1. Relevance of the scheme

In recent years, the ownership and production structure of the Hungarian agricultural sector has changed significantly. The number of farms has decreased and the average area of land cultivated by individual farms has increased. Three percent of business associations and two thirds of individual farms use less than 1 hectare of agricultural land. The majority of the former work on lands the size of which is between 20 and 50 hectares, whereas the size of the land cultivated by most individual farmers is under 1 hectare. Bank finance is available for farmers using large areas of land, as the large amounts of land-based subsidies provide farmers with a balanced steady income that makes the lending risk acceptable to profit-oriented commercial banks when financing these farms. However, the financing of micro-farmers, who typically operate as "primary producers", represents a risk that is no longer acceptable to commercial banks operating under strict money market regulation. Also, the favourable subsidised microcredit schemes offered recently were not available to those operating in the agricultural sector due to EU regulations.

In view of the above, it can be reasonably argued that it is in the national economic interest of the state to provide resources to these self-employed farmers and agricultural micro-enterprises, which have only limited access to bank finance, through a new publicly funded **National Agricultural Microcredit Scheme**.

Typical areas where state intervention may be justified

On the one hand, **livestock farming** and labour intensive **fruit and vegetable production** could be one of the potential areas of intervention, as producers without arable land and pasture (due to the lack of land-based subsidies) are in a much more difficult financial situation than the producers of arable crops.
The perception of **individual farms** (despite their good liquidity position) is undermined by the high proportion of land in their assets, which is difficult to mobilise and therefore does not provide banks with sufficient legal security. Therefore, individual farms have more difficulty in obtaining bank credit than collective farms.
For farmers who do not have access to bank loans, direct financing would be very much needed, especially:

- to purchase current assets, input materials - seeds, fertilisers, chemicals, medicines, fuel, spare parts, etc.;
- to finance other investments, the extension and/or improvement of existing business property or leased infrastructure, and to finance the launch, expansion or development of an economic activity, including the purchase of current assets meeting these conditions;
- to purchase smaller tools (e.g. disc plough, plough, etc.), machinery and spare parts (new and second-hand);
- to purchase agricultural land and intangible assets (technology developments, know-how);
- to pre-finance grants and tender funds that farmers can apply for;
- to finance tender funds as well as the own contribution part of major investments (The own contribution requirement of the new tender funds is expected to greatly increase the need for enterprises to borrow to finance their own contribution.)

Surveys show that in Hungary, a significant proportion of people with 50-60 ha (and less than 50 ha) of land do not take out advance loans for land-based subsidies. Typically, due to the small loan amount requirement (HUF 2.5 – 3 million) and the conditions set by the banks, this option is not available to farmers through banks. This amount is set aside for input materials in anticipation. If this large number of farmers could raise funds, the amount previously budgeted for input materials could be used for developments, small machinery investments or even for stock increase, as the banks do not deal with them because of the size of the amount. According to our information, 80 – 100 thousand farmers nationwide receive / apply for subsidies based on their lands, which are not large amounts.
In case of livestock farming there is no regular support for farmers, and there is no form of financing developed yet. The average age of those working in agriculture is typically high, but an active young entrepreneurial class has appeared and a generational renewal is taking place. In the interest of development, young farmers should also be

supported in the form of loans, as this group is more flexible in its response to the use of funds, which would further strengthen the sector.

2. What is social microcredit?

Social microcredit (as defined by the European Microfinance Network and the Microfinance Centre):

- a **loan of small amount** (usually smaller than the EU per capita GDP);
- proposed **for the creation or expansion of income-generating and job-creating activities or microenterprises**, in other words the financing of investments and/or working capital;
- offered to socially or financially **excluded people** (generally without collateral or credit history) lacking access to mainstream sources of finance;
- with **a social and financial inclusion objective**, on terms adapted to the analyzed repayment capacity (to prevent over-indebtedness);
- and coupled with access to high-quality **business development services.**

Social microcredit can be seen as an alternative to social grants. A non-profit approach is important for publicly funded programmes, as this is the best way to ensure the positive social impact of microcredit (*Rome Directive No. 5*).

3. Implementation guidelines

When designing the conditions and the operational mechanisms of the programme, it is recommended to take into account the professional guidelines issued by the Committee of European National Microfinance Networks (MicroFINET) for political decision-makers *(Budapest 2013, Rome 2016 – hereinafter referred to as Rome Directives)*, as this is the most appropriate way to ensure the optimal social impact of the programme.

4. Non-profit microfinance providers - *enterprise promotion foundations of the counties and the capital®*

According to Hungarian legislation, only ***the enterprise promotion foundations of the counties and the capital®*** are eligible for the financial implementation of the programme, because

- only they are entitled to provide microcredit outside the scope of the Act on Credit Institutions in Hungary, so
- only they are authorized to provide social microcredits for clients with no or reduced creditworthiness because they cannot offer adequate collateral requested by the profit-oriented organizations,
- they are the only non-profit microcredit providers in Hungary,
- they have a unique, 25-year experience and significant international recognition and awards in the field of social microfinance,
- only they provide mentoring and technical assistance together with the funding,
- only they have an established social impact measurement system or regularly measure the social impact of their microcredit activity,
- with a regional organization, they can cover the whole country through more than 100 contact points nationwide providing uniform service,
- they are able to meet all information needs with a single IT system (CREDINFO), which passed the test in the JEREMIE programme and has received international recognition,

- in the JEREMIE Programme, they achieved the best client outreach on average *(Source: 2016. Péter Vonnák: Microcrediting in Hungary – How can we optimize the social usefulness of microcredit schemes?; in terms of number of transactions per organization, the highest performance of 59.61% was achieved by the enterprise promotion foundations, significantly outperforming the performance of financial enterprises (30.85%), savings cooperatives (4.03%) and commercial banks (5.51%)).*

5. Hungarian Microfinance Network®

In its current form, the Hungarian Microfinance Network® started operating in 2013 on the basis of a voluntary consortium agreement among its members. **The aim of the agreement is to cooperate, coordinate and harmonize the activities of the Hungarian microfinance actors who have signed the consortium agreement in order to develop microfinance**.
The parties have agreed to cooperate in the further development and promotion of microfinance in Hungary to combat poverty and impoverishment, paying particular attention to the dissemination of good practices of foreign "non-bank microfinance" organizations in Hungary, in order to achieve the above-mentioned objective.
The lead organization and coordinator of the consortium is Fejér Enterprise Agency.
All the enterprise promotion foundations of the counties and the capital – that are entitled to perform microlending activities outside the scope of the Act on Credit Institutions – are members of the network.

6. Operational and funding model

One of the most important findings of the recent European Union project collecting international microfinance good practices (**Access to Microfinance for Small and Medium Enterprises -** *ATM for SMEs Interreg Europe project /Project leader is Fejér Enterprise Agency, Hungarian partner is the Ministry of Finance and Zala County Foundation for Enterprise Promotion/)* is that the best publicly funded microcredit programmes focusing on positive social impact so far are linked to **revolving local credit funds**. It is therefore important to use this approach to channel the resources provided under the National Agricultural Microcredit Scheme to the target group.
The recommended operational model:

- The consortium lead partner of the Hungarian Microfinance Network® performs the tasks of programme coordinator, therefore
- the Ministry of Agriculture signs a contract with the coordinator for the implementation and financing of the programme;
- the coordinator also concludes a contract with the local enterprise agencies involved in the implementation of the programme.
- The funds are transferred directly by the Ministry to the coordinator as leader of the consortium, who then transfers them to the eligible microcredit foundations participating in the programme in accordance with the pre-established allocation plan.
- The foundations are obliged to use the allocated funds as a revolving credit source in the National Agricultural Microcredit Scheme within the period specified in the contract.
- Monitoring (possibly internal control) of the programme through a single IT system (CREDINFO), professional feedback to funders, training, central promotion of the programme will be ensured by the coordinator.
- The allocation is determined by the Monitoring Committee, whose members may include representatives of the Ministry of Agriculture (Managing Authority), the National Chamber of Agriculture, MAGOSZ (Association of Hungarian Farmers' Clubs and Farmers' Cooperatives), and the Hungarian Microfinance Network®.
- The operation of the scheme is financed by fees and interest paid by the clients to the lending foundations.
- For the coordination costs, the foundations transfer the coordinator a predetermined percentage of the interests paid by the clients to them on a monthly basis as a reimbursement of the costs (0.5% in the first year of the programme, then 0.4% of the capital outstanding). *(It complies with Rome Directive No. 9.)*

In the operation of the National Agricultural Microcredit Scheme, the following principles should be particularly taken into account:

- The positive social impact (promoting self-employment, job creation and retention, stimulating the economy, increasing taxpaying capacity, etc.) is prioritised over keeping resources at nominal value (*Rome Directives No. 4; 4.1; 4.2*).
- During the implementation of the programme, the known high credit risk must be assumed by the funder (*within the limits set out in its internal lending policy*), which expected losses with high risk are recognised by the programme in such a way that capital loss write-offs and the costs of claims management, recovery and legal fees associated with the programme, paid for an external expert, may be chargeable to the fund (*Rome Directives No. 6; 6.1*).

7. Practical arrangements and loan products

Taking into account the significant Hungarian and international microcredit experiences and good practices of the past decades, we propose to implement the National Agricultural Microcredit Scheme according to the following main criteria:

- the funds act as a local **revolving credit line**, from which the foundation is obliged to engage in social micro-lending for the period specified in the contract, in accordance with its own internal lending rules;
- from the local Agricultural Microcredit Funds, they are obliged to offer credit products with **centrally prescribed parameters** (*e.g. those set by the monitoring committee*);
- the foundations have the right to develop and offer their **own local microcredit products**, within a framework;
- the products can be combined with central and local **interest rate subsidy programmes** provided for clients.

Main parameters of the centralised agricultural microcredit schemes proposed at the start of the programme:

Investment Agricultural Microcredit:

- Eligible businesses: farmers in the agricultural sector (primary producers, sole traders, micro-enterprises);
- Use: for investment (up to 50% for the purchase of durable current assets);
- Loan amount per transaction: HUF 1 – 10 million;
- Repayment: determined taking into account the specific farming characteristics;
- Maximum value of loan capital owed at any one time by one client: HUF 20 million;
- Duration: from 12 months to 120 months (10 years);
- Base rate: 3.9% fixed interest rate per annum, payable monthly;
- Interest surcharge: in the event of a 90-day delay (during the period of the delay), the interest rate is: "base rate" + 9% interest surcharge per annum;
- Interest on arrears: in the event of late payment, the debtor is liable to pay interest on arrears on the overdue loan capital (principal) and any unpaid interest on the transaction by the due date, the rate of which is 20% per annum;
- Deadline for using the credit: The loan agreement must be concluded within 60 days of the approval of the credit and the use of the credit must start within 60 days of the conclusion of the agreement.
- Legal collateral: real estate collateral to the extent specified in the notice of the lending foundation.

General Purpose Agricultural Microcredit:

- Eligible businesses: farmers in the agricultural sector (primary producers, sole traders, micro-enterprises);
- Use: it can be used freely for business purpose. No invoices are required to prove the use of the loan.
- Loan amount per transaction: HUF 1 – 3 million;

- Repayment: determined taking into account the specific farming characteristics;
- Duration: from 12 months to 36 months (3 years);
- Base rate: 6.9% fixed interest rate per annum, payable monthly;
- Interest surcharge: in the event of a 90-day delay (during the period of the delay), the interest rate is: "base rate" + 9% interest surcharge per annum;
- Interest on arrears: in the event of late payment, the debtor is liable to pay interest on arrears on the overdue loan capital (principal) and any unpaid interest on the transaction by the due date, the rate of which is 20% per annum
- Deadline for using the credit: The loan agreement must be concluded within 60 days of the approval of the credit and the use of the credit must start within 60 days of the conclusion of the agreement.
- Legal collateral: real estate collateral to the extent specified in the notice of the lending foundation.

Additional possible fees:

- Registration fee: for loan applications submitted in paper form: HUF 40,000 + VAT; for on-line loan applications: HUF 25,000 + VAT.
- Availability fee: **4 %** per annum on the unused loan capital (principal) at the debtor's disposal from the date of the contract concluded with the debtor for a period of **30 days** after the date of the contract until the date of each disbursement.
- Contract amendment fee: HUF 50,000 + VAT.

Agricultural Microcredit Scheme for subsidized loan interest

- In case of the Investment Agricultural Microcredit, the interest rate subsidy is 1.4% per annum (base rate 2.5%);
- The subsidized interest rate for the general purpose agricultural microcredit scheme is: 4.4% per annum (base rate: 3.9%);
- In the event of late payment exceeding 90 days, the interest subsidy will be suspended or, if the loan agreement is terminated by either party for reasons attributable to the client, the eligibility for the interest subsidy will cease to exist retroactively and the amount of the subsidy charged so far will be claimed.

The interest subsidy may be granted up to the amount of the funds made available, the allocation of the funds per organization is determined by the monitoring committee.

Proposed general framework for the local agricultural microcredit schemes:

- Eligible businesses: farmers in the agricultural sector (primary producers, sole traders, micro-enterprises);
- Loan amount per transaction: HUF 1 – 10 million;
- Duration: from 12 months to 120 months (10 years);
- Base rate: maximum 10% per annum

The microfinance institutions providing the loan will provide mentoring and advisory services for the farmers benefiting from the loan. *(Rome Directive No. 8)* Additional resources may be allocated to this activity if needed.

8. Further benefits

A further advantage of self-employment support over other employment support programmes (or social assistance) is that self-sustaining work through self-employment has a more positive impact on clients' self-esteem. It also has a positive impact on the mental well-being of the people concerned and on their efforts to create a sustainable society. The social micro-credit scheme helps to retain people in their home areas and reduce their outflow by providing viable, sustainable entrepreneurial programmes.

9. Programme launch – "pilot project"

The first phase of the launch should be a "Pilot project". The project would initially involve four or five foundations, including the national coordinator. We believe that the contracts for the operation and implementation of the programme could be concluded during February 2019. The technical and professional capacity of the participating foundations should allow them to start the programme at any time with immediate effect.

The "Pilot Project" launched under the loan parameters proposed above is projected to require funding as follows:

Budgeted source needs for disbursements (capital)	Budgeted source needs of the interest subsidy programme	Total funding needs under the plan	Possible number of farmers receiving a loan
HUF 800 million	HUF 60 million	**HUF 860 million**	80-120
HUF 4 000 million	HUF 260 million	**HUF 4 260 million**	400-600

Once the pilot project is up and running, it will be possible to assess the actual needs of farmers by analysing its progress and experience, and then to plan the conditions and resources needed for further extension of the programme with more precise parameters.

At Székesfehérvár, on 14 December 2018.

Tibor Szekfü
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