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## Credit guarantees in Ukraine's agriculture: a development mechanism based on international practices

**Abstract.** The paper deals with the conceptual approaches to the credit guarantee system as an effective mechanism of state support for agriculture. The importance of introducing a credit guarantee system in Ukraine and creating the Fund for Partial Credit Guarantee in Agriculture, a specialized non-banking financial institution, is emphasized. This will help to overcome obstacles to crediting small and medium agricultural enterprises. The authors have analyzed global credit guarantee schemes.

The purpose of this paper is to develop proposals for amendments to the Draft Law «On the Fund for Partial Credit Guarantee in Agriculture», in particular a need to provide legal grounds for non-banking financial institutions, the form of business entities, their mission, criteria for agricultural subjects eligible for partial credit guarantees, financing of the relevant institutions and defining the related management bodies, as well as bodies of state regulation and supervision.

The problem statement is attributable to the fact that the effectiveness of institutions providing credit guarantees for small and medium enterprises in agriculture plays an important role in the national economies of most countries.

The authors have proposed an approximate financial model of the Fund for Partial Credit Guarantee in Agriculture and made the required economic calculations. Thus, with an initial authorized capital of EUR 10 million, the Fund for Partial Credit Guarantee in Agriculture, with 50% coverage, is able to provide guarantees for the purchase of 25 thousand hectares of arable land by small and medium enterprises at an average cost of EUR 820/ha, taking into account the average normative monetary assessment of agricultural land by regions.

Consequently, credit enforcement will allow banking institutions not only to balance credit risk, but also to open access to small and medium agricultural enterprises to bank crediting to the extent necessary for the purchase of agricultural land and investments in production.

**Keywords:** Credit Guarantee System; Guarantee Fund; Non-banking Financial Institution; Financial Service; Credit

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**Система кредитних гарантій у сільському господарстві України:  
механізм розвитку на основі міжнародної практики**

**Анотація.** У статті проаналізовано концептуальні підходи до системи кредитних гарантій як ефективного механізму державної підтримки сільського господарства. Наголошено на важливості впровадження в Україні системи кредитних гарантій та створення спеціалізованої небанківської фінансової установи – Фонду часткового гарантування кредитів у сільському господарстві, оскільки це сприятиме подоланню бар'єрів на шляху кредитування малих та середніх сільськогосподарських товаровиробників.

Метою статті є розробка пропозицій щодо внесення змін до законопроекту «Про Фонд часткового гарантування кредитів у сільському господарстві». Наголошено на необхідності передбачити на законодавчому рівні правовий статус небанківської фінансової установи; організаційно-правову форму; мету діяльності, критерії для суб'єктів сільського господарства, які мають право на часткове гарантування кредитів; фінансування установи; органи управління, державного регулювання та нагляду.

Актуальність дослідження обумовлена тим, що світова практика свідчить про ефективність інституту системи кредитних гарантій у сільському господарстві для малих та середніх підприємств, які відіграють важливу роль у національних економіках більшості держав. Отже, забезпечення виконання кредитних зобов'язань дозволить банківським установам не лише збалансувати кредитний ризик, але й відкриє доступ малим і середнім сільськогосподарським товаровиробникам до банківського кредитування в необхідних обсягах для купівлі земель сільськогосподарського призначення та інвестицій у виробництво.

**Ключові слова:** система кредитних гарантій; гарантійний фонд; небанківська фінансова установа; фінансова послуга; кредит.

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**Анотація.** В статті проведено аналіз концептуальних підходів до системи кредитних гарантій як ефективного механізму державної підтримки сільського господарства. Зазначено важливість впровадження в Україні системи кредитних гарантій та створення спеціалізованого небанківського фінансового учреждения – Фонду часткового гарантування кредитів в сільському господарстві. Це сприятиме подоланню бар'єрів на шляху кредитування малих та середніх сільськогосподарських товаровиробників.

Метою статті є розробка пропозицій щодо внесення змін до законопроекту «Про Фонд часткового гарантування кредитів в сільському господарстві», в частині, підкреслюється необхідність передбачити на законодавчому рівні правовий статус небанківського фінансового учреждения; організаційно-правову форму; мету діяльності; критерії для суб'єктів сільського господарства, які мають право на часткове гарантування кредитів; фінансування учреждения; органи управління, державного регулювання та нагляду.

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**Ключевые слова:** система кредитных гарантий; гарантийный фонд; небанковское финансовое учреждение; финансовая услуга; кредит.

## **1. Introduction**

On 1 July 2021, the Law of Ukraine No. 552-IX «On Amendments to Certain Regulations of Ukraine on Terms of Transfer of Agricultural Land» adopted on 31 March, 2020, came into force. Its provisions abolish the moratorium on the sale of agricultural land. However, in order to fully launch the land market, it is necessary to establish this complex mechanism and to solve a number of problematic issues at the legislative level. In particular, the unresolved issues today are: improvement of the system and deregulation in the sphere of land relations; sale of land plots of state and communal property or rights to them, namely lease, superficies, emphyteusis, through electronic auctions; creation of the Fund for Partial Credit Guarantee in Agriculture; improvement of quality, accessibility of content and interoperability of cadastral data; implementation of the National infrastructure of geospatial data; implementation of services for open access to the

State Land Cadastre; development and implementation of the agricultural register, etc. It should be noted that mortgage lending and access to funds for small and medium agricultural enterprises remain extremely important for the functioning of agricultural land turnover.

Despite the significant contribution to the manufacture of agricultural goods, small and medium enterprises have limited access to credit resources. Thus, in order to create conditions for the stable functioning of the Ukrainian agriculture and support small and medium enterprises, including farms, by partially guaranteeing the obligations of such enterprises to financial institutions on credit contracts, it is necessary to create and implement a credit guarantee system in Ukraine.

## 2. Brief Literature Review

An analysis of economic and legal scientific literature shows that the theoretical issues relevant to this topic are considered in the works by well-known foreign scientists such as Honohan (2010), O'Bryan (2010), Beck (2008), Torfs et al. (2017), Balog (2018), Zander et al. (2013), Madatova and Kasyanova (2015), Veraksa (2018), Pinkovetska (2020) and others. In Ukraine, there is an experience in researching the credit guarantee institution, in particular the works by domestic scientists such as Oleinik (2013), Vashchik (2009), Yunko (2014), Bortnikov (2018), Borisov (2016) and others. Despite numerous scientific studies, the Ukrainian credit guarantee system in agriculture is not working, which contributes to the choice and relevance of the research topic.

## 3. Purpose

The purpose of the article is a theoretical and practical study of the legal nature of the credit guarantee system in agriculture based on best international practices and substantiation of practical recommendations for assessing the expected result of creating a specialized non-banking financial institution - the Fund for Partial Credit Guarantee in Agriculture.

## 4. Results

### 4.1. International experience of credit guarantee systems

The credit guarantee system is a common economic policy instrument that facilitates access to finance for small and medium enterprises in both developed and developing countries. They cover part of the credit risks and therefore provide an incentive for lenders (commercial banks) for granting funds to those categories of borrowers who would not normally be able to obtain financing. However, the success of this mechanism usually depends on its structure and compliance with the needs and goals of a particular state (Veraksa, 2018).

The content of the credit guarantee system is to cover some of the risks associated with lending to the borrower, who otherwise would not be able to borrow funds on acceptable terms due to perceived high risks or insufficient security. In case of failure to repay the loan, the lender collects a guaranteed amount from the guarantee fund (Veraksa, 2018). The mechanism of credit guarantees works as follows: the process of obtaining a guarantee begins with a small or medium enterprise's application for a loan in the bank; it is processed and evaluated, while the borrower applies to the guarantee Fund for a guarantee. If the Fund makes a positive decision, the guarantee is given to the borrower and covers the lender with the whole amount or some part of the credit (loan). If the borrower fails to fulfill its obligations, the bank makes a claim to the credit guarantee system in order to compensate its losses in whole or in part (Veraksa, 2017). The credit guarantee system charges a fee for its services, which must cover the administrative costs and the perceived risk of non-repayment of the credit (loan). The fee is paid by the borrower, the lender or both parties in the form of one hundred percent prepayment, a series of annual payments during the entire lending period or otherwise (Veraksa, 2018).

Nowadays various credit guarantee systems are used worldwide to support small and medium enterprises in agriculture, with specialized institutions acting as guarantors, that is, guarantee funds, which facilitate access to financing by providing lenders with a guarantee for a significant part of the debt. For example, in the Republic of Lithuania, since 1997, there is an Agricultural Loan Guarantee Fund, established in accordance with the Resolution of the Government of the Republic of Lithuania «On the Agricultural Loan Guarantee Fund» No. 912 as of 22 August 1997. Its main purpose is to help economic entities that do not have sufficient collateral financial resources for the development, creation, modernization and production of

competitive products, creating favourable loan conditions, pursuing social and political goals of the state.

In the Republic of Moldova, there is a Credit Guarantee Fund (FGC) established at the expense of the state budget and operated by the Organization for Small and Medium Enterprises Sector Development (ODIMM). The state provides financial guarantees to support enterprises wishing to obtain loans for development, but not having proper collateral, with the state guarantee covering up to 70% of the cost of the loan (Nikoare, 2018).

During the economic crisis, the Turkish government has decided to stimulate economic growth by facilitating access to financing for small and medium enterprises. Consequently, on 14 July 1993, the Turkish Credit Guarantee Fund (Kredi Garanti Fondu işletme ve Araştırma Ticaret Anonim Şirketi (KGF) was established by the Resolution No. 93/4496 of the Council of Ministers.

For many decades, there have been various guarantee systems in Mexico as well. For example, in 1954, the Ministry of Industry established the Fund for Guarantee and Development of Agriculture - FONDO (The Fondo de Garantía y Fomento para la Agricultura) (Zander et al., 2013) to support micro and small enterprises in agriculture.

In 1977, the Agricultural Credit Guarantee Scheme Fund (ACGSF) was created to support agriculture in Nigeria, with 60% funding from the state budget and 40% from the Central Bank of Nigeria (CBN). In particular, the Fund provides loan guarantees to agricultural enterprises for the cultivation of perennial crops such as coffee, tea, cocoa, rubber, cereals, as well as livestock and livestock production (Zander et al., 2013).

In addition, Agricultural Credit Guarantee Funds exist in Estonia - Rural Development Foundation (RDF), Italy - Italian State Guarantee Fund for Agricultural Credit (ISMEA - **Istituto di Servizi per il Mercato Agricolo Alimentare**), India - Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE), the Netherlands - Sustainable Agricultural Guarantee Fund (SAGF), the USA - USAID Development Credit Authority (DCA) (Zander et al., 2013), the Czech Republic - Support and Guarantee Fund for Agriculture and Forestry (SGFAF), Romania - Romanian Rural Credit Guarantee Fund (FGCR), etc.

Credit guarantees globally are a key policy tool to address the lack of financing for small and medium enterprises, since such entities and startups are usually limited in their ability to access credit due to insufficient collateral, limited credit history or its absence at all (Cusmano, 2013).

It is worth noting that the activity of guarantee funds in foreign countries is formed taking into account the following principles:

- 1) credit guarantee does not cover interest on loans and penalties;
- 2) the average amount of guarantee provided by guarantee funds in different countries varies between 30% and 80% of the loan amount, yet there are cases, for example, guarantee funds in Ireland or France which cover 100% of the loan (Chatzouz et al., 2017);
- 3) terms of credit guarantees are very different and can be granted both for short-term (up to 1 year) and long-term (over 15 years) credits;
- 4) activities of guarantee funds are focused on micro, small and medium enterprises;
- 5) sources of guarantee capital formation are state funds, funds of international organizations or commercial institutions;
- 6) operation on a self-supporting basis from guarantee fees (advance and annual), also administrative fees can be collected to cover administrative costs associated with guarantee activities (Chatzouz et al., 2017);
- 7) guarantees are provided on a fee basis; guarantee fees depend on the cost of the loan for which the guarantee is provided and the term for which the guarantee is provided; as a rule, they are paid by the borrower, and there are single cases when the fee is paid by the lender or jointly by both parties (Reichmuth et al., 2006);
- 8) most guarantee funds are partly or fully exempt from taxes, which is due to the fact that most of them are in public ownership and carry out the goals of public policy (Chatzouz et al., 2017).

Thus, the credit guarantee system in agriculture is a new tool for our state. Therefore, in order to create an effective mechanism, it is advisable to study the best world practices and take into account all the pros and cons.

#### 4.2. Theoretical aspects of establishing guarantee fund of loans in agriculture

On 25 May 2020, the Verkhovna Rada of Ukraine passed the Draft Law «On the Fund for Partial Credit Guarantee in Agriculture» No. 3205-2, according to which it is proposed to establish a

specialized non-banking financial institution called the Fund for Partial Credit Guarantee in Agriculture, which will support small and medium enterprises engaged in agricultural activities through the partial guarantee of the performance of obligations of such entities under the loan agreements.

The legislative definition of the term financial institution is indicated in Paragraph 1 of Part 1 of Article 1 of the Law of Ukraine No. 2664-III «On Financial Services and State Regulation of Financial Markets» as of 12 July 2001, according to which it is legal entities which provide one or more financial services in accordance with the law and enter the register in the manner prescribed by the Regulation on the State Register of Financial Institutions No. 41 approved by the National Commission for Regulation of Financial Services Markets of Ukraine as of 28 August 2003.

According to the current legislation, financial services should be understood as transactions with financial assets carried out in the interests of third parties at their own expense or at the expense of these persons, and in cases provided by law, at the expense of financial assets attracted from other persons, in order to make a profit or maintain the real value of financial assets.

The analysis of domestic and foreign scientific literature shows that scholars have different interpretations of the studied category, which is interpreted as:

1) economic activity related to the satisfaction of demand, which is expressed in the transformation of funds of legal entities and individuals into financial capital in the banking, insurance and investment markets, as well as in the provision of other financing services, carried out by financial intermediaries (Podzugyn, 2013);

2) economic transactions with cash, securities and debentures, carried out for a fee by financial institutions in the interests of customers - consumers, and possible third parties at the own expense of financial institutions, or at the expense of consumers or third parties, or at the expense of funds collected from other persons in order to preserve their real value, and in cases provided by the contract, to generate profits by the consumer (Soloshkina, 2013);

3) the result of interaction between entities in the process when one participant (the financial service provider) satisfies financial needs of another participant (the consumer of financial services, or client) at their own expense, the client's expense or at the expense of attracted financial resources of other consumers, in accordance with the current legislation, in order to make profit, maintain the value of assets, achieve social effects from the sale of such services, etc. (Dubina, 2016).

Part 1 of Article 4 of the Law of Ukraine (2001) «On Financial Services and State Regulation of Financial Services Markets» contains an exhaustive list of services that are considered financial, including the provision of guarantees.

A credit guarantee is a means of sharing risks with credit institutions by compensating (part of) the losses in the event of failure to repay the loan and support entrepreneurs who have insufficient collateral or credit history, unable to meet the requirements of the bank granting the loan (Madatova & Kasyanova, 2015).

As a result of the study of professional literature and approaches to the classification of financial services, it has been proved that one of the criteria for their classification is the entities that provide such services - banking or non-banking financial institutions. At the same time, it is worth noting that the definition of non-banking financial institution has no legislative basis, which is a certain gap in the current legislation. However, representatives of legal and economic science have actively researched relevant issues of the definition of the term «non-banking financial institution», its legal status and role in the financial services market.

Thus, in foreign literature non-banking financial institutions are considered to be financial intermediaries that do not have a certain banking license, but provide alternative financial services (Rateiwa & Aziakpono, 2017).

Domestic scientist Karakulova (2008) defined a non-banking financial institution as a legal entity that, functioning in the financial services market, provides one or more specific financial services in order to meet the financial needs of consumers and make profit.

According to Polishchuk (2012), non-banking financial institutions are highly specialized financial intermediaries that accumulate, convert and direct free cash to business entities in investment processes in order to either achieve commercial or other effects, or to preserve the value of money over time.

Sidelnik (2010) notes that non-banking financial institutions are professional participants of financial services markets, specializing in the provision of one or more financial services to a

separate segment of customers by accumulating and placing temporarily free funds of individuals and entities in the financial market.

Having considered the definitions proposed by scientists and legislative regulation, the features inherent in a non-banking financial institution, the Fund for Partial Credit Guarantee in Agriculture, indicate that:

- 1) it is a legal entity registered in the State Register of Financial Institutions of Ukraine;
- 2) it operates in the financial services markets as a financial intermediary - guarantor;
- 3) it has special legal capacity, i.e. operates on the basis of the Charter and the relevant license obtained in the manner prescribed by the licensing conditions of economic activities to provide financial services (except for professional activities in the securities market), approved by the Resolution of the Cabinet of Ministers of Ukraine No. 913 as of 7 December 2016;
- 4) it provides services of a nature - private credit guarantees; it is a means of ensuring the obligations of small and medium enterprises in agriculture, in order to reduce the risk of their activities and to ensure the risks of non-performance of contractual obligations or non-repayment of loaned funds;
- 5) it is created with the participation of the state and is a certain political instrument to mitigate financial constraints for small and medium enterprises in agriculture.

In order to create an effective credit guarantee system in agriculture, it is mandatory to take into account several key aspects. First and foremost, it is required to specify the goal.

The experience of foreign countries shows that credit guarantee systems are usually created to support a particular sector of the economy or region.

As today's realities show, small and medium agricultural enterprises face a number of problems with lending, namely: high interest rates, lack of interest of banking institutions in lending to the agricultural sector due to high risk, lack of proper collateral and lending history, etc. All this deprives small and medium enterprises of the opportunity to invest in their activities.

Decree of the President of Ukraine No. 837 «On Urgent Measures to Pursue Reforms and Strengthen the State» as of 8 November 2019 determines the need to introduce mechanisms of state support to improve the financial solvency of farmers and small agricultural enterprises by creating a cheaper lending program and credit guarantee mechanisms.

Thus, one of the ways to solve problems in the access of small and medium agricultural enterprises to credit resources to replenish working capital and increase the efficiency of economic activity is the creation of the Fund for Partial Credit Guarantee in Agriculture. This independent specialized institution should become a guarantor, which will be a third party in the relationship between the banking institution and the borrower.

A transaction for the provision of a credit guarantee is drawn up by concluding an agreement between the Fund for Partial Credit Guarantee in Agriculture and the creditor bank and shall determine the scope of guarantee obligations and the procedure for their implementation; the rights, obligations and responsibilities of the Fund and the creditor; the conditions for the occurrence of a guarantee case; the term for making payments in the event of a guarantee case; the amount and procedure for payment for the provision of such a guarantee; the procedure for repayment of debt to the Fund for the fulfillment of guarantee obligations.

The overdue debt of an agricultural enterprise to the Fund and to the creditor bank on the credits secured by the credit guarantee shall be collected from such business entities by the creditor bank in accordance with the procedure established by the legislation and the relevant transaction on granting a credit guarantee, with the subsequent transfer of a proportional share to repay the debt to the Fund.

The next aspect is the target audience, i.e. there should be clearly defined criteria for business entities entitled to a partial guarantee of fulfillment of obligations under credit agreements. Firstly, these are business entities - legal entities, natural persons and entrepreneurs carrying out their activities in the agriculture sector.

Secondly, Article 2 of the Draft Law of Ukraine No. 3205-2 «On the Fund for Partial Credit Guarantee in Agriculture» stipulates that the Fund aims to support small and medium enterprises that meet the requirements for micro, small and medium enterprises under the Law of Ukraine No. 996-XIV «On Accounting and Financial Reporting in Ukraine» as of 16 July 1999. According to Part 2 of Article 2 of the above Law, microenterprises are enterprises whose indicators on the date of the annual financial statements for the year preceding the reporting year meet at least two of the following criteria: the balance sheet asset is up to EUR 350,000, the net income from

the sale of products (goods, works, services) is up to EUR 700,000 and the average number of employees is up to 10 persons. Small enterprises are enterprises that do not meet the criteria of microenterprises and whose indicators on the date of the annual financial statements for the year preceding the reporting year meet at least two of the following criteria: the balance sheet asset is up to EUR 4 million, the net income from the sale of products (goods, works, services) is up to EUR 8 million and the average number of employees is up to 50 persons. Medium enterprises are enterprises that do not meet the criteria of small enterprises and whose indicators on the date of the annual financial statements for the year preceding the reporting year meet at least two of the following criteria: the balance sheet asset is up to EUR 20 million, the net income from the sale of products (goods, works, services) is up to EUR 40 million and the average number of employees is up to 250 persons.

At the same time, the Commercial Code of Ukraine (Verkhovna Rada of Ukraine, 2003), namely Paragraph 3 of Article 55 stipulates that business entities, depending on the number of employees and income from any activity for the year may belong to small enterprises, including micro, medium or large enterprises.

However, EU member states use a different approach to the typology of agricultural enterprises by farm size, including their classification into small, medium and large. Thus, in the EU, the economic value indicator is used for the typology of business entities in agriculture according to their size. It is based on the economic parameter of standard output (SO) and means the possible value of production that the manufacturer is able to obtain by operating the available potential and doing business in a certain region. The economic value of an agricultural farm in the EU member states is determined based on the data on crop acres livestock using the SO parameter - the value of standard output per unit of area or per head of livestock. SO parameters are calculated by regions allocated for this purpose. The sum of SO values of certain crop and livestock species characterizes the total economic size of a farm. Agricultural enterprises are divided into 14 classes according to their economic value (Prokopa & Demchak, 2017).

According to Article 403 of the EU-Ukraine Association Agreement (2014), the parties shall cooperate to promote agriculture and rural development, in particular through gradual convergence of policies and legislation, so it would be appropriate to introduce a European system of the typology of agricultural enterprises with a definition of their economic value based on the standard output parameter.

Thirdly, the primary manufacture of agricultural products and agricultural activities are the main type of activity. At the legislative level, namely the Law of Ukraine No. 771/97-BP «On Basic Principles and Requirements for Food Safety and Quality» as of 23 December 1997, primary manufacture is defined as the production and cultivation of products, including harvesting, milking, breeding until slaughter, hunting animals, fishing and harvesting of wild plants. In this case, the main type of economic activity is considered to be the type of activity of the entity that makes the largest contribution to the gross value added.

Fourthly, such enterprises own and/or use agricultural land in amounts not exceeding 500 hectares, including land plots that are purchased for money received on credit.

Given the above, in order to clarify inaccuracies and confusion in the terms, it would be appropriate to replace in the text of the draft law of Ukraine «On the Fund for Partial Credit Guarantee in Agriculture» the part stating «business entities that are eligible to partial guarantee of credit agreements are agricultural enterprises». The most appropriate term in this case is provided in paragraph 14.1.235 of clause 14.1 of Article 14 of the Tax Code of Ukraine (Verkhovna Rada of Ukraine, 2010), which defines agricultural enterprise as a legal entity regardless of the organizational and legal form or an individual entrepreneur, who is engaged in the manufacture of agricultural products and/or breeding, growing and catching fish in inland waters (lakes, ponds and reservoirs) and its processing on their own or leased facilities, including self-produced raw materials on toll terms, and performing operations on its delivery.

An important aspect of creating an effective mechanism for credit guarantee in agriculture is financing. As the experience of foreign countries shows, credit guarantee funds are financed primarily by the state.

It should be noted that according to Article 4 of the draft law of Ukraine «On the Fund for Partial Credit Guarantee in Agriculture» the authorized capital of the Fund is formed at the expense of the state budget and funds of its participants. At the same time, the state share in the authorized capital of the Fund shall be not less than 51 percent, and a decrease of such a share is not allowed.

This provision is important because in such a case the state acts as the main entity that forms the guarantee capital and is primarily interested in the development of small and medium enterprises in agriculture, which can significantly increase its contribution to the gross income. Moreover, the state can invest in small and medium enterprises without the aim of making profit, since the long-term development of such enterprises is the strategic goal of the guarantee funds.

With regard to the authorized capital, Paragraph 2 of Clause 14 of the Regulations of the State Register of Financial Institutions approved by the National Commission for Regulation of Financial Services Markets of Ukraine as of 28 August 2003 No. 41, provides that financial institutions are required to maintain the authorized (composed) share and/or equity capital at a level not less than that established by the Regulations to the applicant when entering it in the Register. Section X stipulates that the applicant must have equity capital of at least UAH 3 million on the date of application. Thus, the authorized capital of the Fund for Partial Credit Guarantee in Agriculture must be at least UAH 3 million, which is formed at the expense of the state budget and funds of its participants.

Having made the initial financing, the state can stimulate the interest in the financial participation of international financial institutions in the initial and current financing of the Fund for Partial Credit Guarantee in Agriculture. In particular, such international financial institutions include the European Bank for Reconstruction and Development which provides comprehensive support to Ukraine, focusing on the development of agricultural and industrial potential, ensuring quality infrastructure and strengthening the financial sector; the International Finance Corporation, which within the framework of a four-year advisory project «**Ukraine Agricultural Capital Markets Development Project**» will work with the government to provide Ukrainian financial institutions with the necessary tools and knowledge; the German Development Bank (KfW Bank aus Verantwortung), one of the main activities of which is to support the development of small and medium enterprises; the United States Agency for International Development, which according to the USAID Strategy for Coordination of Development of Ukraine for 2019-2024 focuses on promoting economic development and energy security of the state, etc. Thus, the legal regulation of the Fund's activity should be clearly defined at the legislative level in order to attract international partners as potential investors, which in turn will not only raise funds, but also contribute to the functionality and increase the scope of guarantees.

As the world practice shows, credit guarantees are provided on a fee basis to cover the administrative and management expenses of the financial institution. The cost of such a fee is determined either as a percentage of the credit amount or as a percentage of the guarantee amount. Besides, for the purpose of effective functioning of the Fund for Partial Credit Guarantee in Agriculture and prevention of misuse of funds, the volume in which the guarantee is provided (coverage ratio) and the term of the credit guarantee should be determined.

An important tool for minimizing risks is the coverage ratio, which is the percentage of the credit amount that the guarantee covers. The larger the credit amount that is not covered by the guarantee, the greater the incentive for lenders to qualitatively assess credit risk and monitor the credit, thereby reducing the likelihood of credit default. On the other hand, a low coverage ratio can lead to a loss of lenders' interest in the scheme (Oliynyk, 2013).

Governments around the world are seeking to encourage credit institutions to provide credits to small and medium enterprises for economic development. However, the credit guarantee system has become a common method of such incentives. The greatest risk for credit institutions is primarily associated with non-repayment of the borrowed funds, which is why the credit guarantee system should compensate for this risk.

Credit risk should be distributed between the creditor, borrower and guarantor, at such a level as to encourage credit institutions to participate in the credit guarantee scheme in agriculture, that is, to exceed 50%, but also be significantly lower than 100%. Therefore, for the effective functioning of the credit guarantee scheme in Ukraine, it is advisable to provide for the coverage ratio for the Fund for Partial Credit Guarantee in Agriculture at the level of 50% initially.

Based on the examples of the global credit guarantee schemes (Table 1), an approximate financial model of the Fund for Partial Credit Guarantee in Agriculture is presented in Table 2 and Figure 1.

As part of the creation of conditions and implementation of the agricultural credit guarantee system of Ukraine, the Organization for Economic Cooperation and Development (OECD) has developed a means to guarantee part of credits to agricultural small and medium enterprises. Taking



Table 1:  
Global credit guarantee schemes

		Maximum guarantee coverage ratio	Maximum guarantee amount	Maximum guarantee duration
Romania	Romanian Rural Credit Guarantee Fund	80%	EUR 2.5 million	-
Hungary	Rural Credit Guarantee Foundation	85%	EUR 8 million	25 years
Lithuania	Agricultural Credit Guarantee Fund (Garfondas)	80%	EUR 1.16 million	-
Estonia	Estonian Credit and Export Guarantee Fund (KREDEX)	80%	EUR 5 million	20 years
Italy	Italian State Guarantee Fund for Agricultural Credit (ISMEA)	80%	EUR 2 million	-
Latvia	ALTUM	80%	EUR 1 million	10 years
Bulgaria	National Guarantee Fund (NGF)	50%	EUR 1.5 million	10 years
Croatia	Croatian Agency for SMEs, Innovations and Investments (HAMAG BICRO)	80%	EUR 1.3 million	15 years
India	Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE)	85%	EUR 170,000	5 years
Netherlands	Sustainable Agricultural Guarantee Fund (SAGF)	90%	EUR 850,000	5 years

Source: Compiled by the authors based on official information

Table 2:  
An approximate financial model of the Fund for Partial Credit Guarantee in Agriculture

Maximum amount:		Maximum loan amount	2,000,000	
		Guarantee coverage	50%	
		Maximum guarantee amount	1,000,000	
Total portfolio:		Total loan portfolio	100,000,000	
		Total guarantees issued	50,000,000	
Classification of loans / guarantees	Level of expense reserve	Portfolio structure	Total guarantees provided in each class, EUR	Loss reserve, EUR
Standard	2%	40%	20,000,000	400,000
Under control	5%	25%	12,500,000	625,000
Substandard	20%	15%	7,500,000	1,500,000
Questionable	50%	10%	5,000,000	2,500,000
Hopeless	100%	10%	5,000,000	5,000,000
<b>Total:</b>		100%	50,000,000	
<b>Necessary equity:</b>				<b>10,025,000</b>

Source: Authors' own calculations based on current legislation

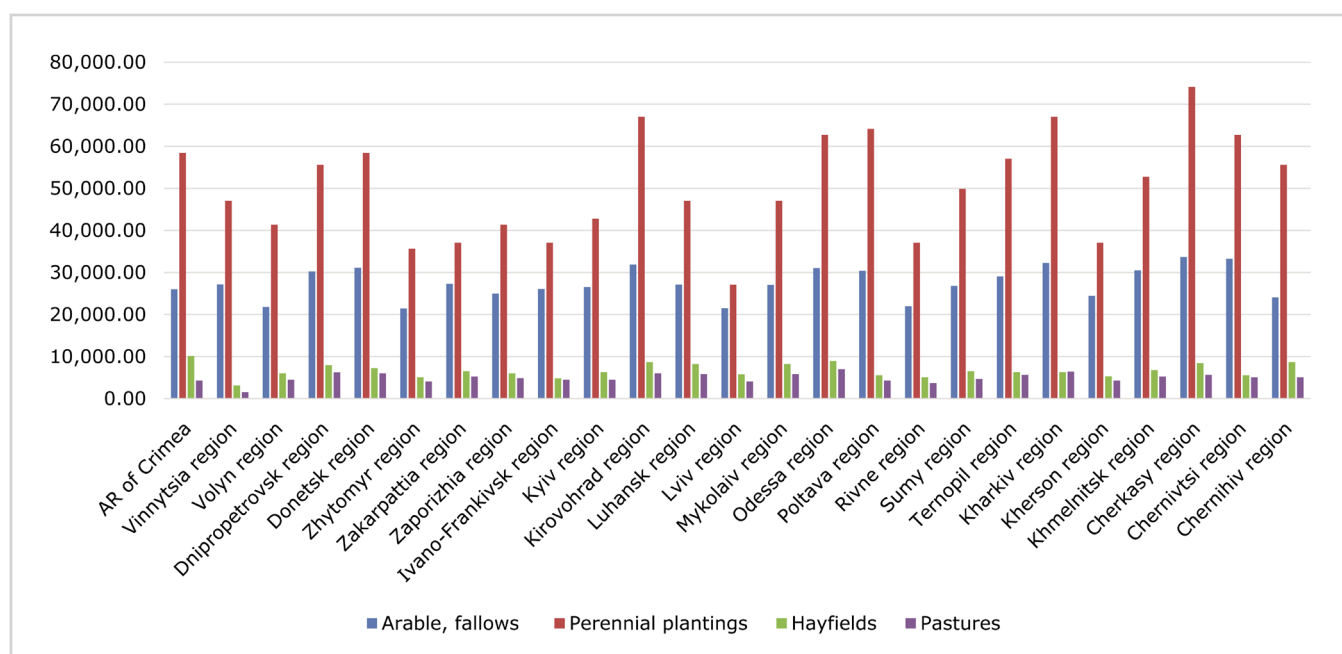


Figure 1:  
Normative monetary valuation of agricultural land in Ukraine as of 1 January 2021  
(calculations in EUR)

Source: Authors' own calculations

into account international experience, the OECD has provided a number of recommendations for maximizing the economic and financial life efficiency of the agricultural credit guarantee system. In particular, financial modeling of the credit guarantee system (capital, expenses, income, credits issued and repaid, etc.) has been performed. For instance, it is determined that it is recommended to allocate EUR 1.5 million for the first 24 months of the Fund's operation to cover administrative expenses (salary, office equipment, software, etc.). In addition, at the initial stages, by the time the Fund generates revenue, there is a need for funding in the amount of EUR 10 million. As for the Fund's income, based on the results of financial modeling, it is proposed to establish a fixed amount of commercial credits at the level of 1% of the guaranteed credit amount in a lump sum and 1% of the annual payment for the guarantee provided.

Thus, it should be emphasized that with an initial authorized capital of EUR 10 million, the Fund for Partial Credit Guarantee in Agriculture, with 50% coverage, is able to provide guarantees for the purchase of 25 thousand hectares of arable land by small and medium enterprises at an average cost of EUR 820/ha, taking into account the average normative monetary assessment of agricultural land.

The issues of the organizational and legal form, regulation and supervision of the Fund for Partial Credit Guarantee in Agriculture also deserve attention.

According to Article 8 of the Law of Ukraine «On Financial Services and State Regulation of Financial Services Markets» (2001), financial institutions can be created in any organizational and legal form. Hence, when creating the Fund for Partial Credit Guarantee in Agriculture, the organizational and legal form should be determined, i.e. the model on the basis of which its further activity will be carried out.

The structure of the basic organizational and legal form of a legal entity depends on the legal means aimed at satisfying the main interests of their founders/participants in: ownership, management and control over the property transferred by them to form the authorized capital of the legal entity. These interests are projected in the structure of the organizational and legal form of legal entities, which consists of the following elements: the order of establishment, reorganization and liquidation; the legal status of founders and participants; the system of management bodies; the legal regime of property; the distribution of responsibility between the founders and the legal entity (Borysov, 2016).

Thus, considering that the Draft Law of Ukraine (2020) No. 3205-2 «On the Fund for Partial Credit Guarantee in Agriculture» does not define the organizational and legal form of the Fund as a legal entity, in particular what kind of legal entity the legislator stipulates (a joint-stock company, a limited liability company, an additional liability company, a full company or state institution), which will determine the authorized capital, the order of increasing or decreasing it, the order of convening, competence and procedure for decision-making by management bodies, etc. It seems appropriate that the organizational and legal form of the Fund for Partial Credit Guarantee in Agriculture should be provided for by law.

Also, attention should be paid to the management bodies of the Fund for Partial Credit Guarantee in Agriculture. Article 7 of the Draft Law (2020) No. 3205-2 stipulates that the management bodies are the General Meeting of participants, the Council of the Fund and the Board of the Fund. The supreme management body of the Fund is the General Meeting of participants. The Council of the Fund is the management body of the Fund, and the Board of the Fund is the executive body of the Fund. Part 2 of Article 16 of the Draft Law No. 3205-2 states that the internal auditor is appointed, dismissed by and is accountable to the Council of the Fund. However, the Law of Ukraine «On Financial Services and State Regulation of Financial Services Markets» defines the forms of internal audit, including the formation of a structural unit - the internal audit service (control) or the appointment of a separate official - the internal auditor (controller). Internal audit is independent of other subdivisions of a financial institution and performs supervision and inspection of economic activity of a non-banking financial institution. The creation of a structural subdivision or appointment of a separate official is within the competence of the supreme management body or supervisory board of a financial institution (Article 15-1). The structural subdivision or the separate official carrying out internal audit (control) is subordinated to the Supervisory Board, and in cases when the formation of a Supervisory Board is not required by law - to the supreme management body of the financial institution and reports to them. Thus, the above makes it possible to conclude that the current legislation and the Draft Law No. 3205-2 have contradictions in the regulation of internal audit issues and require mutual coordination and bringing the provisions of the draft in accordance with the requirements of the legislation.

The management and supervision of the Fund for Partial Credit Guarantee in Agriculture should be structured in such a way as to ensure its sustainability, to avoid corruption, and to introduce clear controls, transparency and accountability. Generally, non-banking financial institutions in other countries are accountable to and controlled by the Central Bank, for example in India (Reserve Bank of India) under the Companies Act No. 18 as of 29 August 2013, in Bangladesh (Bangladesh Bank) under the Financial Institutions Act No. 27 as of 6 August 1993 (Gupta et al., 2013).

According to Paragraph 2, Clause 7 of the Final Provisions of the Law of Ukraine No. 79-IX «On Amendments to Certain Legislative Acts of Ukraine on Improving the Functions of State Regulation of Financial Services Markets» as of 12 September 2019, the National Bank of Ukraine and the National Commission on Securities and Stock Market from 1 July 2020 are legal successors of the National Commission, performing state regulation of financial services markets in the exercise of powers and functions on state regulation and supervision in the field of financial services markets within the powers established by the Law of Ukraine «On Financial Services and State Regulation of Financial Services Markets» (2001). Thus, the state regulation and supervision over the activities of the Fund for Partial Credit Guarantee in Agriculture is within the power of the National Bank of Ukraine.

## 5. Conclusions

It should be noted that with the opening of the land market, agricultural producers will feel an urgent need for bank crediting. Today's realities point to a number of existing problems that inhibit bank crediting to agricultural enterprises, including the lack of liquid collateral, imperfect legislative mechanisms, high tax rates, inadequate level of state support and guarantees, and so on. One of the ways to solve the problems that exist in crediting agricultural enterprises is the consolidation of an effective mechanism for guaranteeing the risks of non-repayment of loans by agricultural enterprises.

The experience of foreign countries shows that the effective functioning of a non-banking financial institution, such as the Fund for Partial Credit Guarantee in Agriculture, can produce a significant economic effect, while meeting the needs of entities in the necessary capital. The introduction of a credit guarantee system is the most effective mechanism of state support for small and medium agriculture enterprises.

According to the provisions of the Law of Ukraine «On Financial Services and State Regulation of Financial Services», a credit guarantee is considered a financial service. For this reason, the system of credit guarantees in agriculture is able to function within the framework of the current legislation of Ukraine. However, in order to properly regulate the internal control mechanism, risk management procedures, external supervision, etc., it seems appropriate to develop a special regulatory legal act.

The analysis of the provisions of the Draft Law of Ukraine «On the Fund for Partial Credit Guarantee in Agriculture» allows us to conclude that most of the provisions are declarative, and the terminology needs to be unified. The introduction of proper legal regulation will create an effective credit guarantee system in agriculture, which in turn will encourage credit institutions to increase the volume of credits to small and medium enterprises and attract «donors» to ensure due financing of the Ukrainian Fund for Partial Credit Guarantee in Agriculture.

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