Managing rural finance for growth and poverty alleviation in Moldova - towards an efficient European integration

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Abstract

At present, though, Moldova's leadership puts the question more actively – it declares that European integration is an external policy priority of the country. The Government has finally prepared the Concept for European Integration, which emphasizes that "on the internal level the actions of the Republic of Moldova will be mostly oriented towards meeting the Copenhagen criteria". And further on: "a progressive economic development of the Republic of Moldova represents the basis for the improvement of economic environment and consolidation of the relations with the EU. Promotion of structural economic reforms is a way to modernize the Republic of Moldova, to lessen and gradually eliminate gaps between developed European states and to create a functional and transparent market economy compatible with the EU principles, norms, mechanisms, institutions and policies".

Keywords: *Concept of European integration; Managing rural finance; Poverty alleviation; Structural economic reforms.*

Introduction

Moldavian agriculture under the transformation process has being influenced by many economic, social and other phenomena, one of the most important parameters in this context becoming the emergence and rapid development of an adequate financial and crediting system. The rural sector in Moldova accounts more than half of total employment and approximately two-thirds of rural employment is in agriculture. A healthy and well-functioning rural finance system can help in achieving two policy objectives: accelerating agricultural growth and reducing poverty. In Moldova today, however, existing credit system is not helping to attain these objectives. Investment in agriculture is low, and productivity growth in this sector is therefore stagnant. The international practice regarding the development of rural financial and crediting structures, the issues faced by economies in transition in this field have been elucidated in the papers of such scientists as Gutu I., Petrick M., Ditges C. and others [1; 3].

Methodology and material used. A monographic survey has been developed during the period of transition of agricultural sector to market based relations, in order to identify the best incentives to be used for an adequate development of financing instruments in agriculture. The survey presumed the use of research methods such as: statistical method, which involved application of group methods analysis, monographic method, analysis of development indexes, comparative method etc. The information was delivered by the National Statistics Bureau of the Republic of Moldova, as well as by NGOs involved in assessing the trends of country's agricultural sector development, and author's investigations in this field. At the same time, the practice of developed countries was significant in identifying the steps to be taken in this sector and finally in achieving the goals of sustainable development and poverty alleviation.

Results and discussion. The breakup of collectivist structures and the virtual disappearance of most of the centralized upstream and downstream support services have left the new, private land owners without important service support needed to act efficiently and productively and to dispose of their output effectively and profitably. A rural Gap Assessment (1999) and a Baseline Survey (2001) confirm the critical lack of services to support agricultural production.

Since Moldova is not a real candidate for the EU membership in the mid-term perspective, there is enough time for adaptation of its economy to the European criteria as an "EU neighbor" [5]. But, to speak about integration, in European agriculture in particular, means to pose for discussion one of the most complex and difficult problems our country is confronted with nowadays [6, p. 51]. Moldova is a small, agriculturally rich land. Fifteen years ago it was still maintaining the 6th place among the former union republics concerning food production volume, yielding only to the territorial giants – Russia, Ukraine, Kazakhstan and Uzbekistan [1, p.210]. Unfortunately, due to the slow achievement of the economic reforms, agricultural production has declined lately. For a prospective EU integration the domestic producers should partially reorient their directions of commercialization and suit the criteria posed by the European market.

The future position of the Republic of Moldova as an EU neighbor will depend mostly on the economic policy pursued today. On the whole, the nature and direction of reforms initiated in 90's – given all their inconsistency and contradictoriness – transformed a centrally planned economy into a market one.

Over a short period of time economy of the Republic of Moldova firstly went through a sharp downfall (by 2/3 as regards GDP), later endured a stable depression (aggravated by consequences of the Russian financial crisis of 1998) and, finally, during the last seven years, experienced renewal of economic growth, increasing internal consumption and incomes of the population.

Moldova's economy and its trade, earlier fully oriented to the East, have started to turn gradually to Europe. Thus, in 2007 more than 1/3 of Moldova's export fell on EU and CEE countries. To a certain degree, this was facilitated by realization of the Partnership and Cooperation Agreement between the EU and Moldova (since 1998). Priorities realized now by both parties are as follows: negotiations on a Free Trade Area, investment promotion, customs and cross-border cooperation, justice, home affairs and legal approximation.

Moldova's narrow agricultural economy is partly a function of geography, which endowed it with a favorable climate, and the fertile "black earth" that covers more than three-quarters of its agricultural land. It is also a function of the extreme economic concentration favored by Soviet economic planners. For decades, Moldova acted as a major supplier of food and beverages to the other republics, providing almost 20 per cent of the Soviet Union's grapes and wine, 30 per cent of its tobacco, and 10-15 per cent of its fruit and vegetables. This economic concentration intensified even further after independence, when Transdniestria's secession from the rest of the country deprived Moldova of much of its industrial capacity, since Soviet planners had situated most of the country's heavy industry and electricity generating capacity in Transdniestria. The importance of the farming sector in the rest of Moldova rose sharply as a result, and the industrial sector become disproportionately reliant on agro-processing plants. These plants now account for over half of total industrial output, with wine alone responsible for one quarter of total manufacturing sales. In terms of exports, the economic concentration is even more extreme, with agriculture and agro-processing accounting for nearly two-thirds of export revenue.

In this context, the integration processes, globalization processes, and liberalization of international trade also accompany the restructuring of national agriculture. Agriculture, the backbone of Moldova's national economy, is following a difficult path of reforms of reorientation from a centralized economy, mainly based on public property, towards an economy oriented to market relations, based on private property. By 2007, agriculture still remains the key-sector of the national economy. Together with the food industry it ensures 35% of GDP and holds a considerable share (about 65%) of export volume. Also, more than 36% of the active population is directly engaged in the agricultural production. That's why an accurate agricultural policy is the basis for the prospective development of the country, in order to overcome the crisis and to get better quality products.

The internal agricultural and food market of the Republic of Moldova is limited by those only 3,5 million consumers and is conditioned by their buying capacity. The agricultural and food production, even in this situation of profound crisis, clearly exceeds the necessities of the inner market. The situation created on the inner market for this important segment of the national economy imposes the penetration of agricultural and food products on the external markets.

The outer market of agricultural and food products accounts about 2/3 of the total export of the Republic of Moldova. Moldova's unusually narrow economic base has rendered the need for meaningful structural reform that much more urgent. In order to reduce the serious risks posed by bad weather, Moldova needs to encourage the expansion of industries and services not related to the agricultural sector. Even then, as agriculture and agro-processing will inevitably remain of undeniable economic importance, Moldova also needs to boost competitiveness in these traditional sectors. Without greater competitiveness, these sectors will find it difficult to penetrate the EU market, which offers no concessions to key Moldovan exports such as wine, fruit or vegetables, yet appears to be the most obvious alternative to the less predictable Russian market. Shifts in Russian trade policies and import demands have repeatedly underlined the need to diversify into new markets, most notably following the collapse in exports to Russia during the rouble crisis in 1998, and more recently Russia's decision to introduce quotas for key Moldovan exports such as sugar, tobacco and liquor.

To this end, national agricultural and food policies must diversify the export in geographical terms, orienting as well to the EU member countries from the following reasons:

I. The European Union imports from the Central and Eastern Europe (Moldova being a part of) pork meat and poultry meat products, live cattle, fruits and vegetables, rape seeds, tobacco and wine. Moreover, it imports exactly what represents our best export card.

II. The Common Market has become sufficiently favorable for the Republic of Moldova due to:

1) the Partnership and Cooperation Agreement according to which [2, p.24-25]:

- the parties accord to one another most-favored-nation treatment in all areas (art.10);
- the principle of free transit of goods is an essential condition (art.11);
- goods originating in the Republic of Moldova and the Community respectively are imported into the Community and the Republic of Moldova respectively free of quantitative restrictions (art. 13).

2) the generalized system of preferences according to which for the agricultural and food production exported from Moldova the customs duties reduce as follows:

- ✓ for the first group of products which, by the way, includes almost all fruits and vegetables, sediment-free wines and some sort of tobacco, the custom duty reduces by 15%;
- ✓ for the second group which, among other things, comprises nut fruits, some frozen, conserved or dry fruits, natural wines from grapes with natural or aromatized extract, cigarettes, some kinds of dark tobacco if fermented, the custom duty is decreased by 30%;
- ✓ for the third group which, among other things, includes whole nuts, light cigarettes and sorts of tobacco, tobacco residues, it reduces by 65%;

- ✓ from the forth group, which is entirely free of custom duty, we could export oils of oil-bearing plants, perfumery and cosmetics products, frozen pork meat, bovine meat, beans, etc.

3) Beginning with 1st of March, 2008, the Republic of Moldova disposes of its Autonomous System of Commercial Preferences with the European Union.

Evidently, under these sufficiently advantageous conditions, one require adequate policies as well from the side of public national authorities to enhance the export of agricultural and food products to the European market. Integration into the European Community and promotion of agricultural and food products on the Common Market represent the opportunities which must be turned to account by the Republic of Moldova through:

- impelling the signing and implementation of a new strategic Agreement with EU;
- implementation of the strategy for European integration and spacing out the activities of harmonization of the national legislation to the community regulations;
- development and putting into application of market economy mechanisms to get through competition pressure and market forces from the inside EU.

A country like the Republic of Moldova, lacking strategic resources (energetic, raw materials), is much more sensible and vulnerable to the changes occurring on the outer markets, and prices of imported goods. The high costs of domestic production dependent on the increasing costs for imported raw materials, especially for energetic ones, make uncompetitive autochthonous production both on the external and inner markets. This leads to the reduction of aggregate revenues and lowering of the population’s living standard.

The required services include the provision of information on prices and market requirements, on legal rights and obligations, on access to capital and input markets, and on agronomic and business practices. These gaps create significant inefficiencies at all stages of the production and marketing chain, and many of the new farmers are compelled to limit themselves to subsistence production.

The initial distribution of land and asset shares only is not sufficient to sustain successful agrarian reform, fuel a resurgence of agricultural production and increase rural incomes. The capital assets of the old agrarian structures that were transferred to the new owners do not match the size or meet the needs of the new rural enterprises, and many are now so deteriorated that they are useless.

A functioning land market would allow consolidation of land ownership in the hands of those who are willing and able to farm, while allowing others to unload the land in return to other assets that would allow them to engage in alternative economic activities.

The lack of access to finance has negatively affected rural growth. The specific of agriculture force the producers to search for external funding. In the years 2000-2007, the total share of agriculture and agro-related businesses in the economy of Moldova is 45-35% while lending to this sector is just about 25-20%. The biggest share (60%) of the loans were disbursed to processing industry, 29% - to all kind of the suppliers and only 11% to the farms. Newly created private farmers do not have cash or other assets to use as collateral to make the equity contribution required by commercial banks. While land is legally allowed as collateral, commercial banks, considering limited transactions on this market, are still reluctant to accept land as full value collateral.

Access to financial services is particularly important to post-privatized farmers and rural entrepreneurs, so that they can take the advantage of the recent market reforms to adjust input use, modify output mixes, according to market signals, and invest in new technology to improve the productivity of their land and labor.

They particularly lack the means to finance appropriate farm machinery and inputs, including quality seeds of appropriate varieties. Emerging agro-businesses similarly lack the means to invest in adequate storage, grading, packing, processing and distribution equipment, and facilities. With the exception of relatively large-scale, commercial farms with adequate fixed assets to use as collateral, most of the small-scale, private farmers and the newly emerging

Private farmers have insufficient access to credits. One of the main reasons of such insufficiency is the excessive prudence of banks caused by the fact that most farmers have negligible property unacceptable as mortgage. Naturally, the banks tend to issue loans to the farmers with more developed entrepreneurial sense with the condition that they assure the complete reimbursement of borrowed money and will fully pay the accrued interest as agreed in the contracts.

Commercial banks are reluctant to lend to farmers and rural entrepreneurs due to the following:

(a) the typical loan size is too small and related transactions' costs are too high;
(b) small-scale clients do not normally comply with collateral requirements;
(c) lending to the rural sector is perceived to be risky due to a lack of past lending history, accounts, and client information; and
(d) the still imperfect legal system to enforce loan recovery makes repossession and disposal of pledged assets extremely difficult.

Contrary to these concerns, many of the new farms and rural enterprises have demonstrated potential for growth and for income-generating investments, assuming they can provide sound business plans and propose bankable investments.

The ways to reduce these constraints are as follows:

1. providing training to lenders until they are more familiar with lending to rural clients, including farmer organizations, which will help reduce both the bias and "perceived risk" associated with small loans;
2. organizing farmers to capture economies of scale, increase average loan size, and continue the wholesale lending to Savings and Credit Associations to reduce transaction costs;
3. providing a one-time grant to substitute for the lack of equity; and
4. streamlining lenders' internal procedures for dealing with problem loans.

Conclusions

This paper argues that a properly designed rural finance system in Moldova must pursue following objectives:

- access to credit should not be hampered by policy or market failures to restrict productivity growth in agriculture;
- credit should be available to promote sustainable development of sector's activities;

- policy interventions that create special lending institutions to meet the first two objectives should be subject to conditions that ensure financial survivability by reducing and ultimately eliminating theirs depend on subsidies;
- when scarce credit is targeted at special groups of farmers or the rural poor, transparent criteria must be established to continuously evaluate targeting performance;
- credit must be made available for non-agricultural rural activities also, in order to develop an adequate infrastructure and processing industries in rural area.

However, one must consider that the viable and efficient functioning of the financial system in agrarian sector will be possible only if the inputs of the farmers increase. Existence of such services as business-consulting, shipments of production resources, managerial and marketing services, etc. are mere preconditions for the efficient functioning of rural financial system, nevertheless, they continue to convince the financial institutions not to evade from serving the agricultural sector.

Promoting the agricultural and food products export remains a vital issue in the economic policy of our country. The promotion of Moldovan food products on the Common Market may be extended only though coordinating the national interests with the ones of the EU member states. With that end in view, the following measures are necessary:

- utilization of investment tools with the object of offering incentives under the form of fiscal facilities to exporting enterprises;
- application of a coherent, stable tax regime, adequate for export stimulation;
- maintaining a stable evolution of the exchange rate of the national currency and its correlation with the convertible currencies of countries with which Moldova has trade relations;
- modifying the legislation with regard to public acquisitions, taking into consideration the big deficit registered in the balance of trade of the country (one of the deficit’s causes is the import of production similar to the one that is produced in the country, but of better quality);
- development of branches producing agricultural and food products which would substitute the imported ones;

• stimulating the competitiveness of all branches from the national economy;

• altering the structure of external trade and increasing the weight of exports goods with a higher value-added.

Only realistic policies and concrete strategies based on the experience accumulated by the countries with prosperous agriculture and on our real possibilities could overcome the difficulties existent in the agricultural and food sector and promote domestic agricultural and food products on the European Market.

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