders about the possibilities of gaining cheap finance to their agribusinesses. Even the ones who are aware of the existence of such funds are sometimes reluctant to fulfill policy conditions required for granting a loan.

For MBDP/Government:

ACDF refinancing activity is an original method of soft subsidy to interest rates not in contrary to WTO Agreement on Subsidies and Countervailing Measures. This operation prevents direct subsidies on interest rates (forbidden by WTO) and states them as a voluntary concession by the PFIs in order to expand their outreach. We have shown that it was effective way to encourage lending to agribusiness.

However, foreign credit lines of which ACDF revolving fund is consisted of (from International Fund for Agriculture Development-IFAD[3], The International Bank for Reconstruction and Development-IBRD[4] and the European Investment Bank-EIB[5]) are in deep process of repayment to the foreign creditors. This creates continuous decrease of available funds for further lending to target groups. At the end of Q2/2013, ACDF account had balance of only EUR 1 m. liquid funds and EUR 16 m. receivables from PFIs which at the same time are liabilities to the international creditors due by 2016.

Compared to ACDF, CF is much more capitalized. As of Q2/2013, CF worth EUR 6 m. liquid funds and EUR 4.7 receivables from previous disbursements.

Having in mind the findings of this analysis, the Macedonian Government should acknowledge the crucial role ACDF has played in the past ten years and should foresee the role ACDF can play in the future regarding the usage of EU pre-accession funds. In short to medium-term, country's emphasis on rural development as part of the EU convergence process is expected to ensure that preferential refinancing rates will continue to be available through ACDF in order to encourage higher levels of PFI investment in agriculture and related industries and serve rurally-based customers (Dimovska E., 2010).

This capitalization will ensure additional EUR 10.7 m. to ACDF account and should meet the financial needs of the target group on short to medium-term, once majority of liabilities to foreign creditors are repaid. Providing agricultural sector with preferable credit lines under terms and conditions acceptable to each farmer and SME will became a challenge for using favorable funds for achieving EU goals and standards. These loans would ensure resources for financing agriculture and rural development projects, thus preparing them to use European pre-accession IPARD fund in near future.

For these purposes, the Government should transfer the remaining funds from CF to ACDF account along with the administration of the receivables and the lending operations for agribusiness at MBDP to be further continued at ACDF conditions.

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Appendix

Year	2004	2005	2006	2007	2008	2009	2010	2011
population (thousands)	2,033	2,037	2,040	2,043	2,047	2,051	2,055	2,059
Inflation (end of year %)	-1.9	1.2	2.9	6.1	4.1	-1.6	3.0	2.8
GDP (m. EUR)	4,442	4,813	5,231	5,966	6,720	6,704	7,058	7,504
GDP (growth %)	4.6	4.4	5.0	6.2	5.0	-0.9	2.9	2.8
GDP agriculture (m. EUR)	491	507	545	484	481	567	554	613
GDP agriculture (growth %)	6.4	0.3	4.8	-2.9	-1.2	17.8	-1.9	10.7
State expenses (m. EUR)	1,437	1,635	1,728	1,920	2,289	2,275	2,500	2,600
MAFWE expenses (m. EUR)*	28	33	47	46	76	84	105	92
Deficit (% of GDP)	0.0	0.2	-0.5	0.6	-0.9	-2.7	-2.4	-2.5
Credit portfolio (m. EUR)	951	1,150	1,507	2,094	2,809	2,910	3,169	3,459
Credit portfolio (growth %)	4.3	4.1	6.7	9.9	10.7	1.5	3.0	3.6

* *Ministry of Agriculture, Forestry and Water Economy*

Sources: State Statistical Office of Macedonia and National Bank of Republic of Macedonia