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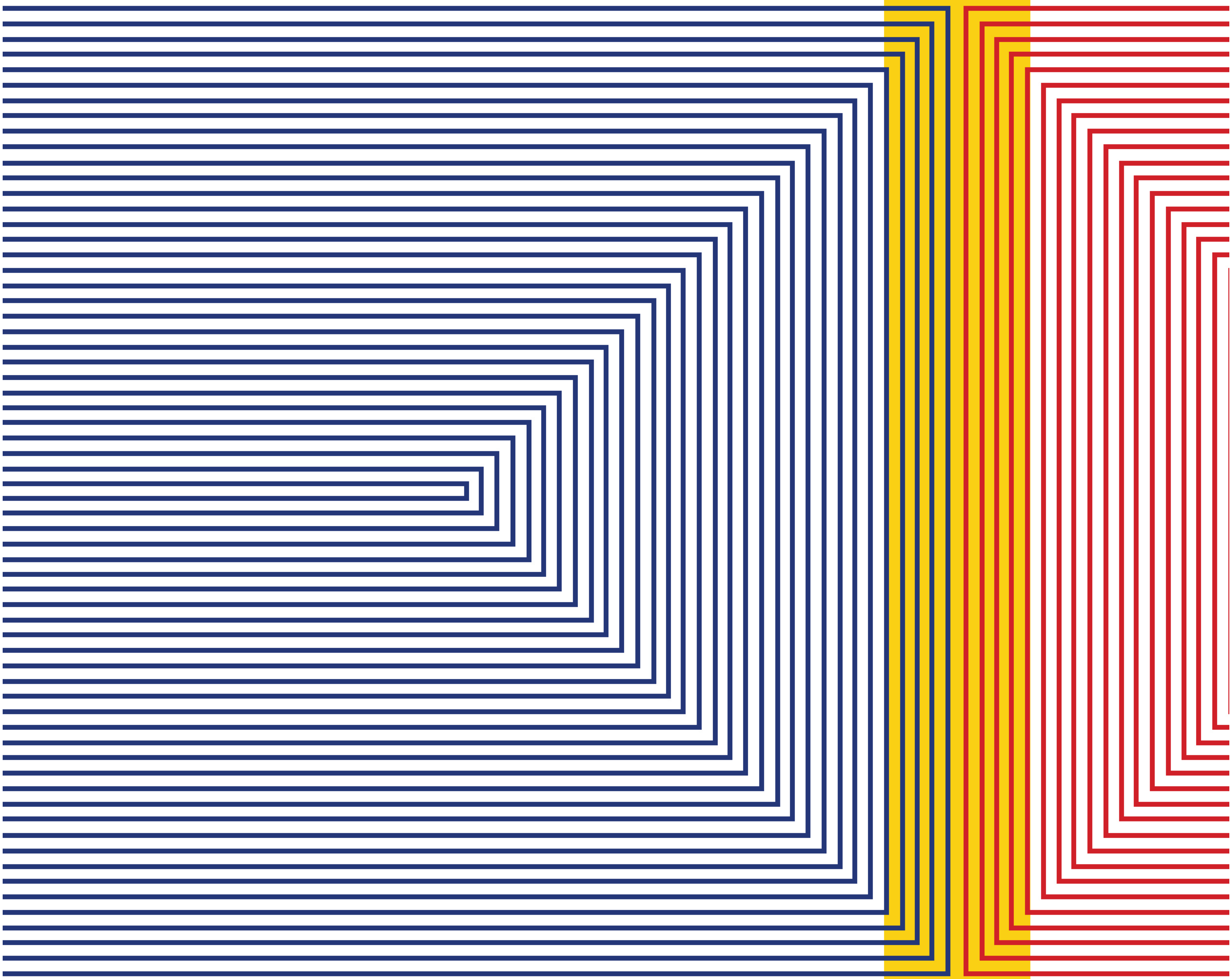

FINANCIAL INCLUSION IN ROMANIA: ISSUES AND OPPORTUNITIES

1818 H Street NW
Washington DC 20433
Telephone: 202-473-1000
Internet: www.worldbank.org

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GLOSSARY

AFIR	Agency for Rural Investment Financing
APIA	Agency for Payments and Intervention for Agriculture
CAGR	Compound Annual Growth Rate
CAP	Common Agriculture Policy
EAFRD	European Agricultural Fund for Rural Development
EIB	European Investment Bank
EIF	European Investment Fund
EMHH	Employee Mutual Help Houses
EU	European Union
FEDCAR	Federation of Mutual Aid Houses
FGDB	Bank Deposit Guarantee Fund
FGCR	Rural Credit Guarantee Fund
FNGCIMM	National Credit Guarantee Fund for SMEs
FSAP	Financial Sector Assessment Program
GDP	Gross Domestic Product
HA	Hectare
IMF	International Monetary Fund
MFIs	Microfinance institutions
MoARD	Ministry for Agriculture and Rural Development
MoPF	Ministry of Public Finance
MSME	Micro, Small, and Medium-sized Enterprises
NBFI	Non-banking Financial Institution
NBR	National Bank of Romania
NPL	Non-Performing Loan

NRDP	National Rural Development Program
PoS	Point of Sale
RON	Romanian Leu
SME	Small or Medium Sized Enterprise
UNCARSR	National Union of the Mutual Aid Houses of the Employees of Romania

INTRODUCTION

This report was prepared by a World Bank team led by Isfandyar Zaman Khan (Lead Financial Sector Specialist and Task Team Leader) and Natalie Nicolaou (Senior Financial Sector Specialist, and co-Task Team Leader) with team members Saniya Ansar (Research Analyst), Juan Buchenau Hoth (Senior Financial Sector Specialist), Danilo Queiroz Palermo (Senior Financial Sector Specialist), and Panayotis Varangis (Lead Financial Sector Economist). The information in the report is based on interviews with stakeholders, data provided by the National Bank of Romania (NBR), the Ministry of Agricultural and Rural Development (MoARD), other sources, publicly available information, relevant laws and regulations, and World Bank research.

The report aims to explore and analyze the major gaps in financial inclusion and access to finance in Romania, as identified in the Technical Note on Financial Intermediation prepared in the context of the Financial Sector Assessment Program (FSAP) (2018). The FSAP technical note analyzed the factors at play explaining the relatively low and declining level of financial intermediation in Romania for both the household and the corporate segment and offered policy recommendations to support sustainable enhancement of financial intermediation. The note made specific recommendations to support financial inclusion including: a) undertaking a cost-benefit analysis related to the further development of the mutual help houses including reviewing the regulatory and supervisory framework, b) investigating reforms of government policies to improve access to finance for rural areas and agriculture particularly focusing on small holders, and c) preparing a national financial inclusion strategy. This current report aims to build on these critical gaps in financial inclusion and provide further insights that could help policy makers in enhancing financial inclusion and access to finance in underserved areas.

The report is organized as follows: Chapter 1 conducts a geo-spatial mapping of financial inclusion and access to finance for both individuals and enterprises. Chapter 2 is a diagnostic assessment of the state of finance for agriculture and identifies constraints and potential opportunities. Chapter 3 provides an overview of the role of the cooperative financial institutions in financial inclusion especially in rural areas and recommendations how this may be enhanced.

EXECUTIVE SUMMARY

SPATIAL MAPPING OF FINANCIAL INCLUSION FOR INDIVIDUALS CONFIRMS A "TALE OF TWO COUNTRIES." Bucharest vastly outperforms all other counties in terms of financial inclusion and access to finance, with higher access to physical banking network, account ownership, value of guaranteed deposits, and access to loans for individuals than the rest of the country. For enterprises, business density is much higher in Bucharest, driven by the overwhelming presence of micro firms however access to loans for enterprises is uniformly low across regions. Only a small share (8.6 percent) of micro firms have access to loans in the country.

SMALL-SCALE FARMERS FACE SIGNIFICANT GAPS IN ACCESS TO FINANCE DESPITE SIGNIFICANT EU AND NATIONAL BUDGET FUNDS FOR SUPPORTING AGRICULTURE. The agricultural sector struggles with structural challenges and requires a holistic approach for transformation, which should also include access to finance. While financial providers have sizeable and profitable portfolios in agriculture, these focus on the medium and larger commercial farmers with significant access to finance gaps in small-scale farmer agriculture. Despite significant flows of funds by the European Union (EU) and national budget, these focus on direct support, which proportionally benefit larger firms. Key constraints for small farms are finding productive activities in which they have a comparative advantage and improving their competitiveness. These constraints can only be overcome through better linkages – infrastructure, markets, technologies, and partnerships. For the less commercial small-scale farmers, access to finance is for overall household financial needs rather than specific needs related to agriculture. The penetration of financial services to the sector could be strengthened through enhancement of the enabling environment (e.g. land titling, warehouse receipt financing), promotion of agricultural insurance, development of new products geared towards small farms, and strengthening delivery channels and institutions that can provide a wide range of broad financial products and services to these small-scale farmers.

THE COOPERATIVE SECTOR, INCLUDING COOP BANKS AND MUTUAL HELP HOUSES, ONLY PARTIALLY ADDRESSES THE FINANCIAL INCLUSION GAPS, ESPECIALLY IN RURAL AREAS. The cooperative sector provides services to segments to the population not adequately served by banks. Cooperative banks could play a stronger role in financial inclusion if they were to increase lending to micro, small, and medium-sized enterprises(MSMEs) and farmers and offer longer-term loans. The cooperative bank segment could enhance its performance and reach if existing legal restrictions to a further consolidation of the segment were to be removed. Employee Mutual Help Houses (EMHHs) and especially those interested in serving micro-enterprises and farms could also play a significant role in financial inclusion of large segments of the population if they were to diversify their services. This would either require legal changes, as well as enhanced oversight (through the Ministry of Public Finance (MoPF) or the NBR) and a financial safety net. Alternatively, EMHHs could transform into coop banks and benefit from the existing supervisory and safety net framework for the sector. In addition, a diversification of services of both types of entities would necessitate that they enhance their operational capacity and use of technology.

GIVEN THE MULTIPLE DIMENSIONS OF THE FINANCIAL INCLUSION ISSUE, THERE IS A NEED FOR A COORDINATED APPROACH. While there are some initiatives supporting financial inclusion, these are fragmented and lack coordination. The authorities should consider establishing a multi-stakeholder task force to prepare a tailored financial inclusion strategy, reflecting a digital approach, to address identified gaps.

COUNTRY CONTEXT

ROMANIA FACES FORMIDABLE CHALLENGES IN ATTAINING INCLUSIVE GROWTH. While poverty has declined, 35.7 percent of the population remained at risk of poverty or social exclusion in 2017.[1] Of Romania's 42 counties, 18 are considered to be lagging (Figure 1). In addition, disparities in living standards between urban and rural areas are striking, with Romania recording the second highest urban-rural income gap in the EU. Rural areas account for over 45 percent of the population and lag far behind in terms of jobs, roads, and financial infrastructure. Poverty is 20 percent higher in rural areas than in urban regions. The Systematic Country Diagnostic[2] undertaken in 2018 highlighted that in fact Romania's transformation has been a tale of "two Romanias" – one urban, dynamic, and integrated with the EU, and the other rural, poor, and isolated. Bucharest is the most prosperous county with a GDP per capita of 81,000 RON[3] as of 2017 and 3.9 percent at risk of poverty rate[4] while some counties in the North East have more than ten times higher poverty rates.

AGRICULTURE ACCOUNTS FOR A SIGNIFICANT SHARE OF THE RURAL POPULATION BUT FACES CONSIDERABLE STRUCTURAL AND FINANCING CONSTRAINTS. While 23 percent of the total population and 47 percent of the rural population are employed in agriculture, the sector is marred by lower income and higher rates of poverty. Agricultural production is characterized by a strongly polarized farm structure, benefitting large sized farms. Unlike its neighbors, Poland or Bulgaria, Romania has yet to establish a viable, commercially-oriented middle-sized farming sector. The main constraints limiting rural development include insufficient access to finance, land fragmentation, ageing population, and lack of technology and skills.

BOTH FINANCIAL INCLUSION AND FINANCIAL INTERMEDIATION ARE LAGGING. According to Global Findex 2017, 58 percent of adults are banked in Romania, unchanged from 2014 data, compared to 65 percent in Europe & Central Asia. The poor are 33 percentage points less likely to have an account, significantly higher than the income gap for developing countries. Financial inclusion is still adversely affected by high mistrust in financial institutions, high cash preference, and low financial literacy. Digital financial services are in their nascent stage and only 3 percent use mobile money despite high mobile phone penetration. The banking sector is shallow reflected in both low loan and deposit penetration. Total assets of the banking sector as a share of GDP was 49.3 percent of GDP in the first half of 2018, significantly lower than in EU peers, such as Poland (88.5 percent), Hungary (93 percent), Bulgaria (98.6 percent), Croatia (124 percent), and the EU-28 average (243 percent). Structural constraints such as poverty, rurality, and informality still persist, affecting both financial inclusion and intermediation.

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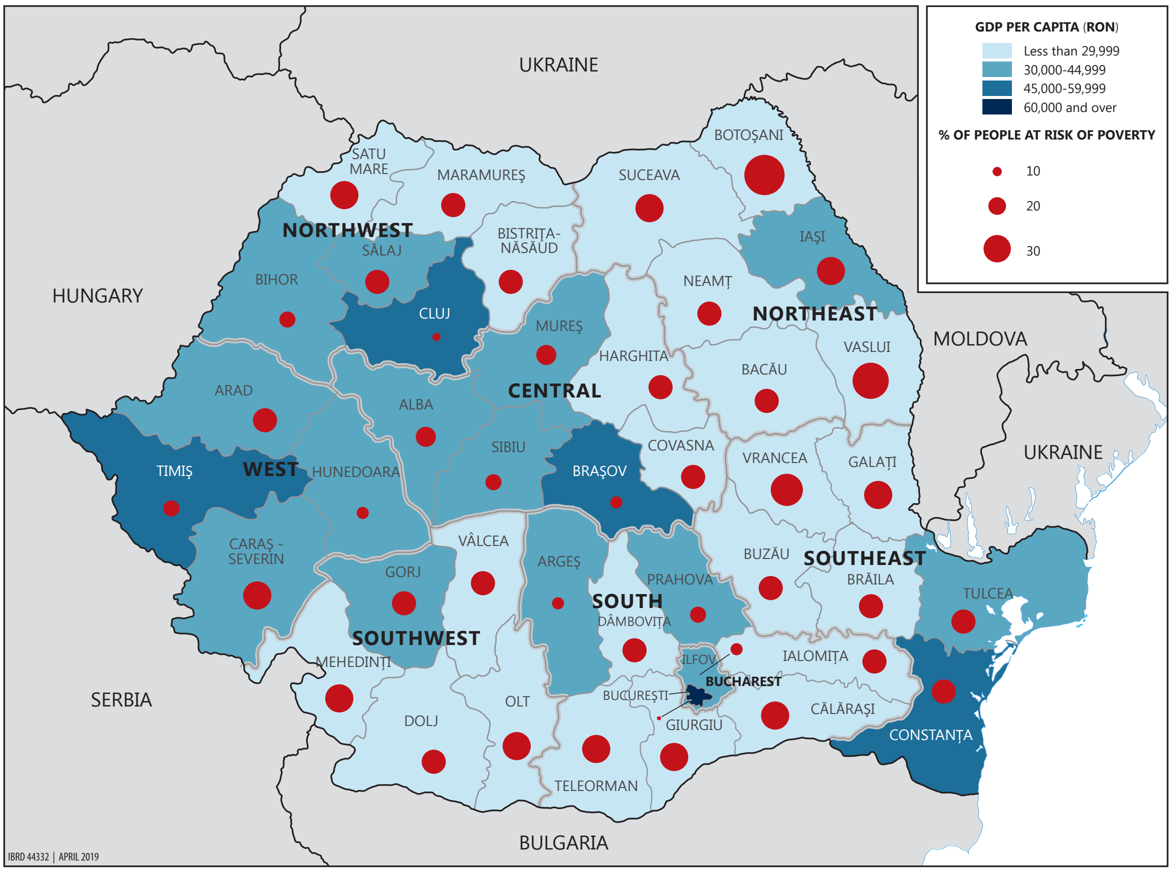
[1] Source: Eurostat. At risk of poverty or social exclusion refers to the situation of people the at risk of poverty, or severely materially deprived or living in a household with a very low work intensity.

[2] World Bank. 2018. From Uneven Growth to Inclusive Development : Romania's Path to Shared Prosperity. Systematic Country Diagnostic;. Washington, DC: World Bank. © World Bank. https://openknowledge.worldbank.org/handle/10986/29864 License: CC BY 3.0 IGO.

[3] 1 US Dollar = 4.26 Romanian Lei on March 9, 2020

[4] "World Bank Group. 2016. Pinpointing Poverty in Romania. Poverty in Europe Country Policy Brief. World Bank, Washington, DC. © World Bank. https://openknowledge.worldbank.org/handle/10986/23910 License: CC BY 3.0 IGO."

FIGURE 1. GDP per capita (in RON) & Adults at risk of poverty (%)



Source: National Institute of Statistics (2017), World Bank Poverty team's estimates (2016)

THE PRIVATE ENTERPRISE SECTOR FACES A NUMBER OF CONSTRAINTS TO GROWTH AND INVESTMENT. Demand for credit by enterprises is adversely affected by: a) relatively low business density in terms of number of enterprises per inhabitant, b) the non-financial constraints businesses face for growth and investment such as fiscal and regulatory unpredictability, c) the poor health of enterprises (44 percent of firms are undercapitalized and hence non- bankable), and d) access to alternative financing (including access to foreign financing, which accounts for 15 percent of corporate debt).

THE CHAPTERS THAT FOLLOW EXAMINE KEY AREAS THAT CAN ENHANCE ACCESS TO FINANCIAL SERVICES. Efforts need to be made on all fronts to ensure that the financial sector can act as a key driver to help address some of the economic challenges.

CHAPTER 1

SPATIAL ANALYSIS OF FINANCIAL INCLUSION IN ROMANIA

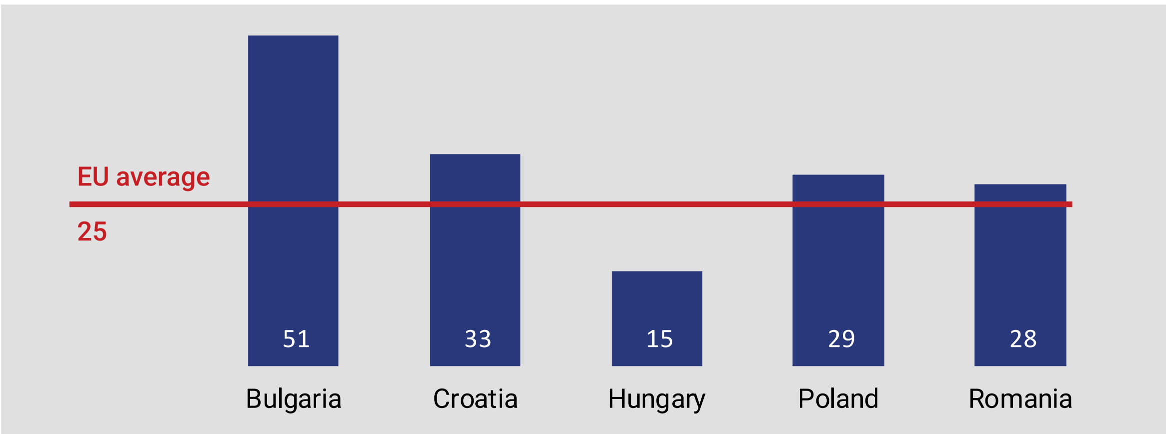
This chapter explores the spatial dimension of financial inclusion and access to finance in Romania across counties including ownership of deposit accounts and access to credit, for both individuals and enterprises, along with assessing geographical access to the banking network.

PHYSICAL ACCESS

THE PENETRATION OF THE COMMERCIAL BANK BRANCH AND ATM NETWORK IN ROMANIA IS COMPARABLE TO THAT OF THE EU BUT THE POINT OF SALES (POS) INFRASTRUCTURE REMAINS UNDERDEVELOPED. As of September 2018, there were 4,515 branches and 10,958 ATMs in the country which equate to 28 branches and 68 ATMs per 100,000 adults (Figure 2, Figure 3). This penetration is at par with EU levels (25 branches and 63 ATMs per 100,000 adults in 2017). The bank branch network has declined by about 30 percent since 2013 and has been replaced by increasing ATMs and PoS, which recorded a 10 percent and 70 percent growth respectively. Despite the high PoS growth, this infrastructure remains underdeveloped relative to peers with 1,200 per 100,000 inhabitants (Figure 4).

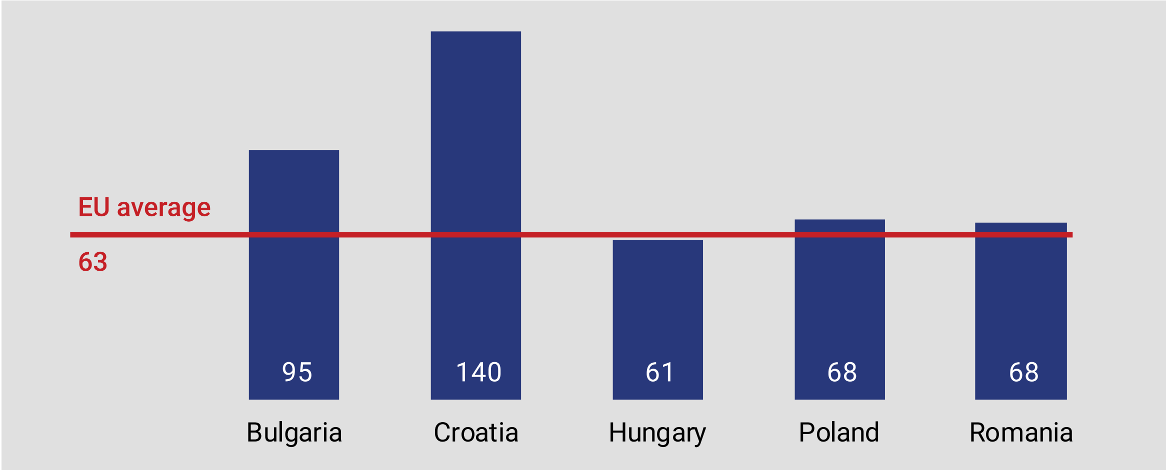
THERE ARE VAST REGIONAL DISPARITIES IN THE PHYSICAL BRANCH NETWORK. In Bucharest there are 49 branches per 100,000 adults, more than twice the level in the North East, South Muntenia and South West (Figure 5). In addition, despite the high degree of rurality, only 14 percent of the branch network is in rural areas. Rural areas have a branch network penetration of only 8 per 100,000 adults, with the lowest penetration in the counties of Constanta and Galati (South East). A low density of branch network is correlated with a lack of services beyond basic banking.

FIGURE 2. Commercial bank branches per 100,000 adults



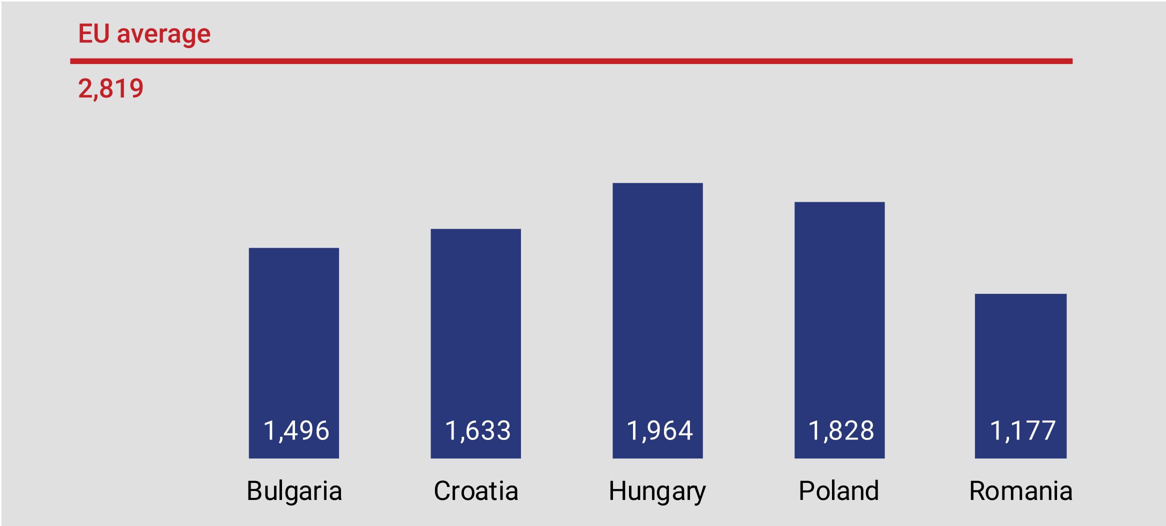
Source: IMF Financial Access Survey (2017), NBR provided

FIGURE 3. ATMs per 100,000 adults



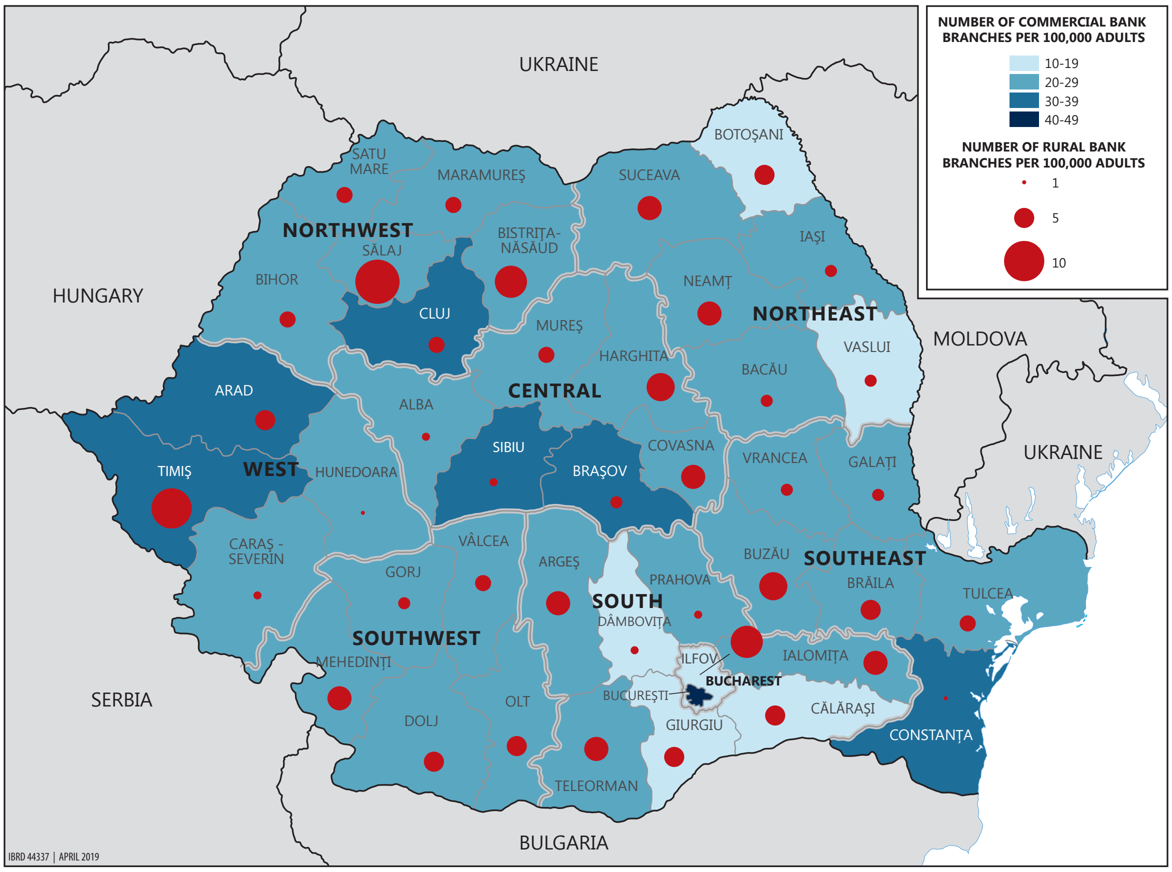
Source: IMF Financial Access Survey (2017), NBR provided

FIGURE 4. PoS terminals per 100,000 adults



Source: ECB (2017); Note: Number of PoS terminals by residents PSPs

FIGURE 5. Bank branches per 100,000 adults



Source: NBR (September 2018)

ACCESS TO FINANCE FOR INDIVIDUALS

ACCOUNT OWNERSHIP IS TYPICALLY FOUND TO BE CORRELATED TO HOUSEHOLD SIZE, INCOME, EMPLOYMENT, AND LEVEL OF EDUCATION. Using Findex data, linear regression results for account ownership in Romania show that the poor, adults without wage employment, and adults without education are less likely to have an account (Table 1). The poorest 40 percent of households are 33.2 percentage points less likely to have an account than the richest 60 percent of households, significantly higher than the income gap for upper middle-income countries (17.9 percentage points). Adults living in larger households were more likely to either have their own or a joint account. These demographics explain 23.0 percent of the overall variation in account ownership.[5] See Table 9 in Annex. Using regional data from the Austrian National Bank Euro Survey, within Romania, adults in the South Muntenia and North East are less likely to own an account. However, even Bucharest, which has the highest account ownership at 59.8 percent, falls well below regional and income peers.

[5] R2 is 23 percent at a 5 percent significance level. For more detail, see Annex.

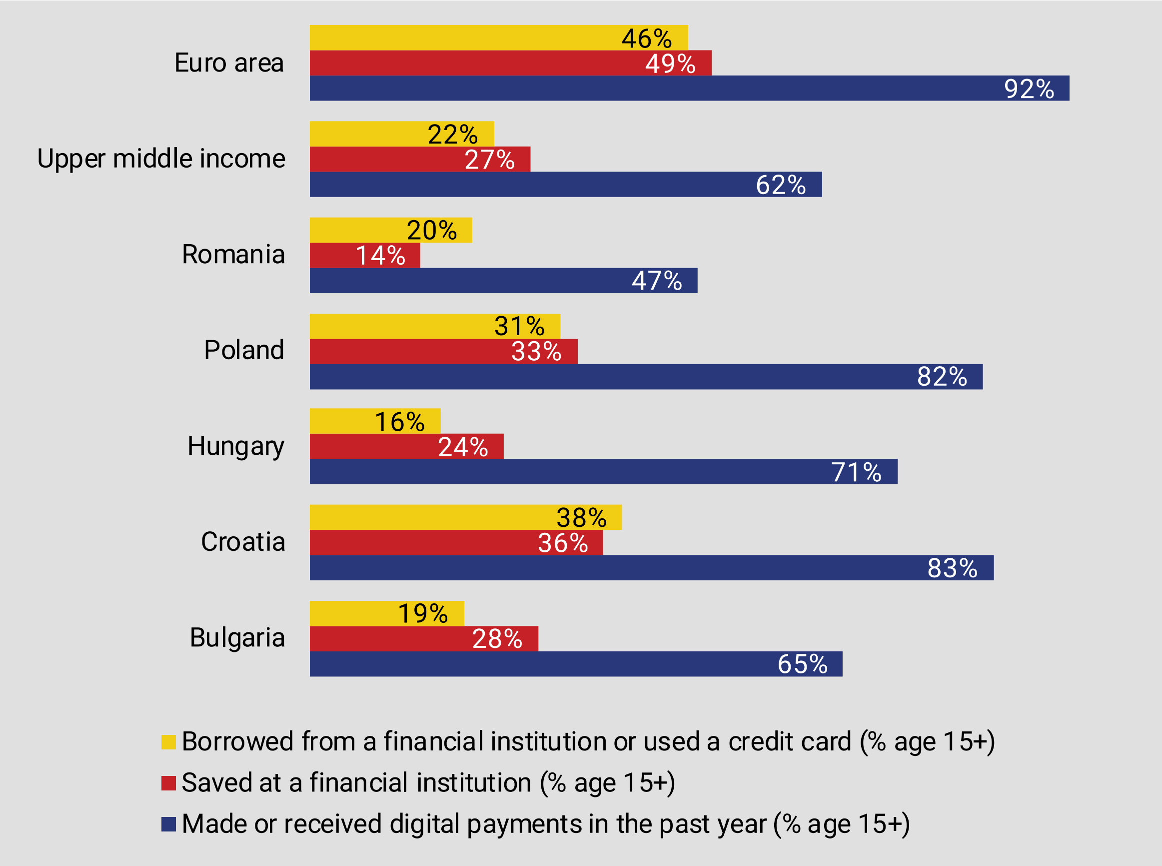
TABLE 1. Account ownership by demographics (%)

	Bulgaria	Croatia	Hungary	Poland	Romania	Upper middle income	Euro area
Account (% age 15+)	72%	86%	75%	87%	58%	73%	95%
Account, male (% age 15+)	71%	90%	78%	85%	62%	77%	97%
Account, female (% age 15+)	74%	83%	72%	88%	54%	69%	94%
Account, young adults (% ages 15-24)	43%	47%	60%	63%	51%	66%	79%
Account, older adults (% ages 25+)	75%	93%	77%	91%	59%	75%	98%
Account, in labor force (% age 15+)	88%	95%	89%	97%	65%	78%	98%
Account, out of labor force (% age 15+)	51%	77%	57%	67%	48%	62%	91%
Account, primary education or less (% ages 15+)	42%	62%	56%	66%	32%	66%	89%
Account, secondary education or more (% ages 15+)	85%	96%	83%	90%	70%	80%	97%
Account, income, poorest 40% (% ages 15+)	55%	81%	68%	84%	38%	62%	94%
Account, income, richest 60% (% ages 15+)	84%	90%	80%	88%	71%	80%	96%
Account, rural (% age 15+)	66%	88%	69%	87%	54%	73%	96%

Source: Global Findex database, 2017

ROMANIANS ARE ALSO LESS LIKELY TO USE THEIR ACCOUNT TO MAKE OR RECEIVE DIGITAL PAYMENTS, TO SAVE, OR TO BORROW. About half of Romanians make or receive digital payments, 31 percentage points lower than their regional counterparts (Figure 6). Only 14 percent of adults in Romania saved at a financial institution, and 1 in 5 adults borrowed formally. Mobile money and internet banking are in their infancy. Even though mobile broadband coverage across the country is high (98 percent) only 3 percent of adults have a mobile money account and 12 percent of adults use a mobile or the internet to access their account, significantly less than peer average (31 percent in upper middle-income countries). This is striking as among the unbanked nearly 80 percent (5.5 million adults) have access to and use a mobile phone.

FIGURE 6. Account usage (%)



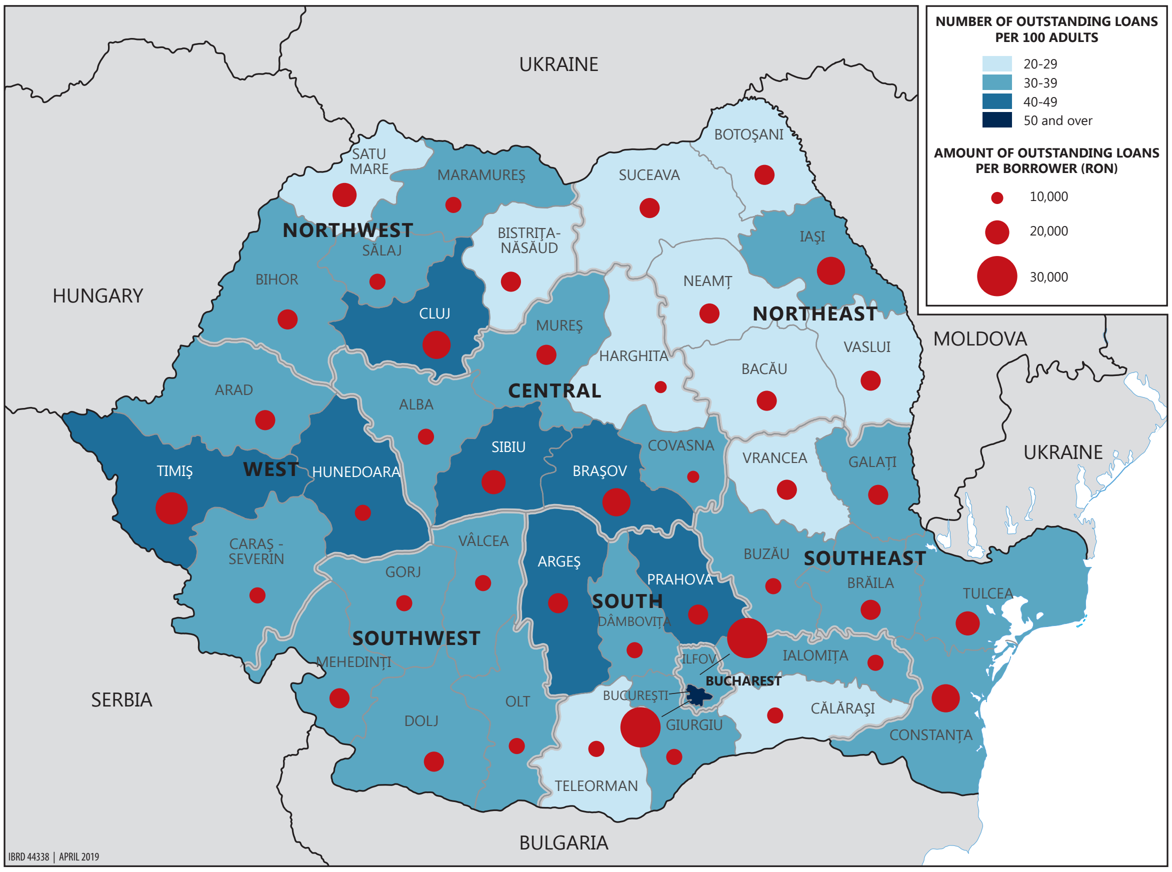
Source: Global Findex database, 2017

BUCHAREST HAS THE HIGHEST VALUE OF ELIGIBLE DEPOSITS PER ADULT. While there no easily available data on total volume of deposits by region, the Bank Deposit Guarantee Fund (FGDB) has county-level information on eligible deposits.[6] By the end of June 2018, the value of eligible deposits per adult in Bucharest was just above 27,000 RON, three times the national average while in regions such as South Muntenia (in particular the counties of Giurgiu and Teleorman), and South-West (in Mehedinti and Olt), this is less than 7,000 RON.

BUCHAREST ALSO HAS A HIGHER ACCESS TO LOANS. USING DATA FROM THE CREDIT BUREAU, ACCESS TO LOANS SHOWS A BIG DISPARITY. In Bucharest, about 65 percent of adults have outstanding loans, compared to a national average of 36 percent (Figure 7). Significantly fewer adults (25 percent) have loans in the North-Eastern region. Furthermore, the average loan size is the highest in Bucharest (about 33,000 RON, 50 percent higher than the national average).

[6] Eligible deposits include time deposits, current accounts, savings accounts, card accounts, joint accounts and other similar leu- or foreign exchange-denominated products, including due interest.

FIGURE 7. Number of outstanding loans per 100 adults & volume of outstanding loans (RON)



Source: Credit Bureau, Credit Register, NBR (September 2018)

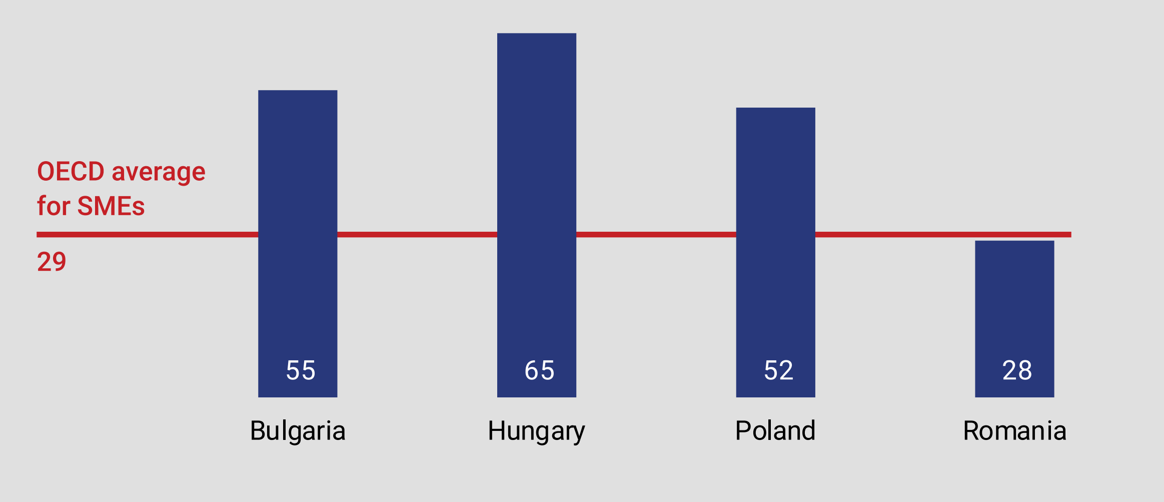
ACCESS TO FINANCE FOR ENTERPRISES

FIRM DENSITY IN ROMANIA IS WELL BELOW THAT OF ITS REGIONAL PEERS, WHICH NEGATIVELY AFFECTS DEMAND FOR FINANCIAL SERVICES. There are about 28 firms[7] in Romania per 1,000 adults (Figure 8). This is half the share of firm density in Bulgaria, Hungary and Poland. By contrast, the share of large firms in Romania is at par with peers. MSMEs in Romania account for 50 percent of the total employment in enterprises and contribute 52.8 percent to value added, less than the EU average of 56.8 percent.[8]

[7] The OECD Structural and Demographic Business Statistics (SDBS) (2016/17) defines small and medium-sized enterprises (SMEs) as those who employ fewer than 250 people. Large enterprises employ 250 or more people. This definition is used for all inter-country, regional analyses.

[8] European Commission (2017)

FIGURE 8. Firms per 1,000 adults



Source: OECD (2018)

BUCHAREST LEADS IN BUSINESS DENSITY ACROSS ALL FIRM SIZES. County level data indicates an uneven firm[9] density. Bucharest has about 90 firms per 1,000 adults, almost twice as many as the region of North West with the second highest share (45 firms per 1,000 adults), driven by higher density of micro-enterprises (Table 2 and Figure 9). The counties of Botosani and Vaslui (North East), Teleorman (South Muntenia), and Mehediniti (South West) have the lowest firm density - fewer than 20 firms per 1,000 adults. Looking at the size composition of the firms, large firms constitute 5 percent of the total firms in Bucharest, higher than other regions, which is to be expected due to the presence of foreign-owned firms in the capital.

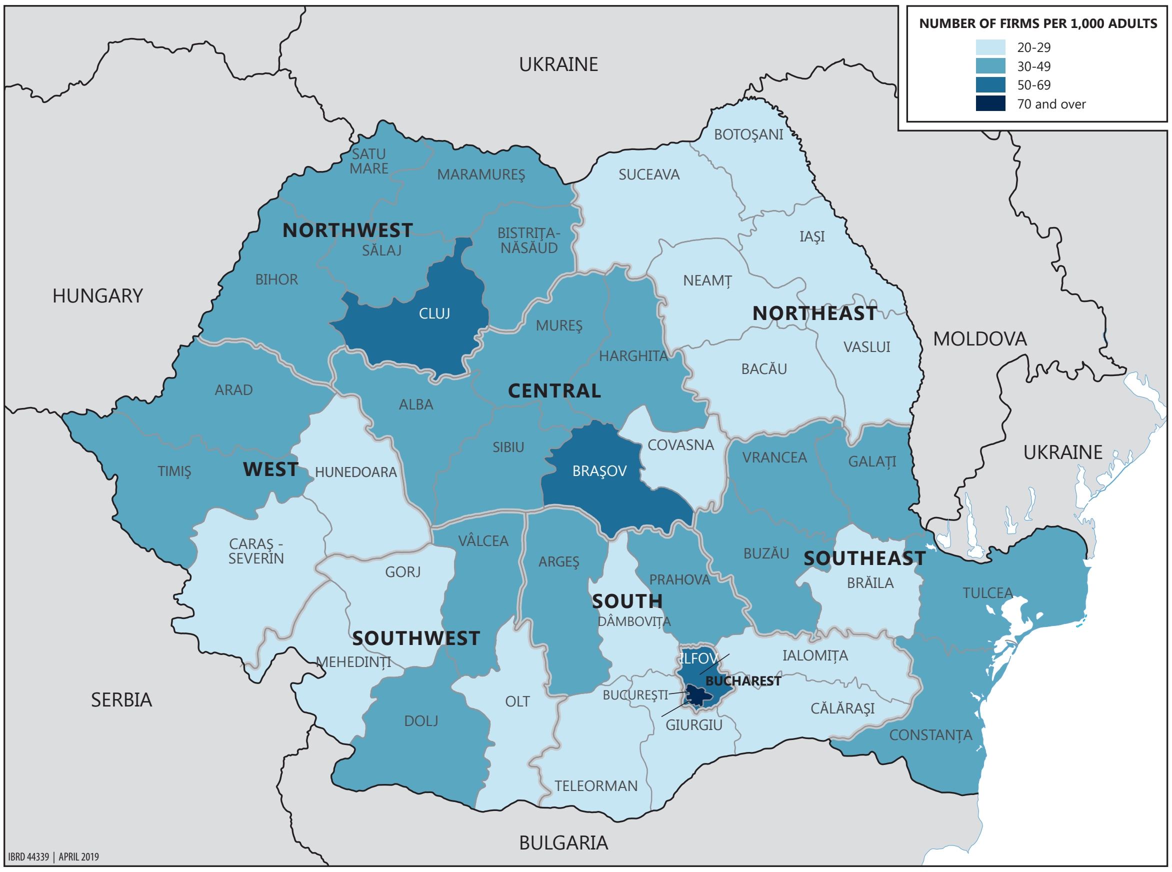
TABLE 2. Firms per 1,000 adults by region

	Total	Large	Medium	Small	Micro
Bucharest	87.6	0.3	1.1	5.3	80.6
Center	38.3	0.1	0.6	3.0	34.6
North - East	25.2	0.1	0.3	2.0	22.9
North - West	45.1	0.1	0.5	3.0	41.4
South - East	35.8	0.1	0.4	2.5	32.8
South - Muntenia	33.3	0.1	0.5	2.4	30.4
South - West Oltenia	27.8	0.1	0.3	1.9	25.6
West	37.5	0.1	0.5	2.6	34.3
Total	39.4	0.1	0.5	2.7	36.1

Source: WB calculations based on data received from NBR, MoPF (2017)

[9] Using EU definition. NBR defines firms as active firms where, micro enterprises have fewer than 10 persons employed; small enterprises have 10 to 49 persons employed; medium-sized enterprises have 50 to 249 persons employed; large enterprises have 250 or more persons employed. SMEs is made up of enterprises which employ fewer than 250 persons and which have an annual turnover not exceeding 50 million euros, and/or an annual balance sheet total not exceeding 43 million euros. This definition is used for all intra-country, county and regional level analyses.

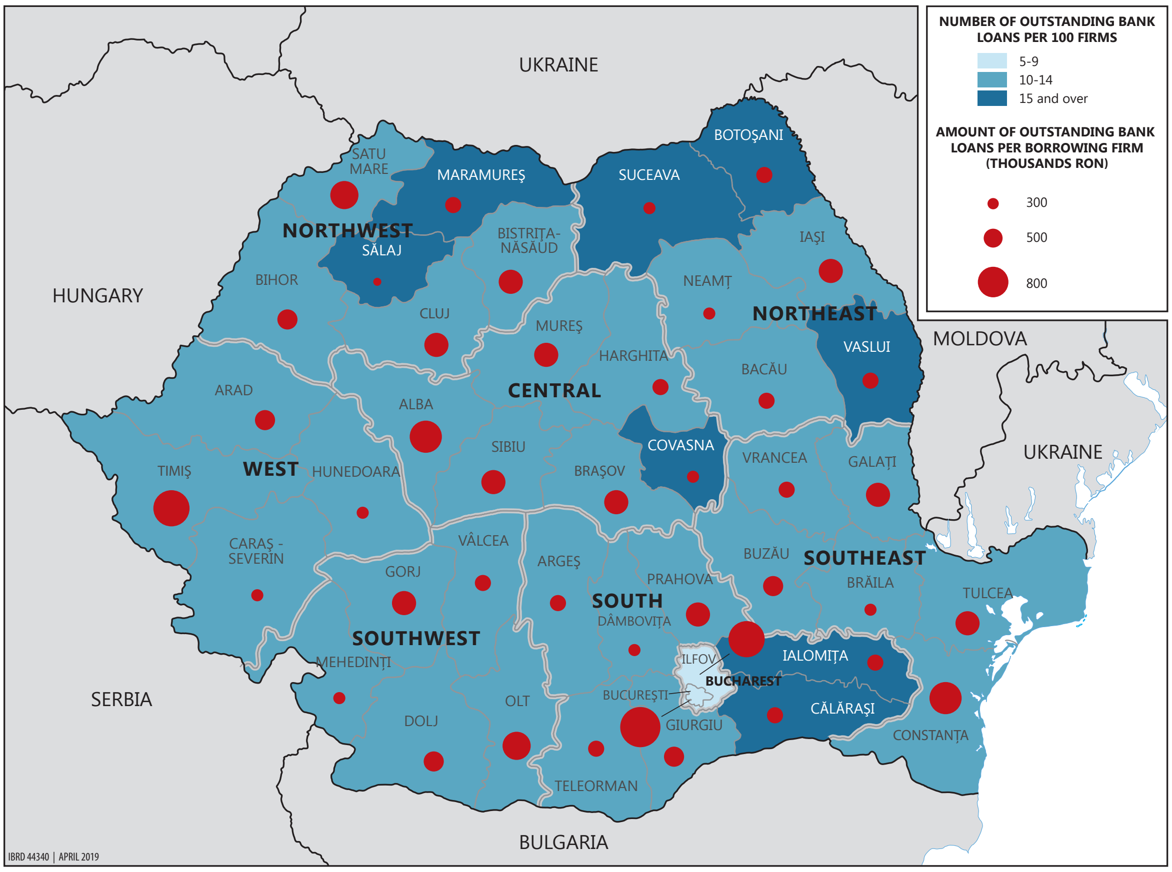
FIGURE 9. Firms per 1,000 adults by county



Source: Credit Bureau, Credit Register, NBR (September 2018)

FEW FIRMS USE BANK LOANS IN ROMANIA. On average, only about 11.8 percent of legal entities have a bank loan. There is significant variation in terms of size of the firm. Large and medium firms have higher access - about 54.8 percent of large firms and 54.3 percent of medium sized firms have a bank loan compared to 43.7 percent of small and 8.6 percent of micro-enterprises. Moreover, there is also considerable variation in the size of the loan across the country (Figure 10). The value of these loans per entity with outstanding loans for all the regions except Bucharest is below the national average (167,000 RON). In Bucharest, this is 250,000 RON, which can be partly explained by the greater presence of larger and foreign-owned companies in Bucharest.

FIGURE 10. Number of outstanding loans per 100 firms & volume of loan (thousands RON)



Source: Credit Bureau, Credit Register, NBR (September 2018)

IN THE CONTEXT OF SUPPORT TO THE LAGGING REGIONS, THE ROLE OF THE FINANCIAL SECTOR NEEDS TO BE EXAMINED THROUGH A SPATIAL LENS. The above analysis lays clear the variation in access to finance across the country to enhance the role of the financial sector, efforts should be concentrated to address the gaps with a regional lens to ensure equal opportunity across the country.

CHAPTER 2

FINANCE FOR AGRICULTURE

This chapter is a diagnostic assessment of the state of finance for agriculture. Section 1 analyzes the conditions that influence the demand for financial services including the structure of the sector, the challenges farms face, the degree of penetration of bank financial services, and alternative sources of financing. Section 2 describes the supply of financial services, in terms of sources and products. Section 3 assesses the public policies that influence agricultural finance and the enabling environment. The last section provides conclusions and recommendations for improving access to finance for agriculture.

AGRICULTURE AND FARM STRUCTURE

AGRICULTURE PLAYS A SIGNIFICANT ROLE IN EMPLOYMENT BUT UNDERPERFORMS. Romania has one of the highest volumes of agricultural production amongst the EU-28 countries,[10] owing to its fertile soil, favorable climate, and aided by a series of government and EU programs. In 2017, livestock accounted for 24 percent and crops for 76 percent of overall agricultural production in Romania.[11] Most agricultural output in Romania is exported, with the lion's share of the total export value accounted by grains and oilseeds. It is estimated that agricultural output potential is three times the actual level.[12] Agriculture accounts for 22.6 percent of total employment, the highest percentage in the EU-28,[13] but only accounts for 4.8 percent of GDP (2017). As of 2015, agriculture makes up 34.8 percent of total rural employment (Eurostat).

ROMANIA HAS A HIGH EXPOSURE TO CLIMATE AND NATURAL RISKS. As highlighted in Romania's Country Partnership Framework,[15] significant risks of climate and natural disaster events threaten the country's economic resilience. Romania's exposure to significant climate and natural risks, particularly to earthquakes and floods, is resulting in substantial social, physical, and financial impacts across the country. Without considerable infrastructure investments and policy reforms, 70 percent of the assets of the poor are vulnerable to destruction. Estimates of the impact of climate-related hazards on critical infrastructure in Romania indicate that expected annual damage to infrastructure alone would double by 2020.

[10] Eurostat. Agricultural Production – Crops. Dataset: Production of Cereals, 2016. Accessed January 4, 2019. https://ec.europa.eu/eurostat/statistics-explained/index.php/Agricultural_production_-_crops#Further_Eurostat_information

[11] Eurostat

[12] Romania Systematic Country Diagnostic. Background Note: Agriculture. June 2018

[13] Study on "Romania – Smallholder Inclusion in Agri-Food Value Chains" Executive Summary. The World Bank. Draft June 16, 2017. Page 1.

[14] Eurostat

[15] World Bank. 2018. Romania - Country partnership framework for the period FY19-23 (English). Washington, D.C. : World Bank Group. http://documents.worldbank.org/curated/en/403461531122178382/Romania-Country-partnership-framework-for-the-period-FY19-23

THERE IS A POLARIZED FARM STRUCTURE AND AGRICULTURAL PRODUCTION. The sector is characterized by a bifurcated structure whereby most farms are tended by smallholders on small plots of land, with a tiny minority of medium and large commercially operated farms. While 43.3 percent of the land in the EU is below 2 hectares (ha), in Romania this share is 71.4 percent. The fragmentation of farmland, along with the small size of operations is also associated with low productivity. Although Romania accounted for about one third of the EU's farms, Romanian farms accounted for only 3.4 percent of the EU's standard output.[16] Economic activity exists both on the small, less efficient side of the agriculture productivity spectrum, as well as on the medium and large, highly productive side, with little in between. As a result, a large share of farmers relies on subsistence agriculture. According to the 2016 Farm Structure Survey, 87 percent of farms consume more than 50 percent of the production (Table 3). Furthermore, county level data also show a 40 percent correlation between the share of agricultural land and the percent of people that are at risk of poverty (Figure 11).

THE AGRICULTURAL SECTOR FACES SIGNIFICANT CONSTRAINTS TO PRODUCTIVITY GROWTH INCLUDING DEFICIENT INFRASTRUCTURE AND LOW QUALITY OF HUMAN CAPITAL. Farms suffer from lack of infrastructure (irrigation, transport) and outdated labor-intensive farming technologies. For example, there is little to no irrigation equipment or practices, leaving many farmers vulnerable to drought.[17] Farmers are also untrained, with only 4.6 percent of farmers having any form of training vs 28.9 percent, on average, in the rest of the EU.[18] Furthermore, 44.3 percent of farmers are age 65 and above with only less than 10 percent under 40.

THE SECTOR HAS BEEN EXPERIENCING HIGHER EXPENSES AND LOWER PROFITS. According to the Survey on the Access to Finance of Non-Financial Corporations in Romania conducted by NBR (June 2018), the agricultural sector experienced smaller turnover and increasing costs in the period April 2017 – March 2018, with 41 percent of surveyed firms in the sector experiencing declining profits.

TABLE 3. Farm comparison by size

Item	Small farms (under 5 ha)	Large commercial farms (≥ 50 ha)
Number	3.1 million	16,400
Percentage	91.8%	0.5%
Output per Year	<EUR 50,000	>EUR 50,000
Average Plot Size	1.95 ha*	368.4 ha*
Utilized Agricultural Area	28.7 percent	51.1 percent

*Source: Farmer Accountancy Data Network (2016 and *2013)*

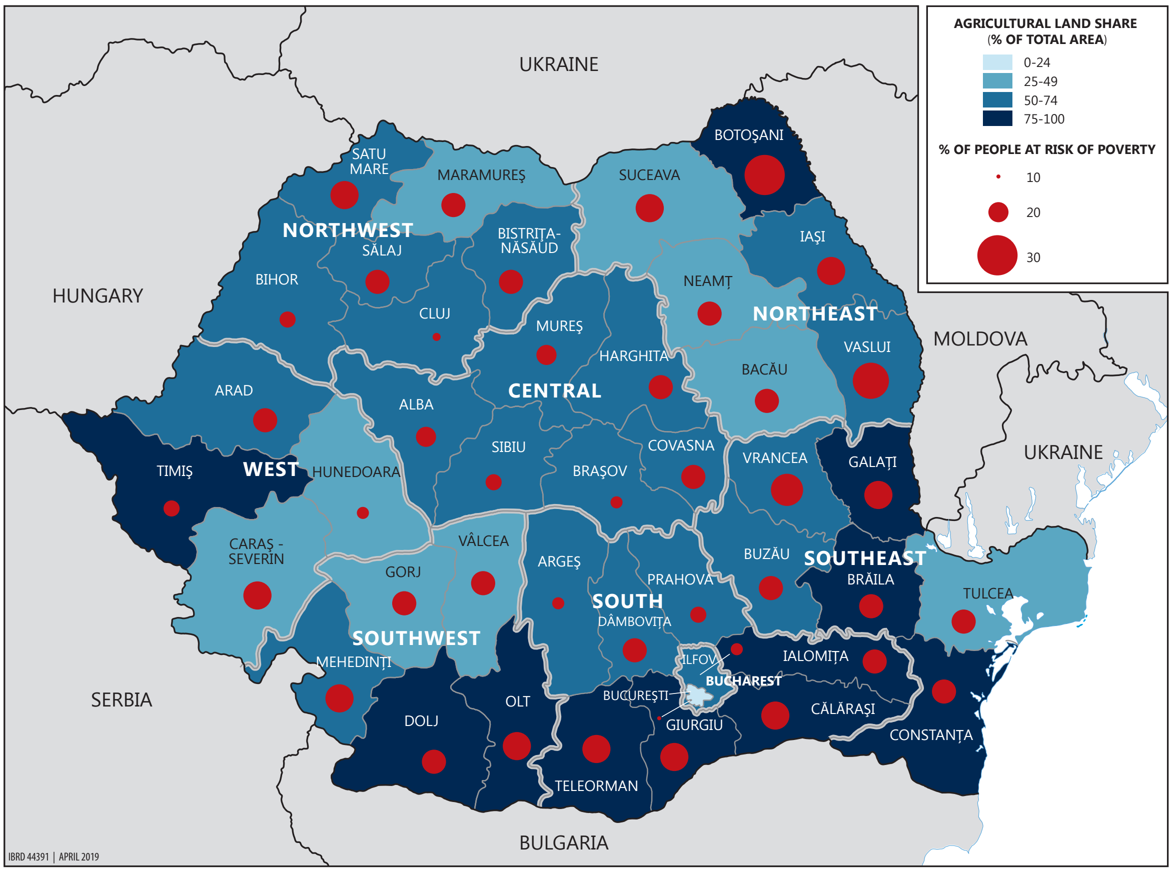
***Note:** 7% of farms fall between a farm size of 5-50 ha.*

[16] Eurostat

[17] Romania Systematic Country Diagnostic. Background Note: Agriculture. June 2018

[18] Study on "Romania – Smallholder Inclusion in Agri-Food Value Chains" Executive Summary. The World Bank. Draft June 16, 2017. Page 3.

FIGURE 11. Agricultural land share (% of total area) & people at risk of poverty (%)



Source: National Institute of Statistics, Romania & World Bank Poverty team's estimates (September 2018)

BOX 1. Key strategic messages from the Romania Systematic Country Diagnostic

Reducing poverty in rural areas entails structural changes to increase the productivity and resilience of the agriculture sector. At the same time, the high exposure of agriculture in Romania to climatic risks requires investments to strengthen the resilience of the sector to these risks. Investments to increase productivity and strengthen resilience can go hand in hand. Improving crop varieties and efficiency in the use of inputs, investing in irrigation, integrating small and medium farmers into sustainable value chains, building capacity to comply with food and quality safety standards, and promoting digital agricultural practices, would lead to both higher productivity, competitiveness, and improved resilience.

Growth in productivity and improving resilience would depend on a strategy that requires the right policies and investments. Such a transformation requires a better utilization of resources under the Common Agricultural Policy (CAP), which currently focuses on direct payments. The resources should instead be leveraged to incentivize investments and crowd in private sector funding. The objectives for the upcoming CAP 2021-2027 should be towards improved competitiveness, more resilience in the farm sector, and bolstering activities in the areas of environment and climate, while promoting vibrant rural areas.

STATE OF PLAY OF AGRICULTURAL FINANCE

FIRMS IN AGRICULTURE MOSTLY FINANCE THEMSELVES THROUGH NON-BANKING SOURCES. According to the NBR Access to Finance Survey, most firms in the agricultural sector use retained earnings (51 percent of firms), loans from shareholders (31 percent), and trade credit (31 percent) for financing. Only 25 percent of firms in agriculture use overdrafts and 16 percent use investment loans.[19] The use of bank financing is still more prevalent than in other sectors. Trade (or commercial) credit is an important financing source for farmers. Input suppliers often provide financing for inputs (pesticides, seeds, fertilizers). The estimated annual total financing needs for inputs (seeds, fertilizers, pesticides and fuel) in Romania is 10 billion RON with a projected increase of around 4 percent annually.

THERE IS ONLY A WEAK CORRELATION BETWEEN AGRICULTURAL LOANS AND EMPLOYMENT IN AGRICULTURE AT COUNTY LEVEL. The correlation between outstanding agricultural loans per agricultural ha in a county and persons employed in agriculture is insignificant. This may be explained by the bifurcated structure of agriculture whereby large numbers of farmers are operating subsistence scale farming without access to credit with most credit going to large commercial farms and exporters. Notably, access to bank branches in a county has little impact on access to credit - with only a 9 percent correlation between physical access to bank branches and agricultural loans.

AS A RESULT OF LOW PRODUCTIVITY, UNDERINVESTMENT, AND LOW CAPITALIZATION, DEMAND FOR AGRICULTURAL FINANCE IS LIMITED. Many farmers lack the training to approach investments from a commercial perspective, find it expensive and complicated to deal with banks, and often do not have acceptable collateral (to banks) and sufficient equity to apply for financing. Farmers are also conscious of the weather risks they face, such as floods and drought on rain fed crops which may limit their demand for financing as they fear what could happen if they cannot repay due to weather events.

[19] The sources of financing are not mutually exclusive.

BANK FINANCE

COMMERCIAL BANKS ARE THE LARGEST LOAN PROVIDERS IN THE AGRICULTURAL, FORESTRY AND FISHING SECTOR, ALTHOUGH THEY HAVE BEEN LOSING MARKET SHARE TO NON-BANKING FINANCIAL INSTITUTIONS (NBFIS[20]) IN RECENT YEARS (FIGURE 12). Outstanding loans to agriculture, forestry, and fishing[21] have grown with Compound Annual Growth Rate (CAGR) of 6.1 percent in the period 2013-2017. As of September 2018, commercial banks (both privately owned and state-owned) accounted for 67.1 percent of these loans, followed by loans by NBFIs (32.9 percent). The share of banks has been declining since 2013, driven primarily by a decline in the share of privately owned banks, which stood at 53.5 percent as of September 2018, down from 63.2 percent in December 2013, and a commensurate increase in the share of NBFIs in the same period. Average loan sizes are 511,000 RON for privately owned banks, 990,000 RON for state-owned banks,[22] and 203,000 RON for NBFIs.

THE COMBINED SECTOR HAS LOWER CREDIT RISK THAN OTHER ECONOMIC SECTORS. Regarding bank loans to the combined sector of agriculture, forestry and fishing, about 23 percent is short term (under 1 year), this is in line with loans to other economic sectors (Figure 13 and Table 4). Non-performing loans (NPL) in this sector account for 7.5 percent of gross loans, higher than the average for the whole banking sector (5.6 percent) but lower than the average for the total non-financial corporate segment (9.8 percent). It is noteworthy that NPLs for primary agricultural loans represent only 2.2 percent, which is very low by global standards. Hence, despite perceptions about the riskiness of agricultural lending portfolios, agricultural NPLs are lower compared to other sectors. Notably, state-owned banks have a higher NPL ratio (17.5 percent) in agriculture than privately-owned banks (4.9 percent). The difference in NPL ratio of private and state-owned banks could be due to different risk profiles of the borrowers but also different standards in credit risk assessment, loan monitoring, and collections.

BANK LOANS FOR PRIMARY PRODUCTION HAVE BEEN GROWING IN RECENT YEARS AND HAVE THE HIGHEST ASSET QUALITY. Agricultural bank loans, including primary production, livestock, and agricultural product processing and trading amounted to 7.7 percent of total bank loans in Romania. Agricultural loans have been declining (CAGR of 1.2 percent), driven by a decrease in agricultural product processing, which is more than half of the total portfolio. It is worth noting the trend during the period 2013-2017 of increasing loans for primary production and at the same time declining loans for livestock and processing and trading, indicating less lending for value added agricultural activities.

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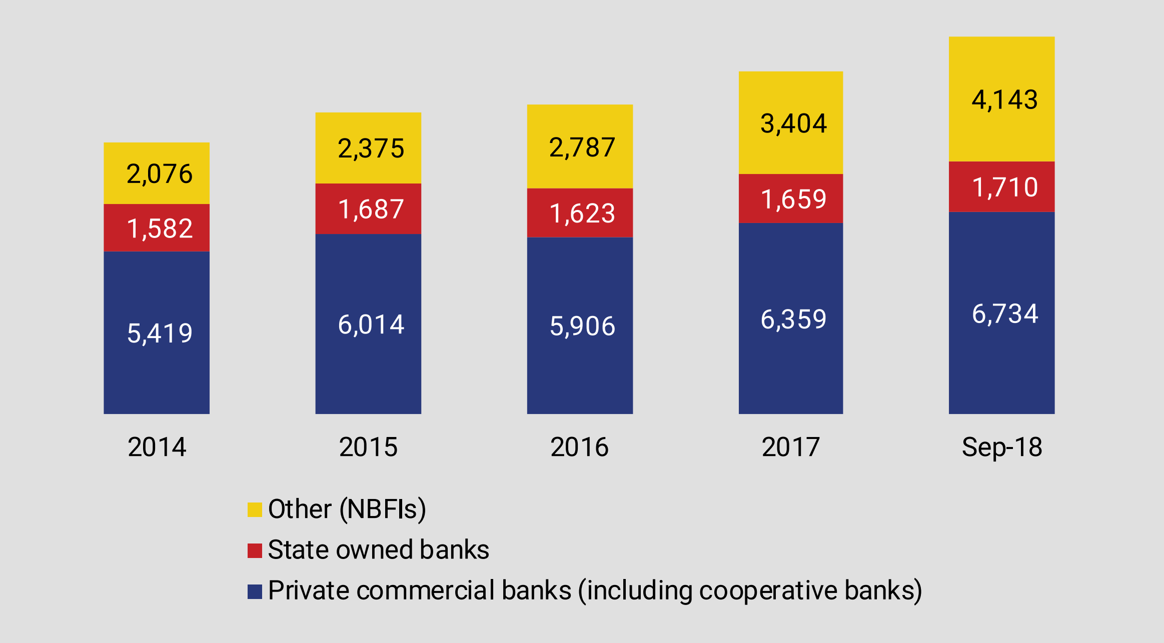
[20] Law no. 93 (2009) on non-banking financial institutions defines NBFIs as entities, other than credit institutions, performing professional lending activity. In the case of agriculture, main NBFIs are typically leasing companies and the financing arms of agribusinesses

[21] Agriculture sector comprises all activities under NACE_REv2 Section A: Agriculture, forestry and fishing. This excludes agricultural products processing and trading.

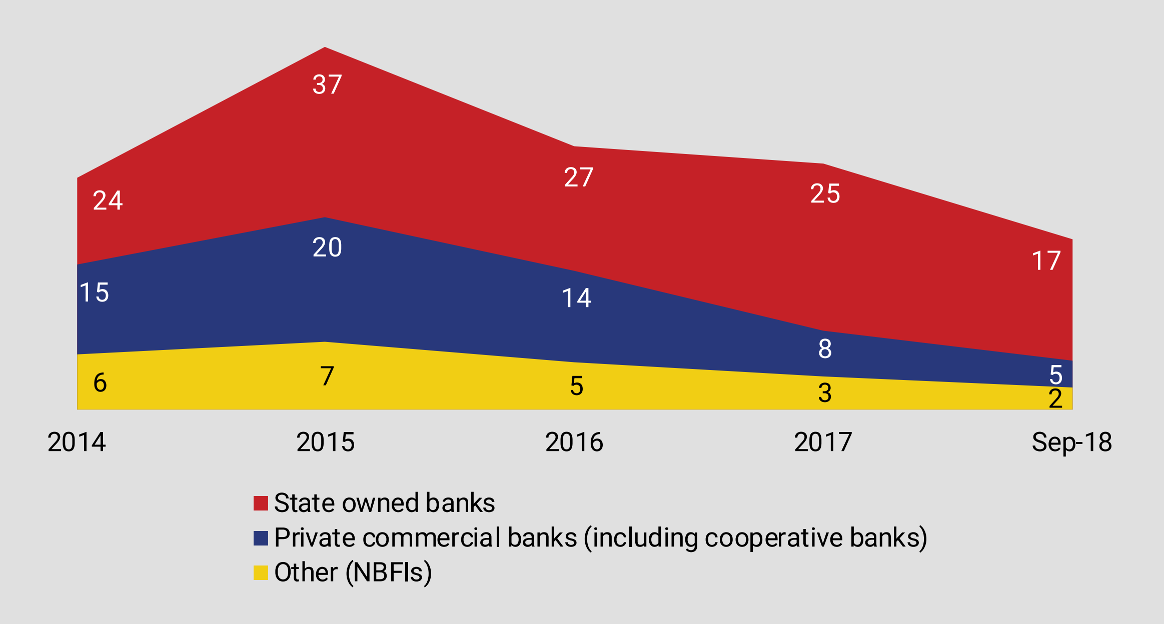
[22] CEC Bank and EximBank

FIGURE 12. Lending volume for agriculture by institution (in millions RON)



Source: World Bank staff estimations using data from NBR and Credit Register

FIGURE 13. NPLs (%) for agricultural loans by institution



Source: World Bank staff estimations using data from NBR and Credit Register

TABLE 4. Agricultural loans by sub-sector

Key indicators	Primary Production	Livestock	Processing / trading
Share of agricultural loans	29%	14%	57%
Average Loan Amount (RON)	475,900	881,542	857,127
NPLs / Gross Loans	2%	8%	7%
2013-2017 CAGR	7%	-2%	-4%

Source: Credit Register, NBR

BANKS LEND TO THE AGRICULTURAL SECTOR ALBEIT CONSERVATIVELY, FOCUSING ON THE MEDIUM/LARGER SEGMENT. Based on interviews, banks have the appetite to lend to agriculture and do so profitably albeit conservatively. Agriculture is generally perceived to be risky, despite the low NPLs. In particular, banks perceive smallholders as uncreditworthy and also face higher costs in serving them due to their fragmentation. Clients are typically commercial farms (registered legal entities) with loan sizes above 50,000 EUR. Typically, banks classify loans as micro (under 50,000 EUR), small (50,000-500,000 EUR), medium (500,000 – 1mm EUR), and large (above 1 million EUR) and focus on low risk clients, medium and large commercial farmers and Small and medium enterprises (SME) agribusinesses. Hence, banks serve a relatively limited number of farmers, usually 1-3,000 farmers per bank. Banks provide longer term finance, and working capital often associated with large projects and preferably with EU grants and state guarantees. About 70-75 percent of bank loans are for longer term financing (machinery, equipment, land, etc.). The remainder is used for working capital and bridge financing for subsidies. As subsidies are paid with a delay, farmers can get credit to pre-finance the subsidies they will receive. Banks lend based on the strength of the business's balance sheet and rarely have uncollateralized loans based only on cash flow considerations. Unsecured loans are only for very high-quality clients.

BANK FINANCING FOCUSED ON MAIN CROP CEREALS AND OILSEEDS, AND LIVESTOCK WHILE THERE IS LIMITED FINANCING FOR FRUITS AND VEGETABLES. According to banks, there is a preference of main crops and livestock (pigs, poultry, and dairy cows). Fruit and vegetable value chains are not well structured, with the exception of grapes/viticulture.

PREVALENT INFORMAL PRACTICES IN THE SECTOR ADVERSELY AFFECT SUPPLY OF FINANCE. Access to finance is exacerbated by the lack of transparency inherent in informal practices, which makes it difficult for banks to evaluate companies' and individuals' creditworthiness. NBR Regulation 17/2012 regarding certain conditions on granting loans is restricted to individuals and obliges that only formal income statements and tax documentation be considered in assessing loan applications. In addition, creditors are required to take reasonable measures to verify level of income, and its flow over a period of time. There are no specific laws for lending to small companies or sole proprietors and banks are open to use their internal credit rating system. Many small farmers, operating as individuals (or even as micro companies) operate informally or face challenges to show documented income statements and tax returns, leading to their exclusion from the financial system.

NON-BANK FINANCE

NBFIS PLAY AN IMPORTANT ROLE IN AGRICULTURAL FINANCE FOR LEGAL ENTITIES AND OFFER SEVERAL ADVANTAGES COMPARED TO BANKS. Main NBFI players in the agricultural market include leasing companies[23] (e.g. BNP Paribas Lease, Deutsche Leasing, and IKB Leasing) for agricultural equipment finance and the financing arm of agribusinesses, Agricover Credit.[24] Generally, NBFIs that are linked to agribusinesses including traders and input suppliers have greater proximity, information, and knowledge about farmers, particularly smaller and medium farmers, compared to banks. Such NBFIs linked to agribusinesses provide financing mostly for working capital: purchase of inputs, paying salaries, and inventory finance (at borrower's premises). A significant difference between the leasing companies and the rest of NBFIs and agribusinesses is on client acquisition: leasing companies rely on a network of agricultural equipment vendors, while agribusinesses and NBFIs linked to agribusinesses have direct knowledge and contact with clients as they are present in rural areas.

THE FOCUS OF SEVERAL NBFIS IS TOWARDS THE SMALLER (40-100 HA) AND MEDIUM (100-1,000 HA) FARMS WHERE BANKS OFTEN PREFER CLIENTS WITH ABOVE 1,000 HA. NBFIs doubt that farms under 40 ha can be viable for crop production, and they are considered subsistence farming. Smaller farms (below 40 ha) can be profitable for fruits and vegetables but access to markets is a key constraint that limits financing. NBFIs dealing with the small farmer market segment employ standardized products, scoring models, and references from other farmers, to streamline processes and reduce operating costs in dealing with small-scale farmers. NBFIs, like banks, focus their financing to legal entities (could be sole proprietor farms) and not individuals. NPLs reported by NBFIs are very low compared to banks, at the overall market level 2 percent, while there are NBFIs that report NPLs below 1 percent, even while serving small-scale farmers.

SUPPLY CHAIN FINANCE IS AN IMPORTANT SOURCE OF CREDIT FOR FARMERS. Large agribusiness buyers and input suppliers are an important source of non-banking credit to farmers, particularly for smaller farmers. Credit is often in kind, in the form of inputs, where farmers repay it after they harvest their crop. There are no statistics regarding the volumes of such financing. In most cases it is expected that agribusinesses that provide such credit borrow from commercial banks mostly locally, so this form of credit should be already counted as banking credit to agribusinesses.

[23] According to some estimates, leasing accounts for a bit over 50% of the total NBFI finance.

[24] Agricover is a registered NBFI. It has 3 products offered to farmers: working capital, investment finance and factoring.

OTHER CREDIT PROVIDERS INCLUDE EMHH AND MICROFINANCE INSTITUTIONS (MFI), BOTH OF WHICH SERVE INDIVIDUALS. While the biggest EMHHs and MFIs operate mostly in urban areas, they also serve individuals in rural areas who are engaged in agriculture. While no statistics regarding volume agriculture-related credit are available, it is estimated that credit for agricultural purposes is below 10 percent of the total credit supplied by EMHHs and MFIs. Since credit to agriculture is not tagged, and the same product is used for all clients, there is no specialized product for agriculture (e.g. a product that has its repayment after harvest). Credit from such institutions may carry a higher cost compared to banks and NBFIs. Chapter 3 explores the role of EMHH and the cooperative banking sector in rural finance in greater detail.

IN ADDITION, MULTINATIONAL TRADING INSTITUTIONS FINANCE FARMERS. Such financing is offered against future crop in the form of prepayment to farmers they are buying from. This type of finance is being phased out and is currently very limited. These companies also offer inventory financing with sale agreements but again for very select clients.

AGRICULTURAL INSURANCE

ONLY A SMALL PORTION OF ARABLE LAND IN ROMANIA IS COVERED BY AGRICULTURAL INSURANCE. Agricultural insurance protects farmers against production risks due to climatic and weather events. For medium and smaller farmers, purchasing insurance assures them of achieving future earnings and protecting their future income. The legal framework for the set-up and functioning of mutual insurance companies exists (Law no. 71/2019), but no requests for the authorization of such funds has been received. Currently about 2.2 million ha are covered by insurance (about 18 percent of arable agricultural land) corresponding to an estimated 11,000 farmers for an average farm size of 200 ha.[25] Overall, the main users of agricultural insurance in Romania are larger farms, as part of the business risk management strategy, while the vast majority of small-scale farmers is without insurance coverage.

LIKE IN OTHER COUNTRIES IN THE REGION AND WORLD-WIDE, ROMANIA INTRODUCED INSURANCE PREMIUM SUBSIDIES IN 2019. Governments often promote risk- sharing in the agricultural sector by subsidizing insurance premiums, which also reduces the likelihood of compensation to farmers in case of catastrophic events. Sub-measure 17.1 Contributions to crop, animal and plant insurance premiums within the National Rural Development Program (NRDP), based on Article 36 and Article 37 of Reg. (EU) 1305/2013 is a new measure, introduced in the NRDP in 2018, which provides a partial reimbursement of the insurance premium paid by farmers. Farmers apply for support by submitting a financing application including their insurance contract and history of

[25] Based on interviews

paid premiums to the paying agency. After the assessment process, if the paying agency finds the financing request eligible it will reimburse the farmer for up to 55 percent or 70 percent of the premium, depending on the size of the farm. The risks eligible under this measure are: drought, scorching heat, floods, hail, frost (early autumn, winter, or late spring), torrential rains or long lasting rains, storms, thunderstorm, hurricane or tornado which can be assimilated to a natural disaster, as well as pest. The first call for applications was launched in April 2019 and by mid-October the paying agency had received 904 financing applications. Following the assessment process undertaken so far, 508[26] requests amounting to 885,683 EUR were declared eligible. First payments for the premium subsidy were expected to be made by the end of the year 2019.

THE GOVERNMENT OF ROMANIA HAS OPERATED PROGRAMS FOR CATASTROPHIC LOSSES DUE TO NATURAL EVENTS. MoARD has previously implemented programs to compensate farmers for losses due to catastrophic events. Legislative acts such as the Government Decision no. 562/2012, no. 606/2014, no. 293/2015 compensating farmers for adverse weather conditions affecting crops in protected areas (snow falls, hail and other catastrophic events) and the - Emergency Ordinance no. 45/2015 compensating the effects of severe drought during April-September 2015 were issued by the Government. In the last three years MoARD has not implemented any program aimed to provide payments to farmers for disasters or catastrophic events. Nevertheless, according to the Fiscal Code in force, an event affecting more than 30 percent of the agricultural area, agricultural producers - natural persons, individually or in a form of association, can benefit from a tax deduction based on the income and loss.

AGRICULTURAL INSURANCE IN ROMANIA FOCUSES ON BASIC PRODUCTS. The main agricultural insurance product in Romania is peril insurance, which is insurance against specific weather perils such as wind, excess rain, hail, frost, storm. This type of agricultural insurance is in line with regional peers (e.g. Croatia, Serbia, Bulgaria) but is a rather basic product compared to more comprehensive but more expensive products like multi-peril crop insurance.[27] Premium costs are set per region and per crop depending on the risk, around 45-70 RON per ha although for some higher risk areas and crops premiums could go up to 400 RON per ha, especially for all climatic risk insurance. Usually, insurance is for a 1 in 25-year catastrophic event or for events with 4 percent frequency. Most insurance is for cereal crops while there is some, but still very limited, insurance penetration for orchards and vineyards. The sum insured is the value of crop produced. Insurance companies offering agricultural insurance products claim that they break even, that is premiums cover the cost of risk plus administrative costs. The reported loss ratio during the last 5-10 years is around 70 percent and admin costs account for another 30 percent. The insurance crop business has a five-year horizon. The insurance companies generate profits with the farmers' segment by cross selling other insurance products (e.g. insurance for equipment, vehicles, etc.) to farmers that purchase crop insurance. Although the insurance companies use their own network to sell insurance, they also make use of brokers. Links to banks to sell insurance as a bancassurance product for credit protection or stand alone have not been successful so far. Insurance is sold either as stand-alone or linked to the supply of inputs. Larger and commercially oriented farmers often purchase insurance as stand-alone. Farmers that purchase inputs on credit could obtain crop insurance to cover the financing of inputs. For example, companies like Agricover, through an insurance brokerage arm, facilitate insurance to farmers when they purchase inputs on credit.

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[26] 172 were still underevalaution, and 224 were withdrawn or ineligible.

[27] In multi-peril crop insurance, a single policy protects crops against all natural perils including adverse weather, fire, insects, disease, wildlife, earthquake, volcanic eruption and failure of irrigation water due to unavoidable causes.

THE AGRICULTURAL SECTOR IS VULNERABLE TO THE EFFECTS OF CLIMATE CHANGE, WHICH ALSO AFFECTS THE PRICING OF INSURANCE PRODUCTS. Market participants expressed concerns over the impact of climate change on the insurance sector as extreme events are becoming more catastrophic and perhaps more frequent. This partly explains the absence of more comprehensive insurance products covering more risks. For example, one of the weather risks is the risk of winter frost. Such risk is very high and quite expensive, limiting its uptake.

PUBLIC POLICY

AGRICULTURAL POLICY IS SUPPORTED BY MULTIPLE INTERACTING AND OFTEN INTERSECTING PROGRAMS. The agricultural sector is supported by the EU (European Commission and CAP) and the government, particularly MoARD (Figure 14). Most of the funding programs for agriculture are in the form of subsidies and grants rather than financial instruments.

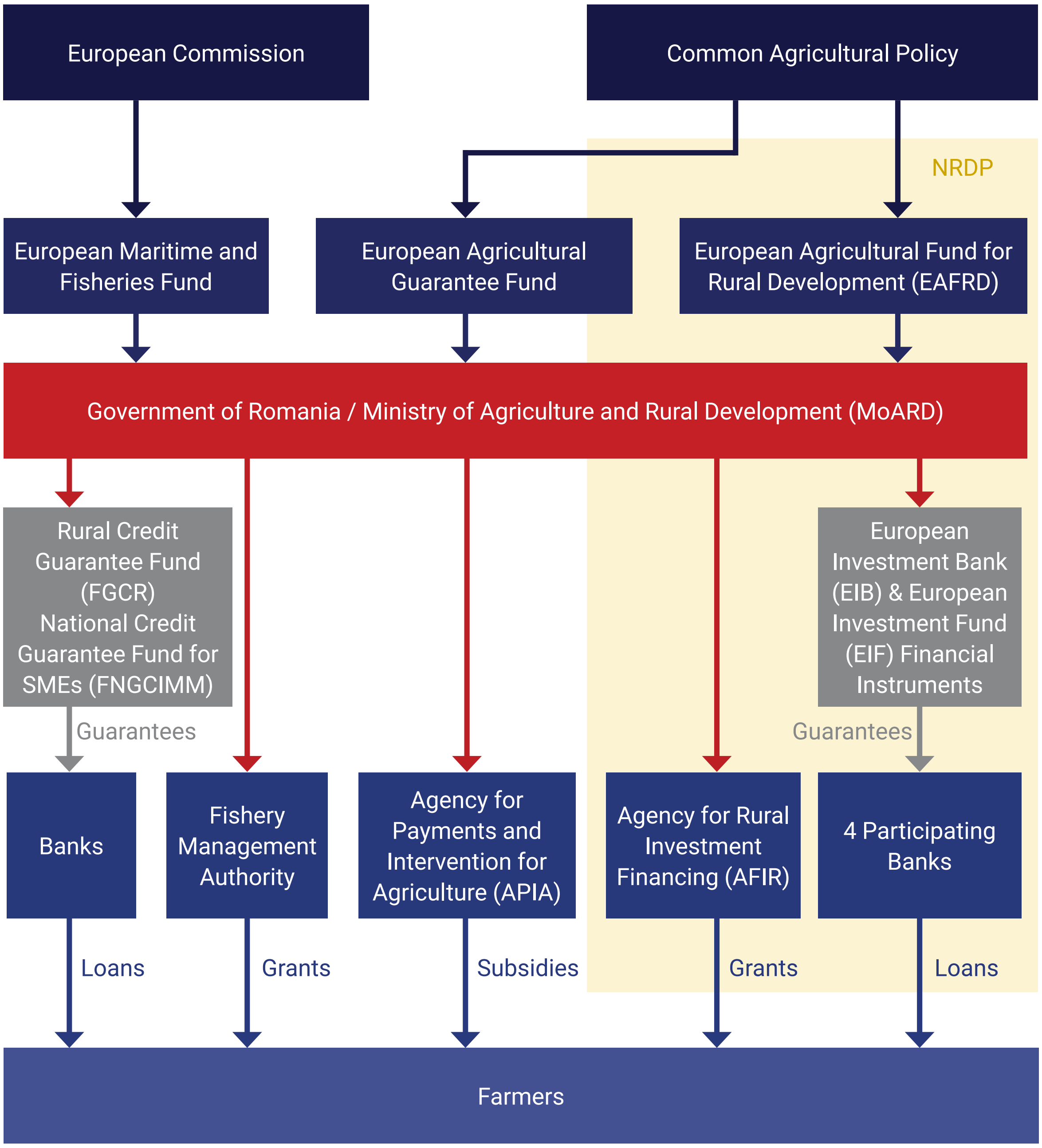
THE EU CAP IS THE MAIN INFLUENCE ON AGRICULTURAL DEVELOPMENT POLICIES IN ROMANIA. While CAP contains various instruments, the most commonly used ones are grants and subsidies, while there is a limited promotion of financing instruments, such as loans and guarantees. However, the use of financing instruments may increase in the future as an instrument for promoting transformation in agriculture. Within financial instruments, an enhanced focus on linkages between programs that promote loans and guarantees could be beneficial.

AGRICULTURE IN ROMANIA RECEIVES SUBSIDIES USING A COMBINATION OF EU AND NATIONAL FUNDS. Direct payments to farmers under CAP are to “stabilize revenues” on smallholder farms; funds are also directed to support country-specific agricultural development plans, such as NRDP.[28] During the period 2014-2020, Romania is expected to invest 18.5 billion EUR in agriculture and rural areas from CAP resources of which 57 percent are allocated to direct payments to farmers (Pillar I) and 43 percent for investments in rural areas (Pillar II). In 2015, 80 percent of Romania’s small-scale farmers claimed direct support through the small-scale farmers scheme (under Pillar I), which targets small farms by offering a lump-sum payment of up to 1,250 EUR per farm. In addition, Romania allocated 12.3 percent of Pillar I’s budget to direct payments for coupled[29] support for production of beef and veal, fruits, vegetables, grain legumes, hemp, hops, milk and milk products, protein crops, rice, seeds, sheep meat and goat meat, silkworms, and sugar beets. From 2018-2020, 5.8 billion EUR of CAP funds will be allocated to direct payments and 3.4 billion EUR to rural development. The managing agency for CAP funds in Romania is the MoARD.

[28] Romania: CAP in Your Country. The European Commission. June 2017.

[29] “Coupled” refers to support which is linked to the production of a specific product.

FIGURE 14. Overview of the main agricultural support programs



DIRECT SUBSIDIES BENEFIT PRIMARILY LARGER FARMS WITH ONLY A TINY FRACTION OF SMALL FARMS RECEIVING SUPPORT. The APIA under the MoARD disburses EU funds to support farmers (direct income support) (Table 5). Based on information received from APIA, APIA supported about 820,000 farms in 2018, of which the majority (73.0 percent) was 1-5 ha while only 0.5 percent were under 1 ha (or 0.23 percent of total farms under 1 ha).[30] Only very few farms below one 1 ha receive APIA support and the share of farms receiving APIA support increases with size. APIA supports proportionally larger farms. Direct payments, coupled, and decoupled support, have limited impact on modernization and productivity improvements. Based on analysis in similar countries dependency on direct payments is usually associated with low technical efficiency.

[30] The overall farm count is from the 2016 Farm Structure Survey. There are some data discrepancies between the two data sources, which could be the result of survey inaccuracies, double counting on the part of APIA farms, or changes in figures between 2016 and 2018.

TABLE 5. Number of farms by size (ha, 2016) and number of farms supported by APIA (2018)

	Less than 1 ha	From 1 to 5 ha	From 5 to 30 ha	50 ha and over	Total farms
Total farms	1,770,569	1,290,569	255,404	25,643	3,342,185
APIA supported	4,051	599,444	181,410	35,936	820,841
As %	0.2	46.5	71.0	140.1	24.6

Source: APIA (2018)

THE MAIN AGRICULTURAL POLICY INSTRUMENT IN ROMANIA IS THE NRDP 2014 – 2020. NRDP is a program of the MoARD. It has a total budget of 9.4 billion EUR, out of which 8.0 billion EUR is funded by the EAFRD, and the balance comes from the government.[31] The NRDP has three overarching objectives: a) restructuring and increasing the viability of agricultural holdings, b) managing natural resources and combating climate change, and c) diversifying economic activities, job creation, and improving infrastructure and services for improving the quality of life in rural areas.

ONLY A SMALL SHARE OF NRDP RESOURCES CURRENTLY SUPPORTS FINANCIAL INSTRUMENTS. Of the 9.4 billion EUR available under the NRDP only 1 percent is allocated for financial instruments while the rest is subsidies and grants. The EIF[32] is the administrator of such financial instruments. The funds are for a funded risk sharing facility (liquidity plus risk sharing) available to financial intermediaries, which will also contribute 30-50 percent to provide loans for farm investments, processing and marketing of agricultural products and for non-agricultural investments in rural areas. The plans for the use of the financial instruments under NRDP started in 2015 but it is only now that this component is activated and will go up to 2023 for loans to be disbursed. The facility is revolving for loans of a maximum period of 10 years and up to 1 million EUR. Loans can finance investments and co-finance the non-grant component of projects. Beneficiaries are legal entities (not physical persons). The AFIR, subordinated to the MoARD, is charged with implementing NRDP.

[31] Romania Systematic Country Diagnostic. Background Note: Agriculture. June 2018. Page 25.

[32] The European Investment Fund, part of the EIB Group, was established in 1994, and is a EU agency for the provision of finance to SMEs through commercial banks and funds.

EUROPEAN AGRICULTURAL FUND FOR RURAL DEVELOPMENT

EAFRD IN ROMANIA IS SUPPORTING ACCESS TO FINANCE FOR AGRICULTURAL SMES. EAFRD is the financing instrument under Pillar II of the EU CAP and co-finances the rural development programs of EU Member States. EAFRD has a budget of 96 billion EUR for 2014-2020 to support agriculture, forestry, and environmental/natural resources as well as sustainable rural development. EAFRD support is provided through grants and, increasingly, through financial instruments. The 2014 – 2020 program is a continuation of a previously successful 2007 – 2013 EAFRD pilot program of a similar nature which leveraged 116 million EUR of funds into 425 million EUR of loans to provide support for financial instruments. In 2017, the Romanian government entrusted EIF with the implementation of the EAFRD financial instrument to spur lending to the agricultural sector via commercial banks. This was done through commercial loan guarantees[33] in support of NRDP such as investments in agricultural holdings, processing and marketing of agricultural products, and the creation and development of non-agricultural activities. In 2018, EIF partnered with 5 commercial banks for the program to provide an estimated volume of 155 million EUR first-use, new financing to an expected number of 1,300 farmers and rural entrepreneurs[34] for capital expenditures on small farms, agricultural holdings, and co-financing of agricultural subsidies. The loans have subsidized interest and special commissions and are guaranteed by EIF at zero cost. Eligible beneficiaries include small businesses in rural areas and operating in the field of production or provision of services and / or enterprises active in agriculture or fruit growing or processing and marketing of agricultural products. This program is still too young to provide details pertaining to volumes or activity.

GUARANTEE FUNDS

ROMANIA HAS TWO GUARANTEE FUNDS THAT COVER AGRICULTURAL LOANS. FGCR and the FNCGCIMM both support SME loans for any sector of the economy, including also agricultural SMEs. There is some overlap between these two funds with regards to agribusiness SMEs. Both guarantee funds provide loan guarantees for agriculture (farm modernization and value add of primary production) and agribusiness SMEs (processing agricultural products).

[33] Article: New EAFRD FoF supports the agricultural sector in Romania. March 16, 2018 – September 30, 2018. www.eif.org.

[34] Article: EIF announces over EUR 150 million of financing for Romanian farmers via four banks. 13 September 2018. www.eif.org.

RURAL CREDIT GUARANTEE FUND

THE FGCR FOCUSES EXCLUSIVELY ON THE AGRICULTURAL SECTOR. FGCR is a majority privately-owned commercial company established in 1994 by PHARE.[35] It has four shareholders: three banks each with 33 percent share (Groupe Société Générale, Raiffeisen, and Banca Comercială Română) and the state through 1 percent held by MoARD. The Board of Directors consists of 3 directors from each of the banks, 3 directors from the MoARD, as well as the FGCR Director General who is appointed by the shareholders' committee. It is dedicated exclusively to agriculture and its target beneficiaries are farmers, livestock producers, and SME agribusinesses. FGCR is a NBFI supervised by the NBR. FGCR is covered by a sovereign guarantee. It is estimated to have a market share of 49.0 percent as of June 2017 (excluding EIF guarantees).

FGCR PROVIDES GUARANTEES OUT OF ITS OWN CAPITAL. FGCR grants guarantees to financial institutions to guarantee loans / financing intended for: a) funding of working capital, b) purchase of agricultural land, c) investments in agriculture without financing from NRDP, d) investments of private beneficiaries co-financed under NRDP, e) investments of public beneficiaries under NRDP, f) bridge loans based on APIA subsidies. FGCR also provides letters of guarantee in favor of AFIR for public beneficiaries to obtain the advance requested from AFIR. Guarantees cover 80 percent of loan principal, although for public beneficiaries under NRDP the guarantee is up to 100 percent. Fees range from 1.25 to 6.3 percent annually[36] of the guaranteed outstanding loan amount. The maximum value of the guarantee is 2.5 million EUR. Beneficiaries of guarantees can be individual farmers, legal entities, and public entities (such as towns, municipalities, etc.). Public sector beneficiaries account for 43 percent of the number of guarantees and 61.4 percent of the value of the guarantees issued over the first six months of 2018.

FGCR HAS SUBSTANTIAL ROOM TO GROW AND MOST BANKS REPORT OVERALL SATISFACTION WITH IT. FGCR's initial capital was 9 million EUR, contributed by PHARE, and of this 6 million EUR remains (Table 6). The leverage of the FGCR is 1 to 5 but currently the exposure is 250 million EUR. The relatively low leverage for the guarantees could be due to a combination of conservative underwriting criteria and demand for guarantees by the banks. In its 24 years of operation, FGCR has provided guarantees for a cumulative amount of 10.5 billion RON for 118,053 loans of total loan value of 15 billion RON, yielding an average guaranteed loan amount of 89,000 RON. FGCR reports a default rate of 3.9 percent in its 24 years of operation, but the loss given default is estimated around 2 percent due to recoveries after claims have been paid. FGCR has paid 0.41 billion RON in claims for 779 defaulted loans. While FGCR provides guarantees for 80 percent of the outstanding loan amount, banks are required to ask clients for collateral for the remainder. Claims can be filed 30 days after loan payments become 90 days overdue. Approximately 20 banks use the FGCR guarantees. In the bank survey conducted as part of the FSAP in 2018, banks' average satisfaction with FGCR is rated at 3.8 (1 = Very Unsatisfactory, 5 = Very Satisfactory).

[35] PHARE stands for *Poland and Hungary: Assistance for Restructuring their Economies*. It is one of three pre-accession instruments financed by the EU to assist applicant countries from Central and Eastern Europe in their preparations to join the EU.

[36] As of 2019, for the guarantees granted to farmers in compliance with GEO no. 43/2013, the guarantee fee is 1.6 percent per year for all categories of beneficiaries, irrespective of their type (commercial companies, authorized natural persons, individual enterprises, family enterprises, natural persons pursuing economic activities, etc.), as well as for newly established companies and companies that have never taken loans before. For the guarantees granted to processors of agricultural products under Law no. 329/2009, the guarantee fee starts at 1.25 percent for commercial companies and 3.8 percent for individuals.

TABLE 6. FGCR Guarantees

FGCR Guarantees Issued	Cumulative	31/12/2017 - 03/30/2018
Total	118,084	265
Of which public	1,925	114
Of which private	116,159	151
Total value in RON	N/A	227,450,000
Of which public	N/A	139,530,000
Of which private	N/A	87,920,000

Source: FGCR

NATIONAL CREDIT GUARANTEE FUND FOR SMES

GUARANTEES TO THE AGRICULTURAL SECTOR ARE ALSO PROVIDED BY THE STATE-OWNED SME GUARANTEE FUND. The FNGCIMM was founded in 2001 as a fully state-owned entity with registered share capital of 931.3 million RON. The purpose of FNGCIMM is "to improve the SMEs' access to finance." FNGCIMM is registered in the Special Register of NBFIs with the NBR while the MoPF represents the state as shareholder. MoPF appoints all board members of which 2 are independent and usually come from the private sector. FNGCIMM provides guarantees for SME loans in all sectors, including agriculture and agribusiness. Beneficiaries are SME legal entities.

AGRICULTURE FORMS A SMALL PORTION OF FNGCIMM GUARANTEES. FNGCIMM provides guarantees to MSMEs based on its own funds guaranteeing up to 80 percent of the loan amount and with a maximum individual guarantee of up to 2.5 million EUR per SME. The amount of loan not covered by the guarantee needs to have collateral. In 2018, NPLs were reported around 2 percent. Banks can make the claim after 60 days of an overdue payment and claims are paid within 90 days from the time the banks/NBFIs submit their claim. As of late 2018, 23 banks were partner financial institutions and 2 NBFIs (both leasing companies). In the same year, outstanding guarantees reached 1.0 billion RON (5,791 loans), of which outstanding guarantees for agricultural loans is 45.3 million RON (211 loans). Hence, agricultural loan guarantees comprise 4.5 percent of all SME loan guarantees.

FNGCIMM ALSO ACTS AS MANAGER OF VARIOUS GUARANTEE FUNDS OF THE MOARD, INCLUDING FOR PROGRAMS UNDER NRDP. In this capacity, as of end 2018, outstanding guarantees related to NRDP reached 2.3 billion RON for 1,881 guarantees (Table 7). Guarantees under this pillar are for public beneficiaries to obtain the advance from AFIR. These guarantees, or letters of guarantee, seem to be for guaranteeing project execution by the public beneficiaries using AFIR funding. These guarantees form the bulk of FNGCIMM guarantees.

FNGCIMM IS CHALLENGED TO FOCUS ON ITS TARGET SEGMENT OF SMES. Currently FNGCIMM has a leverage of somewhere 2 to 3 times vs. a legal maximum of 7. There has been a decline in the operations of the FNGCIMM partly due to increasing use of other guarantees. FNGCIMM is currently re-balancing its guarantee operations with an enhanced focus on SMEs and specific segments such as small businesses, agriculture, rural areas, and tourism.

TABLE 7. Number and value of guarantees

	Number of Guarantees	Value of Guarantees (million RON)	Value of Credit Guaranteed (million RON)
FGCR			
Guarantees Granted in the Period 2013 – 2017	25,799	3,270	4,514
Guarantees Granted During the Period January 1 – October 31 2018	715	415	578
FNGCIMM			
Guarantees Granted in the Period 2013 – 2017	3,511	4,015	5,018
Guarantees Granted During the Period January 1 – October 31 2018	710	592	739

Source: FGCR and FNGCIMM

ENABLING ENVIRONMENT FOR AGRICULTURAL FINANCE

WHILE THE LEGAL AND REGULATORY ENABLING ENVIRONMENT FOR AGRICULTURAL FINANCE IS ADEQUATE, IT IS LIKELY THERE IS A DISPERSION IN THE DISTRIBUTION OF ITS BENEFITS AMONGST FARMERS. Enabling the Business of Agriculture is compiling rankings in 12 key regulatory areas impacting agriculture, one of which is finance. On finance there are three criteria: a) Requirements for establishing and operating deposit taking microfinance institutions and financial cooperatives, b) requirements for third-party agents to provide financial services and provision of e-money and c) use of moveable collateral such as warehouse receipts. Romania ranks 11 out of 80 countries globally in the enabling environment for agricultural finance, higher than Poland, Russia, Serbia, and Turkey. However, the benefits from an enabling environment do not seem to be attainable by the majority of smallholder farmers, for whom subsistence or small-scale commercial farming is far more challenging. The high ranking in agricultural finance may be masking variation in the distribution of benefits amongst farmers (e.g. more commercial and better off farmers are able to reap the benefits from an improved enabling environment) and there is potentially significant room for improvement in the enabling environment targeting more smallholder farmers.

DESPITE THE EXISTENCE OF A LEGAL FRAMEWORK FOR WAREHOUSE RECEIPT FINANCING, THE METHOD IS NOT CURRENTLY USED. Warehouse receipt financing is a common method for commodity-backed agricultural financing. A warehouse receipt system enables warehouse operators to issue receipts as evidence that specified commodities of stated quality and quantity have been deposited at a particular location by named depositor(s). The warehouse operator holds the stored commodity in safe custody, and the depositor can use the receipt as collateral to borrow from banks. In Romania there is a law regulating warehouse receipts with the Romanian Commodity Exchange being the main authority that regulates and supervises the warehouse receipts system. Despite the existence of the law and the regulatory and supervisory authority, there is no use of the warehouse receipts system. Market participants have indicated that warehouse receipts operated in the early 2000’s but banks lost interest due to problems mostly related to fraud and un-compensated losses. However, banks would be interested in revamping a warehouse receipt financing system with proper enabling environment including indemnities for losses due to fraud and professional misconduct.

THE POOR QUALITY OF THE LAND CADASTRE IS ANOTHER CONSTRAINT FOR ACCESS TO AGRICULTURAL FINANCE.[37] The coverage of the land cadastre is limited, including less than 25 percent of the land. Banks typically collateralize loans with land, but lack of clarity on ownership titles challenges such efforts. Untitled land without a clear ownership structure makes lending against land owned by smallholders very difficult, and such borrowers often do not have other assets to collateralize.

ROMANIA HAS ADEQUATE LAWS INTENDED TO LEGALIZE AND SUPPORT THE COLLATERALIZATION OF MOVABLE ASSETS, HOWEVER THE TRANSACTION FRAMEWORK CAN BE STRENGTHENED, ESPECIALLY AS IT PERTAINS TO SECURED CLAIMS. Borrowers are legally able to collateralize movable assets, but banks are often reluctant to lend against most assets save land. Lenders report that lengthy resolution processes (borrowers can appeal every decision), questions on claim enforcement, and degradation of collateral during the resolution process make lending against movable assets a challenging process. An important consideration would be the use of stored commodities as collateral for financing through some system of warehouse receipt financing.

[37] Financial Sector Assessment Program: Romania. Financial Intermediation Technical Note. The World Bank. May 2018.

RECOMMENDATIONS

THE AGRICULTURAL SECTOR TRANSFORMATION REQUIRES A HOLISTIC APPROACH, INCLUDING ENABLING ACCESS TO FINANCE. For Romanian agriculture to reach its potential, smaller farms must be able to access services that enable them to improve profitability through technology investments and improved access to markets. These should be complemented with holistic interventions for improved farmer organization, skills development, product innovation and value chain development, investments in effective public services (food safety, research and development) and public infrastructure, as well as a re-alignment of the CAP, among others. While access to finance on its own will not suffice to improve conditions in agriculture in Romania, particularly for smallholder farmers, combining other non-financial services with access to finance could enable improved access to technologies, new investments aiming at increasing productivity, improved resilience to climatic risks, and better access to markets.

The following recommendations could increase the access to financial services for marginalized and underserved farmers.

1. **CONDUCT AN ASSESSMENT OF THE FINANCIAL NEEDS OF SMALLHOLDER INDIVIDUAL FARMERS PARTICULARLY THOSE OUTSIDE THE MAIN COMMERCIAL CROPS (E.G. CEREALS AND OILSEEDS) AND LIVESTOCK, AND THOSE FARMERS LOCATED IN MORE MARGINAL AREAS.** There is limited information about these farmers, their assets, income/profitability levels, main activities, etc. An assessment and sub-segmentation of these 3 million smallholder farmers (per key crops and regions) could be important to understand their activities and financing needs and to determine the types of products they need and the most efficient channels to distribute these financial products to them. Many of the smallholder farmers may benefit from broader access to financial products rather than specific agricultural finance products as the majority are not linked to particular supply chains and agriculture is likely only part of a broader portfolio of their activities in rural areas.

2. **STRENGTHEN THE ENABLING ENVIRONMENT TO SUPPORT FINANCE AND LOWER RISKS INCLUDING:**

   a. **PROMOTE WAREHOUSE RECEIPT FINANCING OR OTHER FORMS OF FINANCING BASED ON FUTURE CROP PLEDGES AND RECEIVABLES FACTORING.** Undertake an assessment of the potential demand for using inventories as collateral and the main challenges for utilization of the current system. The assessment should include the institutional arrangements for the warehouse licensing authority to supervise warehouses and the warehouse receipt system as well as a system to compensate for losses due to fraud and professional negligence such as using indemnity bonds (through insurance companies) or an indemnity fund. At the same time investigate the potential for introducing crop receipts (registered pledges of future crop production) as collateral. Receivables factoring could also be another solution for suppliers to larger agribusiness firms.

   b. **CONDUCT A RISK MAPPING EXERCISE, ESPECIALLY IN AREAS WHERE LARGE SYSTEMIC RISKS EXIST AND INTRODUCE POLICIES TO EXPAND UPTAKE AND USE OF INSURANCE.** Connect the gap between financing and participation rates by introducing policies such as awareness raising and education for potential users of insurance. Monitor and evaluate the level of and modalities for premium subsidies to assess their impact on beneficiaries (farmers) and reduce moral hazard. Invest in programs such as irrigation systems and agro-climatic information systems that reduce risk along with any other programs that focus on non-insurable and catastrophic risks.

   c. **DESIGN AGRICULTURAL LENDING REGULATIONS TO FACILITATE FARMERS REGISTERED AS SMES OR SOLE PROPRIETORS.** In particular, regulations about collateral or proof of tax returns could have an impact as farmers engaged in agriculture, and particularly small holder agriculture, have limited access to both and usually rely on cash-flow based lending without collateral.

3. **FOCUS ON CONTINUOUS IMPROVEMENT OF AGRI-FINANCIAL AREAS AND PRODUCTS.** Although several programs in various areas already exist, financing schemes to promote the next generation of farmers (young farmer programs) with a focus on farmers in more marginalized (or remote) regions (e.g. mountainous areas), investment programs aiming at promoting innovation, and investments in new technologies (e.g. digital agricultural technologies, higher value processes) could be beneficial. There could be increased focus on programs that improve resilience to climate risks, promote “green” agriculture, and aim to cover more beneficiaries in line with the new CAP objectives. Such programs should be developed taking into account the existing social and economic infrastructure and need to be accompanied with capacity building for the targeted beneficiaries.

CHAPTER 3

COOPERATIVE BANKS AND EMPLOYEE MUTUAL HELP HOUSES

This chapter provides an overview of the main features of these institutions as well as some recommendations on how best to leverage their networks to enhance financial inclusion.

COOPERATIVE BANKS AND EMHHS[38] ARE IMPORTANT PROVIDERS OF FINANCIAL SERVICES IN RURAL AREAS AND FOR UNDERSERVED GROUPS. Their importance resides in that they, as membership-based organizations, are committed to provide services to segments that are not, or not adequately, served by banks. As banks have been closing rural branches at a fast pace, the services supplied by these providers in rural areas gain in importance given their local roots, which in some areas render them to be the only financial service providers (Table 8).[39]

TABLE 8. Overview of EMHHs and Cooperative Banks as providers of financial services

	Cooperative Banks	EMHHs
Number of entities	40	1453
Number of branches / points of service	790	n.a. (at least 1,500)
Number of members/ clients	1,250,000	1,144,000
Growth rate of members 2016/2017	n.a.	2 percent[40]
Total assets (in million RON)	1,215	3,700
Growth rate of assets 2016 / 2017	9.3 percent	12 percent[41]
Date of information	Dec 31, 2017	June 30, 2017

Source: NBR

[38] There is also an important segment of 143 Pensioners' Mutual Help Houses that serves about 1.5 million retirees and a further group of 348 special Mutual help Houses that provide services to 105,000 members of the public security and defense institutions. Unlike the EMHHs serving employees, the Mutual Help Houses serving retirees also assist their members with free or low-cost medical, tailoring, shoe-repair, food, and other services and supplies, activities they oftentimes fund with donations. The present document does not look into the retirees' or the special Mutual Help Houses as their membership is more restricted, the sector is less integrated, and they are less likely to substantially broaden their offering of financial services.

[39] Regretfully, information about the EMHHs is scarce and not consolidated. The MoPF, which is tasked with control over EMHH according to the legal framework (Law 122/1996), does not publish any data for the sector. The data about EMHHs used for this report stem was drawn from different sources (mainly from NBR and the two federations of EMHHs) and data refer, in some cases, to different dates.

[40] Estimated with figures from both federations.

[41] Estimated with figures from both federations.

COOPERATIVE BANKS

COOPERATIVE BANKS ARE FORMAL FINANCIAL ENTITIES OPERATING UNDER THE OVERSIGHT OF NBR THAT COMPLY WITH CAPITAL AND LIQUIDITY REQUIREMENTS AS A GROUP AND NOT AS INDIVIDUAL ENTITIES. Cooperative ("Coop") banks operate under the special provisions of the EU Capital Requirements Directive package[42] that allows cooperative banks operating with contractual or institutional protection schemes[43] to comply with the minimum capital and liquidity requirements as a group and not as individual entities. In contrast to commercial banks, which operate as individual entities, cooperative banks are affiliated to the CreditCoop federation, which has the responsibility of guaranteeing all obligations of its affiliates and to take the necessary measures to ensure the payment of contributions owed by them. To fulfill this responsibility, CreditCoop must ensure the liquidity and capital adequacy of each affiliated cooperative bank and provide financial assistance, if necessary.

THE COOP BANK SECTOR IS SMALLER THAN THE EMHH SECTOR BUT THE AVERAGE COOP BANK IS LARGER THAN AN AVERAGE EMHH. The 40 Coop banks manage 1.1 billion RON in assets, about a third of those managed by the EMHH sector. In order to achieve scale, the Coop bank sector has been actively pursuing a consolidation strategy over the last decades which has allowed them to decrease the number of entities in several steps (from 565 Coop banks in 1999 to only 40 today) while simultaneously addressing the poor financial performance of the sector. As a result, the individual entities are on average significantly larger than the EMHHs.[44] Coop banks would like to further consolidate their membership and form a smaller number of stronger banks but are constrained by legal limitations that establish that a federation must have at least 30 member banks to operate. Such a consolidation would be highly beneficial, as it would allow this segment to achieve significant gains in efficiency.

COOP BANKS HAVE A STRONG RURAL PRESENCE. Coop banks operate 790 branches, 500 of which are in rural areas. The network provides services to over 600,000 members in their areas of influence and to over 650,000 deposit clients.[45]

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[42] Directive 2103/36/EU and Regulation 575/2013/EU.

[43] Such protection schemes are defined by ECB as "a contractual or statutory liability arrangement which protects its member institutions and in particular ensures that they have the liquidity and solvency needed to avoid bankruptcy".

[44] Cooperative banks manage on average 30 million RON in assets, while EMHHs only manage 2.2 million RON each.

[45] Members have to reside in the defined area of influence of a cooperative bank; clients can reside outside that area.

THE SERVICE OFFERINGS OF COOP BANKS ARE SIMILAR TO COMMERCIAL BANKS', ALBEIT WITH SOME LIMITATIONS IN TERMS OF ELECTRONIC BANKING AND THE SIZE AND MATURITY OF THEIR LOANS. While their product offering is broader than that of EMHHs, including prominently different deposit services and loans to firms and farms, Coop banks do not yet offer digital access to accounts. Also, their loans are mostly small[46] and short-term[47], reflecting the short-term nature of their funding sources. Despite their strong rural presence, Coop banks do not have lending products that are tailored to the seasonal cash flows of agriculture, limiting their offering to this sector to a) the pre-financing of the subsidies granted by APIA to farmers and to b) loans to part-time farmers who also have regular, provable income sources for which they pay taxes. As in the case of EMHHs, Coop banks mainly provide loans to salaried employees, given that they face the same limitations regarding what is considered to be acceptable proof of income.

THE NETWORK IS PROFITABLE AND WELL CAPITALIZED. The network generated a 1.3 percent return on equity in 2017. As of December 2017, the system appears well capitalized with a total capital ratio of 27 percent. The network's other performance indicators overall seem acceptable with a comparatively low level of NPLs with a ratio of 1.2 percent in December 2017.

COOPERATIVE BANKS RELY ON A FINANCIAL SAFETY NET. Coop banks rely on the federation's (CreditCoop) guarantee and mandate to provide liquidity and solvency support to its affiliates. In addition, the deposits made at cooperative banks are covered first by the mutualization fund maintained by CreditCoop, and if this fund is not sufficient and CreditCoop fails there is also coverage under the FGDB, which covers all banks participating in the guarantee scheme. Hence, any losses suffered by Coop banks are mutualized by the whole system, which means that if one Coop bank fails, CreditCoop (using a "mutualization fund" formed by contributions of all other Coop banks in the system) will indemnify depositors in full, without triggering FGDB's guarantee. Only in case the mutualization fund is not sufficient and the CreditCoop cannot mobilize funds from the other Coop banks (i.e., the system fails as a whole) will FGDB come into play indemnifying depositors, up to the limit of 100,000 EUR set forth in the law. This structure means that the Coop banks pay two "premiums" for insuring depositors – one to the mutualization fund and another one to FGDB, which may put them at a competitive disadvantage when compared to commercial banks. Another concern of this structure is that FGDB lacks a direct relationship with the Coop banks, so it must ensure that it has updated data of the depositors at all times in case a payout is needed. Finally, CreditCoop's website informs depositors that they are insured by FGDB and that they will be indemnified within 7 days, but this information may be misleading: it may take a while between the individual Coop bank failure and the subsequent CreditCoop failure (which would trigger the 7-day period). In practice, depositors may not be able to receive their funds for a much longer time.

[46] Most loans granted in urban areas are below RON 20,000, loans in rural areas below 12,000 RON.

[47] Up to 5 years maturity.

CREDITCOOP FEDERATION

ALL COOPERATIVE BANKS ARE AFFILIATED TO THE CREDITCOOP FEDERATION. The federation represents its affiliates and provides them a variety of services. In addition to having responsibility for the liabilities of its affiliates, CreditCoop also reports aggregated information to the NBR. The federation also operates its own branches, targeting people who are not members of a first-tier cooperative bank. CreditCoop operates 17 own branches, which provide services to individuals and firms. In comparison to the individual, first-tier Coop banks that offer more basic products (mainly deposit and credit services), the branches of CreditCoop also provide services such as money transfers, money exchange, and remittances, which are very important in Romania. While it was stated by CreditCoop management that its branches do not compete with the local affiliated local credit cooperatives, this situation can be a source of conflict.

THE FEDERATION IS IN CHARGE OF SUPERVISING THE AFFILIATED COOPERATIVE BANKS TO ENSURE THEIR COMPLIANCE WITH APPLICABLE PRUDENTIAL REQUIREMENTS. CreditCoop operates a supervision department with 21 staff that has an independent status within the apex's structure. Although NBR maintains the supervisory authority over the system (apex and affiliates), the task of on-site supervision of the individual affiliates seems to have been delegated to CreditCoop, while the on-site supervision visits by NBR concentrate on the operation of CreditCoop itself as well as on CreditCoop's supervision department. In addition, CreditCoop collects the financial information from its affiliates and takes over financial reporting on behalf of the affiliated entities to NBR.

RECOMMENDATIONS

COOPERATIVE BANKS COULD PLAY A STRONGER ROLE IN FOSTERING FINANCIAL INCLUSION, IF THEY WERE TO EXPAND THEIR LENDING TO MSMES AND TO FARMERS AND THEY ENHANCED LENDING OFFERINGS FOR LONGER-TERM LOANS. To strengthen cooperative banks, it is recommended:

1. To revise and, if necessary, address the potential conflict of interest that arises, if the local branches of the apex organization compete with the affiliated first-tier cooperative institutions;
2. To build the capacity of Coop banks to serve informal and small enterprises, and farms;[48]
3. Although the CreditCoop network has a large number of branches, it is recommended to expand its reach, e.g. by facilitating the use of bank agent networks to significantly increase its geographical presence; and,

[48] The successful development of microfinance in several countries shows that such segments can be served profitably and with high quality loan portfolios, if adequate lending policies and procedures are utilized.

4. Take actions to further consolidate the sector by fostering mergers between Coop banks. For this it is advisable to reform the legal provisions applicable to Coop banks to allow for federations of these entities to operate with less than the current minimum of 30 entities. In addition to this, it is advised to assess options for a full merger of the network into one single cooperative bank, as was done by Rabobank in the Netherlands and by two Albanian Federations of Cooperative entities in 2016. In both cases, the existing federations of financial cooperatives underwent a transformation process, whereby the affiliated local cooperatives merged their operations fully to become new one-tier entities. While significantly reducing the costs and enhancing their operational efficiency, the cooperative systems in both countries maintain their cooperative governance structure, as fundamental decisions continue to be made by a general assembly of delegates from the towns and villages in which their membership resides (maintaining the principle of "one member - one vote"). While such a step would require careful preparation and consultations with the main stakeholders to the CreditCoop system, it could significantly enhance the efficiency of the sector and with it its capacity to grow and compete in a market that today appears underserved.
5. Take preparatory actions to ensure a proper flow of information among the individual cooperative banks, CreditCoop and FGDB, so as to ensure that FGDB is able to reimburse depositors within 7 days in case of failure by the whole Coop system.
6. To adjust the information contained in CreditCoop's website so as to avoid misleading depositors into thinking that the 7-days period will count from the failure of an individual Coop bank (rather than of the whole system).

EMPLOYEE MUTUAL HELP HOUSES

EMHHS HAVE A SUBSTANTIAL OUTREACH. Although the cumulative assets of the EMHHs amount to a total of 3.3 billion RON, the importance of these entities lies in the large number of people they serve and in the significant number of service points they operate. There are over 1,500 service points of EMHHs compared with 4,515 commercial bank branches. In addition, EMHHs are often located in rural areas, operating out of the premises of MSMEs. The largest federation for EMHHS, the National Union of the Mutual Aid Houses of the Employees of Romania (UNCARSR), estimates that about 20 percent of its affiliated entities are in rural areas. Although the EMHHs are restricted in their operations to serving salaried people, they reportedly serve large numbers of micro-enterprises and farms, oftentimes run as informal businesses on a part-time basis by people who also hold a salaried employment.[49]

[49] The shadow economy is estimated to generate almost 28 percent of GDP, the second highest in Europe after Bulgaria. In addition, employment in rural Romania is characterized by high levels of informality (estimated at between 20 and 50 percent of employment).

THE INDIVIDUAL EMHHS ARE VERY SMALL IN SIZE. Those affiliated to UNCARSR manage on average 2.2 million RON in assets, while those affiliated to the Federation of Mutual Aid Houses (FEDCAR) reach around 14.5 million RON. While their small size allows them to be close to their members, it also limits their professionalization (as they do not have the capacity to hire the skilled management that is required to operate a financial institution in an efficient manner), and it generates "diseconomies of scale" (as each of these entities must bear the costs of a dedicated management). As a consequence, many EMHHs have not been able to maintain their independent status and have exited the market through mergers and liquidations. Thus, the number of EMHHs has rapidly decreased from 2,569 EMHHs in 2012 to 1,453 as of June 2017.[50]

EMHHS ARE NOT DEPOSIT-TAKING BUT ARE FUNDED THROUGH "SOCIAL FUNDS."[51] Instead of mobilizing resources through deposits, EMHHs obtain over 85 percent of their funding in the form of "social funds", which constitute a form of long-term savings that cannot be withdrawn at will but only in case of membership termination or death. Social funds are built up over time, oftentimes through monthly contributions, and are relatively attractive, yielding an income that depends on the performance of each EMHH and reported above the yield of term deposits in the banking system.[52] This gives EMHHs a more stable funding base, as only few members terminate their membership to have access to their funds. Social funds are not covered by any form of guarantee.

EMHHS ALSO OFFER SHORT TO MEDIUM-TERM LOANS. LOANS ARE GRANTED TO MEMBERS AT COMPETITIVE INTEREST RATES FOR A VARIETY OF PURPOSES, INCLUDING PERSONAL NEEDS AND BUSINESS DEVELOPMENT OBJECTIVES. The loan amounts are normally determined as a multiple of the amount of social funds of a member[53] as well as by assessing the regular income streams of the members.[54] Loans are collateralized by the member's own social funds, by social funds that are in the name of guarantors, and by other collateral (including real estate). Loan maturities are typically up to three years.

[50] The exit of such a large number of entities has not generated any fiscal costs so far and such costs have apparently been borne by the members of the exiting entities themselves. The World Bank was not aware of any studies that document and analyze these significant developments.

[51] The maximum allowed balance of the social fund for a member is set by the Board of Directors, depending on the size of the social fund portfolio of each EMHH. The social fund can also produce an income if the interest received is superior to inflation, which is the case for most EMHHs.

[52] Even though social funds cannot be withdrawn by the members until retiring from an EMHH, they are not considered part of the equity of an entity. Contributions to the social fund are considered liquid, as the entire amount is available when the member wishes to withdraw from the EMHH, as long as it does not serve as collateral for another member's loan.

[53] Typically three to five times the member's social fund.

[54] For many rural residents, agriculture provides some proportion of their income, but a lack of formal documentary evidence of this income makes it difficult to obtain loans to grow their business. As discussed in the section on agricultural finance, financial entities only consider a borrower's taxable income when determining her or his capacity to repay a loan. In consequence hereof, loans may be smaller than they would be, if all income sources, including those from informal activities (farms and micro-enterprises), were considered.

EMHHS HAVE BEEN GROWING AND SEEM TO HAVE ADEQUATE FINANCIAL PERFORMANCE. Although not corroborated by an external independent supervisor, the indicators reported by the two federations about their affiliates indicate an adequate performance. As of June 2017, the UNCARSR affiliated entities generated a annualized return on equity of 6.2 percent while the network shows a capital ratio of 16 percent, well above the 10 percent ratio that is recommended by World Council of Credit Unions, and an NPL ratio of 3.3 percent. The FEDCAR affiliated network reported as of September 2017 an annualized return on equity of 10.8 percent, and a capital ratio of 12 percent, while the level of NPLs was around 7.0 percent. The absence of external and independent oversight limits severely the credibility of these entities. The assets of the EMHHs have been increasing at a rate of 9 percent annually in the last 4 years, indicating a strong demand for their services. Growth has in part been hampered by the regulatory limitations that affect EMHHs' access to third-party-funding. If such restrictions were lifted, EMHHs could likely expand their offering to their members to include larger and longer-term loans. However, this would mean increased risks on EMHHs' operations, which should be coupled with the introduction of mechanisms to protect the members' social funds.

THE LEGAL FRAMEWORK FOR EMHHS IS LARGELY BASED ON THE LAWS PASSED IN 1996 AND OF 2009, WHICH CONSIDER THEM NBFIS.[55] EMHHs must be registered by NBR and their activities fall under the control of MoPF. In contrast to other EU countries such as Poland or Ireland, Romania did not adhere to the special EU regime that allows comparable entities[56] to provide a broader range of services, due to a lack of consensus of the main sector stakeholders.

EMHHS ARE BY LAW ALLOWED TO ENGAGE ONLY IN A LIMITED SCOPE OF ACTIVITIES. Among other restrictions, EMHHs are not allowed to take deposits and individual EMHHs are not allowed to mobilize third-party resources. Their funding, therefore, is limited to the social funds they capture, the equity they have accumulated (mainly through retained earnings), and funds provided by their federation (which are rather limited). In addition, EMHHs can only serve individual people and they are not allowed to provide services to companies, which inhibits their ability to expand their business by lending to formal MSMEs.

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[55] Law No. 93/2009 on Non-Bank Financial Institutions (NBFIs) and Law No. 122/1996 on the legal regime of employee EMHHs. In contrast to other NBFIs, EMHHs are exempt from the minimum capital requirement of 200,000 EUR.

[56] Credit Unions.

FEDERATIONS

EMHHS ARE ORGANIZED IN TWO NATIONAL FEDERATIONS, UNCARSR AND FEDCAR, WHICH PROVIDE A RANGE OF SERVICES. The federations are trade associations that represent their affiliates and defend their specific interests, especially vis a vis the authorities. Federations provide IT support, training, and also play an important role in overseeing their affiliates. Federations are allowed to establish companies in the interest of the EMHH system and they may obtain external loans to strengthen the system.

UNCARSR ALSO PROVIDES THE SERVICES OF AN INTERNAL CREDIT BUREAU, ALBEIT ONLY COVERING NEGATIVE INFORMATION ABOUT THE PEOPLE WHO BORROW FROM THEIR AFFILIATES. In contrast to banks and other NBFIs, which are mandated to consult and to report to credit bureaus,[57] EMHHs are only able to consult the information stored by the federation's credit bureau about defaulting loans.

THE TWO FEDERATIONS OF EMHHS HAVE DIVERGING VIEWS ABOUT THE DESIRABLE OPTIONS FOR THE FUTURE DEVELOPMENT OF THE SECTOR. While one federation would like to expand and diversify its services, even if stricter oversight is required, the other would like to maintain the current offering, which meets an important demand of its members and has proven relatively stable, maintaining the current oversight structure.

THE MAIN STRUCTURES PROVIDING OVERSIGHT OVER THE EMHH SECTOR ARE THE TWO FEDERATIONS. The federations maintain a separate supervision unit that oversees and supervises their affiliates to ensure proper performance and the safety of members' social funds. The federations also centralize the annual financial statements of the affiliated EMHHs and of their territorial unions for submission to the MoPF and they issue internal regulations, including prudential standards to be observed by their affiliates. The activities of the federations are complemented by the internal audit structure that must comprise in each EMHH at least one auditor who is accredited by the Romanian Auditors' Association.

ALTHOUGH EMHHS AND THEIR FEDERATIONS FORMALLY FALL UNDER THE CONTROL OF THE MOPF, THE MINISTRY DOES NOT SEEM TO EXERCISE ANY OVERSIGHT FUNCTIONS. MoPF does not publish any information about this. NBR also does not perform any supervision of these entities, despite including them in their register of institutions and collecting statistics from them. The absence of independent external supervision over the sector and, especially, over its federations (given the oversight role they play), constitutes an important weakness that should be addressed.

[57] According to NBR Regulation no.2/2012, institutions reporting to the NBR Central Credit Register are credit institutions and non-bank financing institutions registered with the Special Register. The reporting threshold is 20,000 RON.

AS OF TODAY, EMHHS DO NOT COUNT ON ANY FORM OF FINANCIAL SAFETY NET THAT COULD HELP THEM ADDRESS EVEN TEMPORARY SHORTCOMINGS. The resources provided by members in the form of social funds are also not covered by any form of guarantee. This constitutes an important shortcoming given the large number of people they serve and who have entrusted the EMHHs with their savings.

BOTH FEDERATIONS AGREE THAT THE INTRODUCTION OF A GUARANTEE SIMILAR TO A DEPOSIT GUARANTEE TO COVER SOCIAL FUNDS WOULD BE BENEFICIAL TO THE SYSTEM. This would certainly require strengthening EMHHs legal framework and enhancing supervision, but it would make them more attractive to members and be a first step to allow them to engage in a broader range of operations. However, one federation expressed serious concerns about the cost such a guarantee scheme would impose on EMHHs.

RECOMMENDATIONS

EMHHS COULD PLAY A SIGNIFICANT ROLE IN HELPING ADDRESS THE FINANCIAL EXCLUSION OF LARGE SEGMENTS OF THE POPULATION, if they were to diversify the services they provide and to open their doors to other important constituencies such as micro-enterprises and farms. Considering the existing legal framework, there are two non-mutually exclusive options to address the shortcomings described above: a) gradual transformation; b) transformation into a cooperative bank with support from the authorities.

THE PATH OF GRADUAL TRANSFORMATION OF THE SECTOR WOULD ALLOW ENTITIES TO CONTINUE THEIR CURRENT PATH OF DEVELOPMENT, ALBEIT ADDRESSING THE MAIN SHORTCOMINGS OF THE CURRENT MODEL. A gradual approach would require a series of legal and institutional reforms to

1. establish credible and solid oversight over the sector and, especially, its federations. This task would require the participation of NBR to ensure that the supervision policies and procedures are consistent with those applied to small banks and, especially, to avoid any regulatory and supervisory arbitrage. The federations as well as the largest EMHHs should also be overseen by NBR to ensure their sound operation; and
2. implement a financial safety net for the sector and insurance for social funds (and other deposits, if they were to be introduced), considering experiences in other countries.

THE STRATEGIC AND LEGAL FRAMEWORK COULD ALSO BE ENHANCED TO IMPROVE ITS EFFICIENCY AND TO DIVERSIFY ITS SERVICES. The following steps may be advisable: a) define a strategy to foster further consolidation of the sector into fewer and larger EMHHs; b) facilitate access of EMHHs to external funding; and c) allow qualifying entities to expand their services such as channeling remittances,[58] providing longer-term loans, accepting term-deposits, and serving farms as well as micro and small enterprises. Define specific criteria of eligibility to allow EMHHs to provide such services, build capacity at the level of the federations to support the introduction of such new services, and strengthen oversight.

[58] Romania has probably the highest level of migration in Europe. It is estimated that between 3 and 5 million people, in many cases from rural areas, now live and work abroad. As a result, it is estimated that Romania receives 7 billion EUR in remittances annually.

ALTERNATIVELY, THE TRANSFORMATION OF EMHHS INTO ONE OR MORE COOPERATIVE BANKS WOULD ALLOW THEM TO MAINTAIN THEIR COOPERATIVE NATURE WHILE ADDRESSING MOST OF THE CONSTRAINTS THAT CURRENTLY LIMIT THE DEVELOPMENT OF THE SECTOR. Under this path, which may require legal reform to allow for such a transition, the entities transformed into one or more cooperative banks would immediately benefit from the existing supervisory framework, and they would also at once be allowed to enhance the range of services they provide. Taking such a step would entail a well-prepared transition process (and possibly external support with technical assistance) that would require: a) that participating EMHHs merge into one or more larger entity(ies) that would comply with applicable minimum capital requirements as a bank;[59] b) that the new cooperative bank(s) join CreditCoop as the apex organization for such entities; and c) that the new bank complies with applicable prudential standards and that it fulfills applicable organizational requirements. A further condition to adopting this strategy would be that the relationship between FGDB, CreditCoop and the Coop banks is resolved, to ensure that depositors of all Coop banks receive adequate protection from FGDB.

THE VIABILITY OF THE DIFFERENT OPTIONS SHOULD BE DISCUSSED AMONG THE MAIN STAKEHOLDERS AND ESPECIALLY WITH THE TWO FEDERATIONS. Given the complexity of legal changes that may be necessary to successively adapt the legal framework for EMHHs, their transformation into cooperative banks may be the most advisable path for development.

[59] Such processes could be carried out under the leadership of any interested federation.

ANNEX

TABLE 9. Ordinary least squares regression of financial inclusion against individual characteristics

	Account Ownership	Borrowed from a financial institution or used a credit card	Saved at a financial institution
Women	-0.0397 [0.034]	-0.0259 [0.025]	-0.0191 [0.021]
Ages (15-24)	-0.001 [0.058]	-0.112** [0.045]	0.003 [0.036]
Marital status: Married	0.0193 [0.040]	0.0275 [0.037]	0.0337 [0.025]
Household size	0.093** [0.037]	0.085*** [0.031]	-0.024 [0.024]
Primary education and below	-0.240*** [0.047]	-0.082** [0.032]	-0.030 [0.029]
Rural residence	-0.019 [0.039]	-0.043 [0.034]	0.01 [0.029]
Poorest 40 percent of households	-0.253*** [0.038]	-0.060* [0.032]	-0.116*** [0.025]
Employed for wages	0.176*** [0.040]	0.094*** [0.036]	0.01 [0.034]
Constant	0.614*** [0.048]	0.170*** [0.040]	0.190*** [0.039]
Observations	999	999	999
F-stat	31.76	6.220	7.019
p-value of F-stat	0.00	0.00	0.00

Source: Author's estimations using the Global Findex database

Note: *Standard errors in brackets, *** p<0.01, ** p<0.05, * p<0.1, The base categories are Men, Ages (25+), Marital status: Widowed, Single, Divorced, or other, Education status: Greater than primary education, Residence in an urban area, Richest 60 percent of households, Employment status: Unemployed, Out of workforce, or self-employed.*