



The National Committee for Macroprudential Oversight



The NCMO Working Group analysis on addressing vulnerabilities stemming from the widening of the agri-food trade deficit

I. OVERVIEW, CONCLUSIONS AND KEY PROPOSALS FOR MEASURES

The food trade deficit became significant (EUR 4.3 billion, December 2019), doubling in the past five years. This deficit is partly offset by the surplus of foreign trade in grains (EUR 2.2 billion, December 2019). Overall, **the agri-food trade balance has become a vulnerability that may pose a potential systemic risk** for at least two reasons: (i) the strong relationship between the worsening of the current account deficit and the outbreak of a financial or a balance-of-payments crisis and (ii) the need to ensure food security (which is in fact one of the lessons of the COVID-19 pandemic crisis).

The measures proposed for mitigating the vulnerabilities identified have three characteristics. First, **the solutions do not require significant national budgetary resources, relying to a large extent on financing from the Community budget**. In fact, where the financing of government spending will be increasingly challenging in the following years, the projects relying on non-budgetary financing will probably be implemented with priority. Second, the measures put forward **focus almost exclusively on the supply side**. It was deemed that the vulnerability the NCMO working group was called on to analyse can be mitigated especially by using solutions that would encourage firms to produce with higher value added and more innovative. Third, many proposals could seem challenging, given the characteristics of agriculture in Romania, which has largely remained at the level of subsistence farms, dependent on weather developments, with a productivity well below that recorded at the European level and generating low value added. However, **these proposals, although challenging, are in line with the European agenda of the agri-food sector**, which allocates increasingly substantial funds for digitisation, innovative development and environmental protection.

This document contains **ten recommendations** whose implementation will be monitored in accordance with Law No. 12/2017 on the macroprudential oversight of the national financial system. In addition, **the document proposes almost 50 other possible measures** that the authorities are encouraged to analyse whether they are viable or not to be implemented in various programme documents (such as the National Strategic Plan 2021-2027), in close consultation with representatives of relevant associations.

One of the most important proposals formulated in the same context of aligning with the European agenda and of using the considerable fund allocations announced by the European Commission refers to **the implementation of programmes promoting an agri-food sector that supports environmental sustainability and improves product quality**. According to EU statistics, Romania's agriculture lies among the economic sectors emitting the highest amounts of CO₂ and other greenhouse gas. As regards the

quality, for example, statistics show that the organic agricultural area in Romania held a 2.4 percent share in 2018 (up from 1.93 percent in 2015), yet significantly below the EU average (7.5 percent in 2018). The document suggests devising and implementing a strategy to promote quality food items and increase the role of quality schemes and those promoting agri-food items. In contrast to the European trend where quality and promoting quality are a priority, Romania continued a series of programmes focusing only on the development of production capacities that do not always correlate with market requirements.

Another important proposal is the **broad technological innovation in the agri-food sector**. In fact, this theme is at the top of the EU agenda and significant funds will be allocated for its implementation over the next years. Romania could benefit greatly from this alignment to European priorities, for at least two reasons. First, Romania is at a disadvantage at EU level in the field of innovation (including in agriculture), therefore any kind of progress is welcome. For example, only 1 percent of firms operating in the agri-food sector use industrial robots (at the other end are the Netherlands with 22 percent and Sweden with 31 percent). Second, Romania has many strengths to move to the extensive use of digital technologies in agriculture and the food industry: the telecommunications infrastructure, implicitly good internet access, numerous IT specialists, firms' and households' generally favourable attitude towards assimilating digital technologies. In fact, the latter could partly offset the disadvantage of the sharp fragmentation of agricultural land in Romania (by far the highest in the EU).

The very large heterogeneity of the financial soundness of firms in agriculture and the food industry shows that **the measures proposed for these sectors should be targeted**, all the more so given the increasing constraints on budget allocations. In addition, **size matters considerably in the agri-food area**. Most firms operating in these sectors are microenterprises and have not managed to move to a higher size group over the years. For example, 70 percent of medium-sized enterprises in agriculture have remained in the same category over a 5-year horizon, while 25 percent have migrated either to small-sized enterprises or even to microenterprises. Only 5 percent of medium-sized enterprises have risen to the level of corporation in a 5-year period. The issue of high heterogeneity in performance and that of size led to two solutions. First, we propose a transparent methodology (to be published on the NCMO's website) for identifying potential champion firms in the agri-food sector. In the first dry run, this methodology helped identify almost 500 firms (out of the approximately 33,000 companies in the agri-food sector), the overwhelming majority having domestic capital, that would be in the sights of authorities or creditors. Second, the document proposes assigning markedly higher scores, in any support scheme provided by the authorities (grant-in-aids, guarantees from credit guarantee funds, financing through EU funds, promotion of investments, exports, etc.), to firms that: (i) create food chains, (ii) generate local clusters, (iii) produce organic goods, (iv) produce goods listed in Top-10 food imports, (v) are listed among potential national champions, (vi) play an active role in the programmes designed for achieving the

objectives in the Declaration on “A smart and sustainable digital future for European agriculture and rural areas” or those adopting digital technologies on a large scale, or (vii) play an active role in the programmes designed for achieving the objectives in the European Union’s Farm to Fork Strategy or which help fulfil the climate change agenda in the agricultural sector.

Banks, NBFIs and credit guarantee funds could help more the firms in the agro-industry sector that will create higher value added (the above-mentioned (i)-(vii) categories). **Agricultural lending was favoured** (the volume of financing from banks and NBFIs going up by 42 percent in the past five years), yet **lending to the food industry decreased relatively significantly** (by 13 percent in banks’ portfolio, while further posting modest values in NBFIs’ balance sheets). In addition, in both sectors, **financing was granted primarily for treasury needs**, with investment loans holding a minor share (and which is on a sharp decline for firms in the food industry). Financing needs remain high. For example, although firms in agriculture received a sizeable volume of loans from banks, the European Commission and the European Investment Bank (June 2020) show that a large financing deficit for Romania’s agriculture remains (estimated between EUR 2.2 billion and EUR 5.3 billion, especially for long-term loans). We consider that the measures proposed in our analysis, such as a regular dissemination of additional data on lending developments and risk in the agri-food industry, enhancing the role of credit guarantee funds (which currently have an exposure of 6 percent to agriculture and of 2 percent to the food industry), revising the certificates-of-deposit mechanism, identifying potential national champions (of which only 56 percent currently access financing from banks), etc., have the capacity to increase corporate loans in a sustainable manner.

Last but not least, the document proposes the design and implementation by the government of a **strategy for the agri-food sector to tackle the structural issues that built up over the past decades**: the lack of land registration, the need for improving the professional training of the persons involved in the agri-food sector, poor infrastructure (such as irrigations), etc. The key element of this strategy would be implementing an industrial policy for the food sector, which should also aim at a better fulfilment of the government’s role. The strategy should regard agriculture and the food industry as a whole and not as two separate sectors. This measure, the same as the most measures identified in the paper, should be developed in close dialogue with representatives of relevant associations.

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In light of the above, the main proposals of the paper are as follows:

Main action measures

No.	Measure	Institution in charge	Term ¹
1	Development, through close dialogue with representatives of relevant associations, as well as budgeting with priority programmes worth at least EUR 9.4 billion, under the 2021-2027 Multiannual Financial Framework, aimed at implementing the European Union's Farm to Fork Strategy , and also in line with the specific climate risk objectives of the future Common Agricultural Policy. The said programmes should be developed so as to also facilitate green bond issues by the authorities, credit institutions, other investors.	Government (Ministry of Agriculture and Rural Development)	ST
2	Development, through close dialogue with representatives of relevant associations, as well as budgeting with priority programmes worth at least EUR 0.5 billion, under the 2021-2027 Multiannual Financial Framework, that can use the potential of digital technologies, in compliance with the Declaration of cooperation on "A smart and sustainable digital future for European agriculture and rural areas" to which Romania is a signatory party.	Government (Ministry of Agriculture and Rural Development)	ST
3	Enhancing the role of credit guarantee funds (the National Credit Guarantee Fund for SMEs, the Rural Credit Guarantee Fund) and of the Romanian Counter-Guarantee Fund in supporting firms in agriculture (increasing the flow of guarantees by at least lei 3 billion by 2023) and food industry (rising the flow of guarantees by at least lei 2 billion by 2023).	Government (Ministry of Public Finance, Ministry of Agriculture and Rural Development)	ST
4	Review of the certificates-of-deposit mechanism through close dialogue with credit institutions and relevant associations.	Government (Ministry of Agriculture and Rural Development)	ST
5	Improve the legislation on certifying and promoting agri-food products through close dialogue with representatives of relevant associations and ensure adequate budgeting for these programmes.	Government (Ministry of Agriculture and Rural Development)	ST
6	Design and implement, through close dialogue with representatives of relevant associations, a strategy for promoting high-quality food items , also via an increased role of quality schemes . Where the products of the local sector satisfy the quality requirements, the authorities should promote primarily the said goods.	Government (Ministry of Agriculture and Rural Development)	ST
7	Assign markedly higher scores , in any support scheme provided by the authorities (grant-in-aids, guarantees from credit guarantee funds, financing through EU funds, promotion of investments, exports, etc.), to firms that: (i) create food chains, (ii) generate local clusters, (iii) produce organic goods, (iv) produce goods listed in Top-10 food imports, (v) are listed among potential national champions, (vi) play an active role in the programmes designed for achieving the objectives of the Declaration on "A smart and sustainable digital future for European agriculture and rural areas" or those adopting digital technologies on a large scale, or that (vii) play an active role in the programmes designed for achieving the objectives of the European Union's Farm to Fork Strategy or which help fulfil the climate change agenda in the agricultural sector.	Government (Ministry of Agriculture and Rural Development)	ST

8	Implementation of an industrial policy for the food sector leading also to a better fulfilment of the government's role in underpinning the agri-food sector (reducing the hidden economy with agri-food products, enhancing the role played by the National Sanitary Veterinary and Food Safety Authority (ANSVSA) in controlling food safety, cutting back bureaucracy, removing duplication of work in controlling tasks by drafting transparent procedures, supporting education and training of the persons involved in the agri-food sector, etc.).	Government	MT
9	Publish on the NCMO's website the methodology for identifying the firms that could be viewed as potential agri-food national champions and revise this methodology at least once every two years.	NBR (Annex 1)	C
10	Regular dissemination of additional statistical data for improving agri-food firms' access to finance.	NBR (Annex 9)	C (as of December 2020)

Note: ¹) C – continuous; ST – short term (1-3 years); MT – medium term (3-5 years)