

AGENCY FOR ECONOMIC COORDINATION & DEVELOPMENT

1, Levski Str., 1000 Sofia, Bulgaria

WORKING PAPER SERIES

AGRICULTURE AND AGRARIAN POLICY IN 1994

N. Mileva

March 1995

ISBN 954-567-016-9

© *Agency for Economic Coordination and Development*

© *N. Mileva, 1995*

Contents

PREFACE	1
1. THE SITUATION IN AGRICULTURE AND THE IMPACT OF THE LAND REFORM ON AGRICULTURAL PRODUCTION	3
2. FOREIGN TRADE WITH AGRICULTURAL AND FOOD PROD- UCTS	9
3. AGRICULTURE AND CHANGES IN THE STRUCTURE OF RELATIVE PRICES	15
4. SUBSIDIZED CREDITS	19
CONCLUSION.....	25

PREFACE

The period of transition to a market economy created serious problems for the agricultural sector. They stem from the overall economic situation in Bulgaria and are common to all countries applying restrictive stabilization programmes, and from difficulties in the sector itself related to the structural reform. These problems were aggravated by the loss of traditional markets in the former socialist countries, especially in ex-USSR, as well as by the limited access to West European markets. Compared to the other centrally-planned economies in the past, Bulgarian agriculture suffered the hardest problems due to the radical approach to the land reform in the country.

Since 1990 no comprehensive development policy in agriculture has been worked out and applied. The efforts have been focused on the land reform whose progress, however, has been slow. Agriculture was influenced by the overall macroeconomic policy (e.g. high interest rates, restrictive incomes policy), and the attempts to offset its negative impact by tax concessions and programmes for credit subsidies. Therefore, government intervention in the agrarian sector has been characterized by temporary and ad-hoc measures which could only correct the unwanted results instead of tackling the reasons behind. The ongoing land reform is the reason for the lack of well-defined economic agents and organizational forms in agriculture: the socialist-style co-operatives are torn down while the status of the new ones is still in the making. Sagging domestic demand and the rechannelling of trade flows after the disintegration of CMEA markets require the adjustment of domestic output to the new structure and volume of demand (domestic and foreign). The supply of agricultural products, which is hard to predict under these conditions, has become even more unpredictable.

The present paper evaluates some general trends and problems in agriculture in 1994. It is a continuation and elaboration of the study on agriculture over the period 1990-1993.¹ The main aim is to establish the extent to which agrarian policy in 1994 supported the transition to market-oriented agriculture.

The paper has four chapters. The first analyses the changes in the volume and structure of agricultural production in 1994 which relate to the pace of the land reform. The second examines trade with agricultural and food products, as well as the conditions for and obstacles to its development set by the foreign trade regime. Chapter 3 traces the development of the agrarian sector's terms of trade and the impact of the depreciation of the leva on them in 1994. Chapter 4 estimates the significance of credit subsidies which were the main instrument for supporting agricultural producers in 1993 and 1994. The concluding chapter contains the summary of the most important conclusions. □

¹ Mileva, N., Agriculture in the Period of Transition, in *The Transition*, Sofia, 1994.

1. THE SITUATION IN AGRICULTURE AND THE IMPACT OF THE LAND REFORM ON AGRICULTURAL PRODUCTION

Compared to Western Europe, agriculture in Bulgaria is much more significant for the national economy. Changes in recent years had a strong negative impact on the sector. In the post-reform period its share in GDP plunged sizably: from 18.3% in 1990 it fell to 9.2% in 1993. The sector accounts for about one-fifth of overall employment in the country, following an upward trend both in absolute and in relative terms. From 19% in 1991 the share of employed in agriculture rose to 22% in 1993. The ratio of two indicators - value added and employment - points to falling productivity in the sector since 1991 which may be due to the sharp drop and even the actual lack of investment, to financial constraints and poor technological state of the emerging private structures in agriculture. High interest rates and the aggravating terms of trade in the agrarian sector extended the decapitalization from the pre-reform years well into 1994. Financial constraints have been a lasting factor for the fall in production volume.

Drastic shrinking in production volume was registered in 1992 and 1993 when output drop amounted to 12% and 18.2% respectively, mainly as a result of the prolonged drought. After falling for four consecutive years, agricultural production is expected to increase by some 4% in 1994.² **This rise is solely based on the relatively more favourable climatic conditions** which will account for 23% growth in plant production, raising it close to its 1992 level. The expected 1994 rise is limited only to grain, sunflower seed, vegetables and some fruits; the yield of the remaining crops is expected to plunge. The drop in stock-

² AECD forecast based on the expected 1994 yield and the reported volume of livestock production in January-September 1994.

breeding will continue (for a sixth year in a row) at quite the same rate as in 1993 (-15%).

Animal units and output of basic agricultural products

(annual rate, %)

	1991	1992	1993	9m.94/ 9m.93*
Animal units				
cattle	-20.1	-26.4	-22.9	-25.3
pigs	-25.0	-14.7	-22.7	-14.8
sheep	-15.6	-28.2	-21.8	12.8
fowl	-22.5	-8.4	-8.4	-10.7
Meat produced (slaughter weight)	-15.6	-7.1	-11.3	n.d.
Milk produced	-15.9	-10.0	-16.6	-14.5
Vegetables	-3.4	-7.4	-25.3	43.2
Fruit	-20.8	7.8	-41.2	3.1
Grain	10.4	-26.8	-11.2	22.0
Sunflower seed	11.7	37.1	-25.7	52.1
Wine grapes	2.3	6.9	-35	-4.6
Oriental tobacco	0	-7.0	-30.2	-25.0

* Rates for crops are calculated on the basis of reported 1993 figures and expected output in 1994.

Source: NSI, AECD

In 1994 the land reform went on at twice higher rates than in the year end 1993. By the end of November 1994, municipal land commissions had issued certificates for **final restoration of ownership of land** (within existing or restorable real boundaries, and based on land division plans) on a total of 1 736 800 hectares (against 790 000 Ha at the end of 1993). The rise is mainly due to land restitution based on land division plans. At the end of November 1994, certificates for final ownership restoration covered **32.8% of land subject to restitution** (5 302 400 Ha).

At the end of 1993 the government granted extended powers to land commissions to issue title deeds. As a result, by the end of

November 1994 the area for which title deeds were issued had tripled compared to the end of 1993, yet remaining rather small (11950 Ha). The average size of land plots is tiny (2.2 Ha). Only a small part of former land owners - those who had contributed land to the old co-operatives - were issued title deeds. Should they be dead, the heirs get a joint title deed on the estate and are forced to undergo long legal procedures for its partitioning. At the end of November 1994 land allocated for **temporary use** amounted to 1 950 300 Ha or **36.8% of land subject to restitution**.

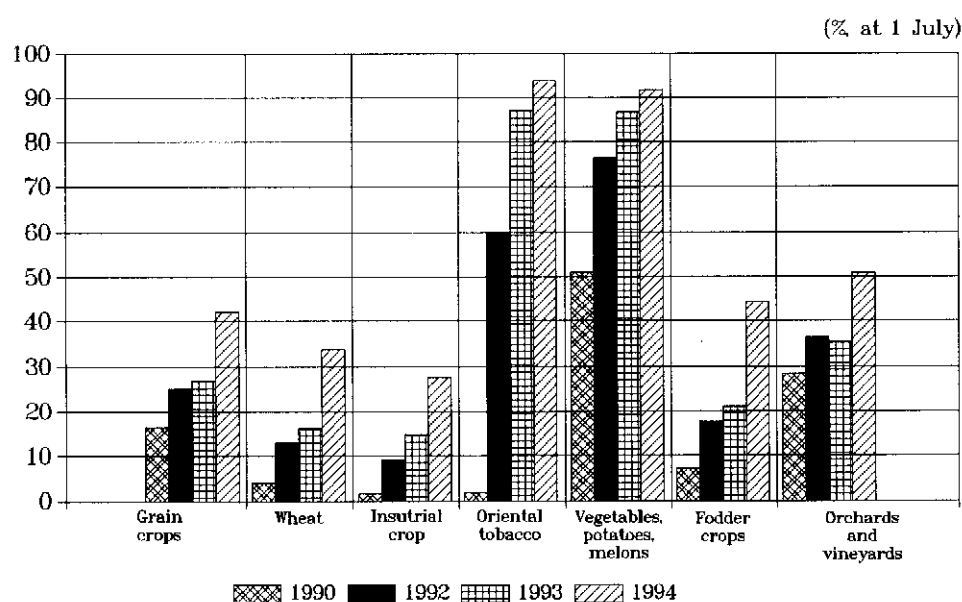
The process of land reform exerts a definite impact on the efficiency, volume and structure of agricultural production and the forms of land tenure. The shortage of working capital and rising input costs together with the temporary form of land tenure reduce the area under crops and the use of mineral fertilizers and pesticides, disrupt rotation, and permanently worsen the soil composition. In 1993 the amount of mineral fertilizers applied reached only 30% of the 1990 level. For potassium fertilizers this ratio was 7%. Uncropped land has been expanding with each post-reform year. In 1994 it covered 13.3% of arable land (against 9.7% in 1993 and 4.2% in 1992). A large part of idle land (38%) is concentrated in the private sector.³ Uncropped land accounts for 11.5% of privately-owned areas. For co-operative land this share is sizably smaller - 5.7%. The temporary form of land tenure forced farmers to lower expenditures for amelioration and investment and reduce activity in all types of farms, which reflected on yields. This caused lasting changes in the structure of arable land, detrimental to perennial crops. Forage crops and perennials were avoided by all economic agents: private farmers, leaseholders, co-operatives, associa-

³ *In this case, statistics includes under „private sector“ the forms of land tenure outside the liquidation councils; institutes; experimental agro-stations and bases of the Agricultural Academy and co-operatives. The term signifies mainly the individually-cultivated land except land leased to co-operatives and others, as well as the land belonging to associations, religious organizations etc.*

tions and liquidation councils alike. Area under forage crops in 1994 fell short of one-third of its 1990 level, accounting for just 7% of arable land. Perennial fruit and berry crops plunged by 27% over the same period, amounting to only 4.8% of arable land in 1994. Grain crops which are highly mechanized and preferred by the liquidation councils, raised their share from 46% in 1990 to 52% in the last two years.

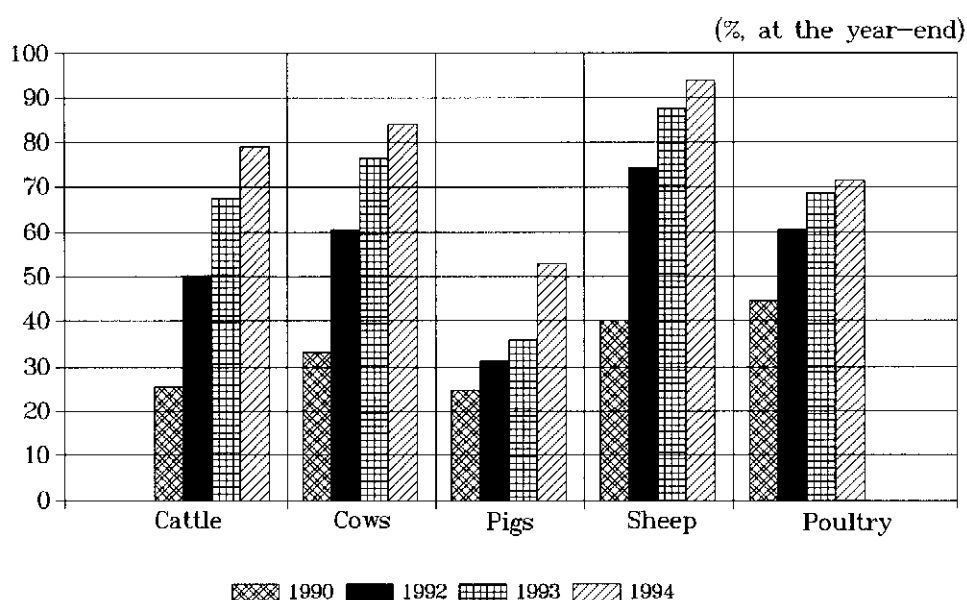
Private sector in agriculture continued to expand and in 1994 became the main form of land tenure. The area cultivated by private farmers and private associations reached 44% of arable land (compared to 28.9% in 1993). Area cultivated by liquidation councils decreased more than two-fold over a year, and its share in arable land shrank from 61.6% in 1993 to 30% in 1994. **Temporary land tenure and the slow progress in the land reform gave rise to mushrooming co-operatives for land cultivation.** The area they cultivate expands relatively faster than that of private farmers or private associations: compared to 1993, it increased 2.7 times to reach 25.8% of arable land in 1994.

Private Sector Share in the Land Sown



The private sector share in agricultural production is expected to exceed 60% in 1994 (and amount to about 62%). In stock-breeding the private sector is predominant (about 74%), while its share in plant production is expected to total 55% in 1994.

Private Sector Share in the Livestock



Private farmers raise such crops as vegetables and tobacco, where labour is chiefly manual. In 1994 (as of 01.10.1994) the private sector accounted for 94% of sheep-breeding, 80% of cattle-breeding and 72% of poultry-breeding. The state-owned sector has kept a substantial share only in pig-breeding (47%). **A new negative development in 1994 (January-September 1994 relative to the same period in 1993) is the falling number of all kinds of livestock in private farms.** By 1992 these farms registered annual decreases only in the number of pigs (1991) and fowl (1990 and 1991). All other livestock groups marked an increase by heads against the overall fall in livestock quantity. The biggest rise was registered in 1990 as a result of livestock „restitution“ in its capacity as share in the property of former co-operative farms. In

1993 the number of pigs and sheep decreased, and 1994 the fall spread across all livestock groups. Sharply rising production costs and the lack of financial resources pose a threat to the still weak private sector as well. The slow progress in land restitution and the unstable macroeconomic environment breed insecurity and act as impediment to the renewal and increase in the number of livestock. □

2. FOREIGN TRADE WITH AGRICULTURAL AND FOOD PRODUCTS

Trade with agricultural and food products in 1993 plunged due to the poor harvest and adverse external factors. In 1994, however, it recovered its share in total volume of trade. In the nine-month period of 1994 the balance of trade with agricultural and food products was positive at 318 mn USD. It exceeded the balance in the same period of 1993, closing on the annual 1993 figure. Agro-food exports restored their share in overall exports (22.86%) after the sharp plunge in 1993 (21% annually, 18% in the nine-month period). This was based mainly on the good harvest and the wider spread between domestic and export prices due to the BGL depreciation. A notable increase was seen in the share of agro-food imports within overall imports, which peaked at 10.3% (compared to 9.4% in 1993). When goods imported to be reexported are excluded (for reasons of comparability to the nine-month periods in 1992 and 1993 when these were not included), the share of agro-food imports in overall imports in January-September 1994 would amount to 7.7%. Its increase compared to the same period in 1993 was negligible (0.6 percentage points). Against the same period in 1992, it plunged by 0.3 percentage points.

The main items in both the export and import lists have the largest contribution to the growth in agro-food trade. Sugar and sugar products have the biggest share in imports, and tobacco, cigarettes, beverages and spirits, fruit and vegetables - in exports.

Major commodity groups in agro-food trade

(% in total exports/imports of agro-food products)

Commodity Groups (Chapters of the Harmonized System)	1992	1993	9m.92	9m.93	9m.94*
EXPORTS					
1. Live animals	10.2	5.3	14.1	7.3	7.8
2. Meat and edible offal	6.9	4.6	9.3	4.9	4.5
4. Milk and dairy products...	6.3	5.9	8.2	6.1	5.2
7. Vegetables...	5.0	3.0	6.8	3.8	4.8
8. Fruit...	1.9	2.7	2.4	2.5	9.3
10. Grain	7.7	1.7	7.0	2.1	1.3
12. Oilseeds and fruit...	4.8	3.6	3.5	4.4	1.9
15. Fats and oils...	1.4	3.1	1.9	5.6	2.8
20. Fruit and vegetable preparations...	5.4	8.1	6.4	8.8	5.1
22. Beverages and spirits...	10.1	16.7	10.6	15.7	15.5
24. Tobacco and manufactured tobacco substitutes	31.0	31.9	22.5	26.6	26.7
IMPORTS					
1. Live animals	1.3	1.2	1.4	2.0	0.9
2. Meat and edible offal	1.0	4.6	0.2	4.8	4.8
4. Milk and dairy products...	2.2	3.5	2.2	3.9	4.9
7. Vegetables...	0.9	1.8	0.9	0.8	2.5
8. Fruit...	5.5	7.7	4.7	8.2	11.0
10. Grain	2.4	4.8	0.5	3.6	1.6
12. Oilseeds and fruit...	0.9	0.8	1.2	1.2	1.4
15. Fats and oils...	3.0	4.9	2.7	3.6	4.9
17. Sugar and sugar products	23.3	16.9	17.2	16.9	26.1
20. Vegetable and fruit preparations...	2.5	2.6	2.7	3.9	2.4
22. Beverages and spirits...	9.9	5.8	12.9	7.6	6.6
24. Tobacco and manufactured tobacco substitutes	22.7	23.1	28.6	14.9	15.0

* Preliminary data for the nine-month period as of November 1994.

Source: ICC-MF, AECD

After the good 1994 yield, vegetables and fruit may restore their position in the agro-food export list. The relative share of live animals in exports is also increasing, although on a slower rate. The EU embargo on imports of live animals and meat from Southern Bulgaria because of the 1993 foot-and-mouth outbreak remained a limiting

factor in 1994 as well. Unlike live animals, milk and dairy products continued to decline in relative terms, accounting for the weakening contribution of animal products in overall agro-food exports. The share of animal products in agro-food exports considerably increased after the reform due to the loss of fruit, vegetable, tobacco and cigarettes markets in the former CMEA area, mainly in Russia. This contrasted to a sustained or growing export of live animals, meat and meat products for the EU and the Arab countries. In the nine-month period of 1992 this commodity group accounted for 35% of agro-food exports. In 1993 (the nine-month period), due to the foot-and-mouth outbreak and the embargo imposed by EU and Arab countries, Bulgarian exports of live animals and meat dropped to 23%, plunging to 22% in January-September 1994. Sunflower seed exports fell considerably both in absolute and relative terms, due to the sharp rise in export taxes which impeded export (from 45 USD/t till August 1993, the export tax was doubled in September 1993 and in 1994 twice raised: to 120 USD/t in July and to 200 USD/t in October). The export ban accounts for the sharply falling share of grain crops in overall agro-food exports in the last two years.

Imports were restructured by the growing share of vegetables and fruit. Potatoes contribute the largest share to vegetable imports due to the low potato yield in 1993. The bulk of fruit imports belong to citrus fruits and bananas. In the last two years meat increased its contribution to the agro-food import list more than 5-fold. This provoked the introduction of minimum import prices on pork and chicken in 1993.

Decree No.241 of the Council of Ministers adopted in December 1993 did not envisage fundamental changes in the foreign trade regime of agricultural and food products in 1994. Trade measures during the year, however, pointed to an **increased use of quantitative**

non-tariff restrictions (quotas for duty-free or low-duty imports and for lower export fees), as well as to expanding the toughest restriction - export bans. After expiring on 30 September, the export ban on cereals was extended till 15 November 1994. Export bans were also imposed on sunflower seed and female animals. Duty-free import quotas on bread wheat, maize and barley were preserved in 1994 as well. New quotas on refined sunflower oil were opened. These measures were intended to suppress the growth of domestic prices and remove temporary deficits.

Agro-food trade policy in 1994 was situational and had short-range aims. It was not based on analysis of long-term and stable trends in domestic production, prices and trade with agricultural products. Such an analysis would show that, due to the wide gap between domestic and export tax after 1992, there is a danger of an explosive growth in sunflower and sunflower oil exports. Adequate preventive measures, such as the gradual increase of the export tax to avoid market deficits after the poor 1993 harvest, could have been taken as early as the end of 1992. Instead, the export tax was raised sharply only after the emergence of deficits, which led to exporters' losses from already concluded deals. This inconsistent policy was a source of insecurity for both importers and exporters. The contradictory effect of sporadic measures often went beyond the limits of trade policy. They also clashed with the other economic instruments which regulated agriculture. For example: despite the export restrictions, a large quota was set for the export of sunflower seed for sowing without export tax; on one hand, agricultural producers are supported by subsidized credits and duty-free import of machinery, spare parts and chemicals, while on the other, they are denied higher prices through export restrictions and duty-free imports; quotas are opened for duty-free import of vegetable oil which runs contrary to the imposed limit prices in the domestic market.

The use of non-tariff quantitative restrictions and absolute bans disagrees with the negotiations for Bulgaria's membership in the GATT and the World Trade Organization.

In 1994 the Interim Trade Agreement with EU came into force. Despite the compensations received for its delayed entry into force, nine-month results indicate that **the share of EU in overall agro-food trade is declining**. From 85 mn USD in 1992 and an average of some 60 mn USD in 1990 and 1991, EU trade balance in the agro-food sector fell to 24 mn USD in 1994.⁴ In the nine-month period of 1994 Bulgarian exports to the EU amounted to 18% of overall agro-food exports (against 24% in 1992), and imports from the EU - to 30% (against 39% in 1992). The incomplete use of preferential quotas may get different explanations: the lack of experience in Bulgarian producers and scant information; the technical difficulties in monitoring the Bulgaria quota implementation; the export ban on live animals and meat from Southern Bulgaria to the EU; the low quality of Bulgarian goods; the lack of developed marketing system and warehouse network which is important for the competitiveness of Bulgarian exports.

These concrete reasons reveal some fundamental problems in Bulgaria's trade with the EU and the trends for improving the mechanism of Bulgarian trade in agro-food products. The most important conclusions for the progress of Bulgarian trade with EU are:

1. It was not Bulgaria, but **the EU that actually benefited from trade in the transition period**. (This is also true for the remaining five countries which have signed Interim Association Agreements with the Union). In theory, the Agreement ensures asymmetrical liberalization of trade, with faster easing of protection on the part of EU. In practice, however, EU imports into Bulgaria rose faster than Bulgarian exports

⁴ Data for the nine-month period are preliminary - as of early November 1994. Source: ICC-MF and AECD.

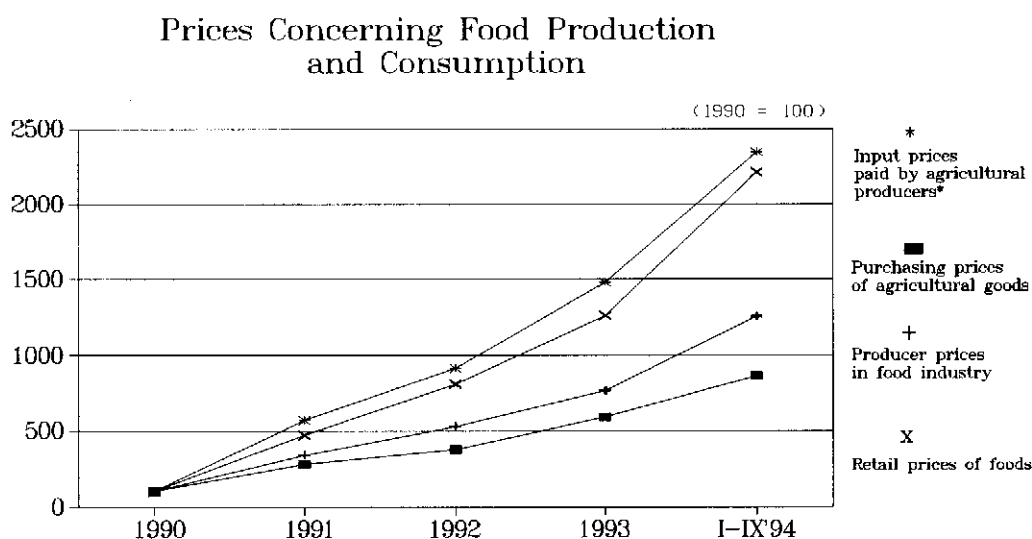
for the Union, i.e. just the opposite - an asymmetrical real market access in favour of EU. The reference period (1989-1991), serving as basis for setting preferences, is old and does not reflect the export structure and relative advantages of Bulgaria in trade with EU under the present conditions, viz. after the breakdown of the CMEA markets. (Thus, for example, the import of live animals and meat from small cattle from Bulgaria needs much more generous real concessions.)

2. During the short term of the Agreement, the EU is the side **which first took advantage of the clause for unilateral imposition of protective measures in case of threat.** There is a danger of furthering the practice of hasty bans on Bulgarian exports at unconfirmed information. Such practice **does not improve our trade relations. What we need is a more flexible mechanism in tune with the specific features of Bulgarian economy in the transitional period.** In fact, this requires development of the preventive mechanism, conducting consultations before imposing embargoes, and more real stimuli to Bulgarian exports. □

3. AGRICULTURE AND CHANGES IN THE STRUCTURE OF RELATIVE PRICES

In 1994 (the nine-month period relative to the same period in 1993) purchasing prices of agricultural products lagged behind consumer price inflation, falling by 15.9% in real terms.

In the high-inflation environment of 1994, domestic terms of trade in the sector (the ratio between purchasing and input prices) continued to deteriorate.



* Producer prices of fertilizers, electricity, fodder, pesticides, diesel fuel.

Source: NSI, AECD

In the nine-month period of 1994 (relative to the same period in 1993) input prices rose by an average of 58.2%, and purchasing prices of agricultural products - by 47.4%. Over the whole post-reform period purchasing prices have been lagging behind input prices by 63%.

The highest rises among purchasing prices were observed for export products like fruit (104%), vegetables (55%), sunflower (76%), as well as for the undersupplied meat products like beef, (82.8%) and mutton (55%). Given the richer 1994 crop, the export ban on cereals sustained their artificial oversupply and low prices (29.8%).

The high nominal interest rate, the introduction of VAT and the BGL depreciation accounted for the substantial rise in input prices. The BGL depreciation had a two-way impact: on one hand raising production costs and consumer expenditures, and boosting the competitive edge of Bulgarian agricultural products in the world markets on the other. Due to the imposed export restrictions, however, **the negative effect was stronger in the nine-month period.**

After its relative pickup in 1993, in 1994 the share of purchasing prices of agricultural products in producer prices and consumer prices of foods fell considerably. Similar to the first two reform years, in 1994 the share of raw agricultural products in retail prices underwent a sharper drop (-37%) than their share in producer prices (-26%). In a sectoral aspect, this share is larger for animal products, due to their low supply.

These changes in the parity price ratio for agricultural goods indicates that the market system for foodstuffs is inefficient, redistributing the revenues from the higher prices in favour of processors and traders at the expense of agricultural producers. The lack of competitive environment in purchasing and processing is a revenue-depressing factor (through prices) in the sector.

Deviation of domestic from international prices of some basic agricultural products*

	measure	1990	1991	1992	1993	9m.94
wheat - deviation of prices	%	159	-42	-41	-16	-31
purchasing price	lv/t	342	922	1522	2621	3304
export price (import price in 91)	lv/t	132	1596	2566	3116	4760
sunflower	%	131	-30	-46	-28	-51
purchasing price	lv/t	626	2383	2683	3944	6299
export price	lv/t	271	3412	4959	5455	12737
veal and beef (live weight)	%	386	-42	-33	-20	-36
purchasing price	lv/t	3437	9548	14134	19013	27002
export price	lv/t	707	16597	21090	23804	41901
pork (slaughter weight)	%	334	-43	-36	29	-13
purchasing price	lv/t	4093	13283	21446	33352	49555
export price till 92, import price in 93,94	lv/t	944	23397	33646	25779	56728
chicken (slaughter weight)	%	201	-42	-29	-5	-8
purchasing price	lv/t	3108	13531	18538	27279	41448
export price till 93, import price 94	lv/t	1033	23192	26174	28704	45289
mutton and lamb (live weight)	%	81	-45	-26	-17	-34
purchasing price	lv/t	2021	9056	15999	23038	33727
export price	lv/t	1115	16500	21492	27655	50952

* Domestic prices are equal to purchasing prices at farm gate, world prices are equal to the average unit value of exports/imports, depending on whether the country was net exporter/importer of the product.

Source: NSI, ICC-MF, AECD

Agricultural producers get lower domestic prices compared to their world equivalents. The difference in 1991 and 1992 is substantial. In 1993 it narrowed, and in 1994 again increased. The draining of producers' revenues through prices is a result of the distortions in the price system, the export restrictions and the lack of competitive environment in trade with agrarian products. Exchange rate changes largely contribute to the difference between domestic and world prices denominated in national currency. In 1990 the highly overvalued leva (0.79

BGL/USD) determined the low level of leva-denominated world prices. Vice versa - the sharp depreciation in 1991 (16.7 BGL/USD) considerably widened the price differential. In the next two years it was not fully exhausted despite the real BGL appreciation. The BGL depreciation in 1994 (54 BGL/USD annual average; a 96% nominal depreciation compared to 1993) further expanded the difference between domestic and world prices.

The obvious conclusion is that **the BGL depreciation in 1994 did not bring the expected improvement in the domestic terms of trade in the agrarian sector.** Under the existing vertical structure, agricultural producers are separated from processors, traders and exporters, and have weaker market power. The BGL depreciation gives potential opportunities to agricultural producers for higher profits, but the profits go to processors and trades. **The link between BGL depreciation and high inflation indicates that the rise in nominal prices (due to the BGL depreciation) does not guarantee that the real relative prices of agricultural products will be sustained. The effect of BGL depreciation was quickly offset by domestic inflation.** □

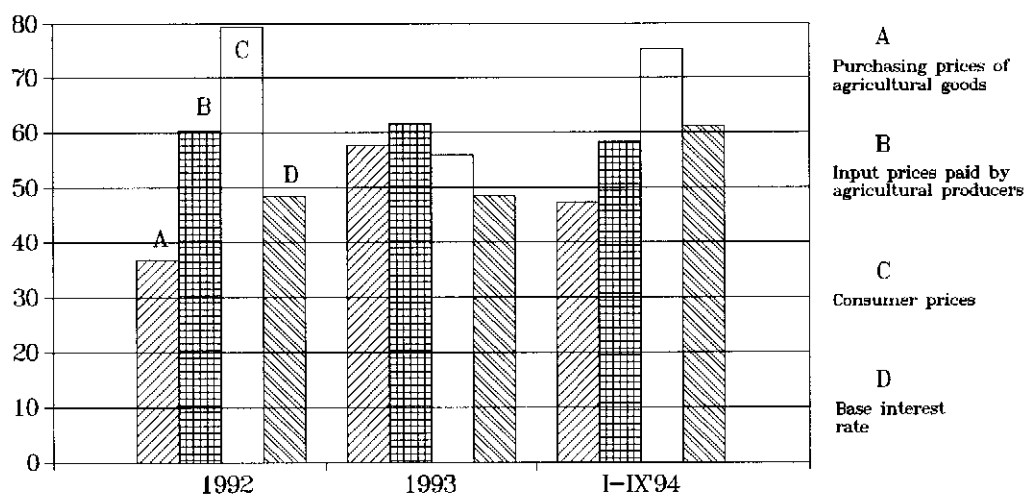
4. SUBSIDIZED CREDITS

High nominal interest rates and deteriorating domestic terms of trade in the agrarian sector imposed subsidized credits for working capital as a main instrument for government support in the transition period. This indirect form of support for agrarian producers has a number of shortcomings and is basically incompatible with market principles. Budget constraints and the unclear production structures predetermined its use instead of direct subsidies.

Conditions for granting subsidized agricultural credits in the last two years underwent changes, imposed by the macroeconomic situation. The general trend in the laws on financing the agriculture (LFA) pointed towards a **greater liberalism**, without which their further implementation was impossible. The compulsion (in force in 1993) on commercial banks with over 50% government share to extend risk credits against future production only and assume half the outstanding principal and one-third of outstanding interests, was lifted in 1994. Government guarantees which covered the other half of the outstanding principal were also removed, while **the safety of credit collaterals was increased**: from future production to real assets and property. The preferential interest rate on credits was kept at 3 percentage points over the base interest rate. Government subsidies for two-thirds of the interest were also preserved. Credits were granted to physical and legal persons tilling the land, whereas the range of credited activities for the agricultural 1993-1994 was expanded: animal products were added to crops (except vegetables).

Did the LFA achieve their aim, what is the net effect for the economic agents and the macroeconomic effect of subsidized agricultural credits?

Annual Inflation and Interest Rate



Source: NSI, AECD

Subsidized credits could not stop the decline in agricultural production. They did not offset the effect of the falling real prices of agricultural products. Even the preferential interest rate and the payment of only one-third of the interest proved a burden which aggravated the bad financial condition of agricultural producers. Taking credits from liquidation councils and the failure to repay them meant mounting debts for the owners of land and machinery. The reluctance to take credits and the exclusive reliance on own resources - savings or current incomes (unpaid wages) - was the normal adjustment of many co-operatives and individual farmers to the new market conditions.

In 1993 not even one-third of the amounts in the budget assigned for subsidizing agricultural credits was used (only 296 mn BGL out of 1 bn BGL were used). In 1994 the whole budgeted amount (1 bn leva) is going to be used. There are several possible explanations for the difference in using the budgeted amounts in those two years. The Law

for financing agriculture in 1993 covered a relatively shorter time-span (April-October 1993) and had a relatively narrower credit object. The LFA in the agricultural 1993-1994 covered the period from November 1993 till October 1994, including both the sowing and animal production. The substantial rise in input costs and the change in commercial bank behaviour are the other two factors behind the full utilization of the indirect budget subsidies. The greater freedom granted to the banks and the „strengthened“ collaterals increased their propensity for credit extension according to the borrower's creditworthiness and the return on credits (in regions with higher average yield). The acute liquidity crisis of the banking system at the end of 1993 enhanced the relative attractiveness of subsidized agricultural credits since they were not subject to credit ceilings and the resources for them came from the BNB. BNB refinancing is extended at a relatively low interest rate, close to the base interest rate, so that preferential credits for agriculture ensure profits to commercial banks which experience credit resource shortages. The banks also suffer losses from these high-risk credits. Agriculture is the sector with the relatively highest percentage of bad credits in overall credits to the sector. BNB data in 1993 put the share of bad credits in the credit outstanding at 27.1% against 18.3% average in the real sector. Commercial banks are pressed by increasing credit arrears due to accumulating interest which „actively“ wait to be transformed into government debt. Direct subsidies, lower profits-tax revenues from commercial banks, and eventually the growing domestic debt all affect negatively the government budget. In just one year (1993) bad credits in agriculture rose by some 3 bn leva. Rough estimates show that budget expenditures for subsidized interests in 1994 (987 mn BGL as of 02.11.1994⁵); correspond to some 3 bn leva. Using the 1993 share of bad loans in the credit outstanding (27%) 810 mn leva out of these 3 bn leva

⁵ Data from the Ministry of Agriculture

will turn into commercial bank bad credits. In one year, the interest accrued will raise the amount to 2758 mn leva. In this way, 1 leva of budget expenditures for subsidized credit generates 1.8 leva bad loans in an year, which is potential domestic government debt.

Subsidized credits had short-term objectives - to satisfy the need for working capital under limited access to credit resources. **As an instrument of temporary use and short-term orientation, they were not „embedded“ in macroeconomic policy and clashed with the other objectives and mechanisms. The government subsidized inputs for grain crops production, at the same time depressing the domestic prices of these agricultural products through export restrictions (export ban or high export taxes). The existing oligopolistic and inefficient government structures in purchasing and processing contributed to the latter. Introduced to cushion the negative impact of the macroeconomic policy and business situation in the country, subsidized credits and their utilization depended on them. The solution is in the structural reform and the emergence of a competitive and efficient environment.**

It is interesting to see **whether and to what result it was possible to use direct subsidies and guaranteed prices (instead of subsidized credits) in the last four years.**

Our estimates point to certain advantages of subsidized credits to direct subsidies and/or guaranteed prices in the **transition period**, characterized by unclear production structures and budget constraints.

Subsidized credits incur lower expenditures to the budget than the possible amount of direct subsidies or guaranteed prices of agricultural products, because, in the second case, all producers of a given product would be entitled to this aid. In 1994 it amounted to 2.4% of the forecast crop value and to 1.4% of the forecast value of the overall

agricultural production. (The amount of credits for animal production is small.)

This percentage is substantially lower than the *5% de minimis provision* for agriculture, stipulated in the final agreement of the Uruguay Round of GATT negotiations.

In principle, subsidized agricultural credits are not linked to any particular kind of product and therefore do not have such a strong distortive impact on the production mix as guaranteed prices and direct payments for a given output volume. Due to this, **they are a more flexible instrument for adjusting production to the new market structure and conditions and the changes in foreign trade.**

Subsidized credits directly tackle the main problem in the period of transition - the limited access to credit resources. Guaranteed prices tackle this problem indirectly, so the possibility for failing to solve it is greater. It is hard to set the level of minimum prices, even using market-based calculations as, for example, some ratio to the average level of world prices over the past three years instead of price calculation on the basis of the expenditures of a certain group of producers plus a given profits margin.

Experience in subsidized credits hints at the future contours of the agricultural credit system and the main sources for credits to the agrarian sector. Here the main problem is whether this should be a specialized credit institution or specialized divisions within the commercial banks. Some of them (Balkanbank, The United Bulgarian Bank, the First Private Bank etc) have already set up such divisions with personnel trained in agricultural crediting. They also implement their own programmes for financing the sector. Probably, **commercial banks will be the main source of credits for agriculture in the future as well. The diversity of credit sources (commercial banks together with the**

emerging co-operatives) is a basis for competition and gives the agricultural producers the possibility to choose.

Specialized credit institutions can exist only temporarily as channels for government subsidies. It is appropriate that they give guarantees for agricultural credits or preferential interest rates over a short period of time, support beginner farmers and co-operatives, and provide medium and long-term investment for agriculture. **The use of extra-budgetary funds** to aid agriculture, which have accumulated considerable resources since the reform onset, should not be postponed any longer. (We have in mind foreign financial aid - for example, PHARE aid back from 1991; the 15% share of the revenues from the privatization of state-owned enterprises which are allocated to the Agriculture Support Fund under the Privatization Law; resources received from investors for the allocated land for non-agricultural needs under Articles 15 and 16 of the Land and Pastures Law and which, in addition to land reclamation and anti-erosion projects should be used for building enterprises on uncultivated lands etc.)

The windup of the land reform - the dissolution of liquidation councils and the creation of stable production structures - sets the prerequisites for replacing subsidized credits with market-oriented instruments. They should be financially transparent and lack the distortive impact on trade and production. These are the main requirements in the General Agreement on Tariffs and Trade for the admissible *de minimis provision* for agricultural producers. Direct subsidies meet these criteria if they are not linked to the products' volume, type and price. They should be granted under stringent criteria such as the income and status of the producer, land owner, leaseholder etc.. They should also have a strict time frame - to emerge and die out with the situation which required them. □

CONCLUSION

In 1994, too, the macroeconomic environment was a source of insecurity, pushing investors to short-term profits and speculations. Under these circumstances the attractiveness of agriculture as a potential investment target sharply declined. Agrarian policy in 1994 did not contribute to cushioning the negative effect of restrictive macroeconomic policy either. The progress in the land reform in 1994 did not have a real positive impact on production. The temporary regime of land tenure is still dominant. It breeds insecurity for all agricultural agents and has a destabilizing effect on output volume and structure. Issued title deeds still cover a small area of farm land. This has blocked the land market and restricted the access to credit resources (due to the inability to use it as collateral).

In 1994 there was a highly acute **need for the adoption and implementation of a comprehensive strategy for the sector's development**, for coordinating the various types of measures and the implementation of a consistent agrarian policy as a source of security to economic agents. When defining the nature of agricultural policies and choosing between discretionary and mandatory policy, Bulgarian policy-makers should take into account the existing realities and trends of development. Among these are the budget restrictions in Bulgaria and the negative end result from agricultural subsidies and sustained high prices of agricultural products in the industrialized countries. The integration of the country into the world economy would be less painful if it is consistent with the process of world trade liberalization. □