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FINANCIAL INSTRUMENTS IN CAP 2020+*INSTRUMENTY FINANSOWE W WPR 2020+***Key words: common agricultural policy, financial instruments, support for agriculture***Słowa kluczowe: wspólna polityka rolna, instrumenty finansowe, wsparcie dla rolnictwa**JEL codes: Q14, Q18, G23*

Abstract. Financial instruments (FIs) have been an element of EU policies for almost 2 decades. They are in use also in CAP. Yet, they have not gained much popularity due to both their novelty in CAP and the complexity of their implementation. However, given the diminishing allocation of funds for CAP they are sure to become an important part of CAP support as they offer an important advantage to policy makers due to the leverage effect which enables the funds to be used more than once and thus to offer support to a larger group of beneficiaries. The paper is based on literature review and the analysis of EU documents related to FIs. Its aim is to assess the proposal of the EC relating to the use of FIs in the CAP 2020+ taking into account the lessons learnt during the implementation of FIs in rural development programmes (RDPs) in the previous and current programming periods. Results show that wider use of FIs in CAP 2020+ as compared to the current period is inevitable. Yet, there are serious problems that have to be tackled to make the FIs' implementation a success. This included careful planning and educating potential beneficiaries.

Introduction

Financial instruments (FIs) have become part of EU policy instruments. They have been part of EU rural development policy for 16 years. Yet, despite almost two decades of experience, their use in rural development programmes has remained highly limited. This is not only the case of the European Agricultural Fund for Rural Development (EAFD), but also of other EU funds. However, the European Commission (EC) has been increasing its efforts to make FIs more important tools for EU policy targeted at increasing EU competitiveness.

FIs are a way to tackle the problem of the financial gap. A financial gap is defined as an unmet demand for external financing [Fi-compass 2018b]. This problem occurs when there is lack of access to finance in a given sector of the economy. This is the result of market failure. Trying to stimulate investment among EU companies, the EU decided to overcome the problem of the financial gap by using FIs.

The use of FIs is supposed to have numerous benefits. They offer the key possibility of supporting more enterprises with the same amount of money than when using grants still typical of EU structural funds and CAP. This is possible thanks to the involvement of financial institutions and the revolving use of public funds. This is a result of following effects related to the process of implementing FIs. These include: the multiplier, leverage and revolving effect. They are a result of mobilising additional private and public funds to complement the initial public funding and the use of the same funds in several cycles [ECA 2016].

The EC in its communication on CAP 2020+ [EC 2017] stated that the investment gap in agriculture should be addressed by a wider use of FIs. According to the EC, FIs “should leverage additional support from Rural Development programmes in order to provide low cost and longer term loans for entrepreneurs that are willing to invest in rural areas” [EC 2017].

The aim of the paper is to assess the proposal of the EC relating to the use of FIs in CAP 2020+ taking into account the lessons learnt during the implementation of FIs in rural develop-

ment programmes (RDPs) in previous and current programming periods. The paper is based on literature review and the analysis of documents related to the implementation of FIs in CAP and other EU policies.

Material and methodology

The paper is based on document analysis and literature review. The analysed materials included, inter alia, a research paper, evaluation reports, audit reports, European Commission documents and Fi-compass publications¹.

In the first stage of research, the rationale for applying financial instruments within the EU policy was examined. The second stage involved an overview of the experiences with making use of FIs in rural development programmes. Here, special emphasis was placed on reports elaborated by the EU Court of Auditors. In the third stage, proposals presented by the European Commission for FIs within CAP in the programming period 2021-2027 were assessed. Based on the results from the above-described stages of research, conclusions on the potential role of FIs in the development of EU agriculture and rural areas were drawn.

Research results

“Financial instruments”² is a term applied to a number of different products offered by the financial sector. There is no universally accepted definition. In the case of the EU, the use of this term applies to a wide range of instruments including: loans, guarantees, co-investment, equity capital, venture capital and Mazzine capital [Fi-compass 2014]. The rationale for their use in the EU is the need to tackle market failure concerning the existence of a financial gap, especially among enterprises belonging to SMEs sector. The lack of accessibility to external financing among these entities hinders their investment and thus impedes the growth of the EU economy.

FIs have been in use in EU policies for almost two decades. Already, in the programming period 2007-2013, FIs set up under the European Regional Development Fund (ERDF) and the European Social Fund (ESF) were used by 25 out of 28 EU Member States [ECA 2016]. Yet, so far their use has been limited when it comes to the scale of funds involved in FIs. This applies both to CAP and to other domains of EU policy (fig. 1). In the programming period 2014-2020, FIs are currently being implemented in 28 out of 109 RDPs [Fi-compass 2018a]. Their use is limited to 6 (in total 16 different sub-measures) of the 20 measures envisaged in the EU regulation 1305/2013. They include a wide range of measures:

- M04 – Investment in physical assets;
- M06 – Farm & business development;
- M07 – Basic services & village renewal;
- M08 – Investment in forest areas;
- M16 – Cooperation;
- M19 – LEADER/CLLD.

The current financial gap in EU agriculture is estimated to amount to EUR 7.06-18.8 billion [Fi-compass 2018b] (tab. 1).

In the EC’s communication on the future of CAP, it was stated that FIs should be used to support new entrants to the agricultural sector. It is confirmed in the EC’s proposal of the CAP 2020+ regulation, where the combination of grants and FIs is mentioned as well as preferential conditions for this group of beneficiaries [*Proposal...* 2018].

¹ Fi-compass is a body founded by the European Commission and European Investment Bank. It is “a platform for advisory services on financial instruments under European Structural and Investment funds” [<https://www.fi-compass.eu>].

² Until 2014 in EU documents the term “financial engineering instruments” was used.

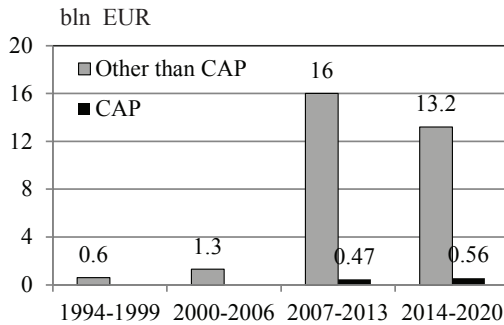


Figure 1. Level of funds allocated for the implementation of FIs

Source: [Kulawik et al. 2018]

Table 1. Estimated financial gap in EU agriculture

Loans	Lower boundary [EUR]	Upper boundary [EUR]
Short-term loans	1 565 006 622	4 120 785 592
Medium and long-term loans	5 498 698 235	14 478 505 168
Total	7 063 704 857	18 599 290 760

Source: [Fi-compass 2018b]

Experience with the implementation of FIs showed that they are more complicated to implement than grant support. It is related to both their novelty in EU policies and to the need of involving yet another element of the implementation system – intermediaries. The novelty of FIs results in the lack of detailed regulations or too rigid regulations.

It must be underlined that with each programming period the regulations concerning the implementation of FIs change. The changes are a result of both lessons learned and the recommendations stipulated by the European Court of Auditors (ECA). For example, in 2012 in its report on FIs for SMEs, the ECA called for making sure that the use of FIs “is duly justified by an SME gap assessment of sufficient quality, including a quantified analysis of the financing gap” [EC 2012] and in the programming period 2014-2020 ex-ante assessment is legally required from managing authorities.

In the programming period 2014-2020 one of the problems related to the implementation of FIs was Article 49 of Regulation 1305/2013 that stated that the selection of operations for support should give equal opportunities for all applicants. It was not clear whether the first in – first served method used in the case of FIs was legally possible. These concerns were addressed by the Omnibus regulation.

Managing institutions still state that they need more guidance from the EC and other bodies on how to conduct ex-ante assessment of the need to apply FIs, the choice of financial intermediaries and other issues related to the implementation of FIs within their RDPs [Fi-compass 2018a].

Experience with using FIs in RDPs is even less promising. In the European Court of Auditors’s report of 2015, it was stated that “financial instruments had been unsuccessful in the field of rural development and although the 2014-2020 period is potentially promising, it will be a considerable challenge to achieve the desired impact” [ECA 2015]. Despite the changes in regulations and a growing availability of guidance offered to managing authorities, the key problem may be a lack of demand. Implementation of FIs in the agricultural sector requires a wide reaching information campaign for farmers to demonstrate the functioning of different FIs. Experience gained thus far by Member States that have already applied FIs in their RDPs are limited and mixed³. Moreover, so far, only loans and guarantees have been implemented in RDPs, which is probably due to the needs of the sector and the simplicity of these instruments as compared to other FIs.

³ Some of the experiences with implementation of FIs in both CAP and other EU policies can be found in the case study section of the publications available at: <https://www.fi-compass.eu>, access: 30.06.2018.

In response to the question whether FIs are worth being a part of RDPs, Barbara Wieliczko stated [Wieliczko 2016] “yes, but”. The “but” related to the difficulties with assessing the demand for FIs and the time and costs associated with the implementation of this form of support. Despite much effort of the EC and Fi-compass in popularizing FIs and offering guidance, this still is the case and the implementation of FIs will always remain more complicated than grant schemes.

Summary and conclusion

Financial instruments are implemented within different EU policies, including CAP, to tackle the problem of the financial gap and make the most of EU public funds by also mobilising private money. They are also supposed to guarantee a better quality of project by using the expertise of financial institutions in evaluating projects and decreasing the number of economically unviable projects due to the need of repaying the support received.

The popularity of FIs as a mechanism of supporting agriculture and rural development within RDPs has been limited. There is a number of different reasons that lead to the lack of implementation of FIs within RDPs in the programming periods 2007-2013 and 2014-2020. They include, inter alia: lack of experience of managing institutions, difficulty in assessing demand, regulatory issues and problems with settling relations with intermediaries.

Undoubtedly, an important disadvantage of FIs for the RDP managing authorities is the time needed to launch such measures which can endanger full absorption of the EU funds allocated for a given RDP. Therefore, EC should consider a prologed period for absorbing funds earmarked for FIS instead of sticking to the n+2 rule as this could make the FIs more attractive from the perspective of RDP managing bodies.

For the programming period 2021-2027, the EC calls for even wider use of FIs perceiving them as a way of tackling problems related not only to a lack of investment in EU agriculture, but also as a way of dealing with increasingly important issues of generational renewal by helping young farmers and new entrants in gaining access to financing.

The implementation of FIs is a must, given the decreasing amounts of funds allocated for CAP. Yet, FIs are a complicated way of supporting agriculture when compared with grants. They are also more costly and time-consuming at a design and implementation level. Yet, they can improve the quality of projects supported by including banks and other institutions specialised in project assessment.

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Streszczenie

Celem artykułu jest ocena propozycji KE dotyczących instrumentów finansowych w ramach WPR 2020+, z uwzględnieniem doświadczeń zdobytych podczas poprzedniego i obecnego okresu programowania. Dokonano przeglądu literatury i analizy dokumentów UE związanych z instrumentami finansowymi. Instrumenty finansowe są elementem polityki UE od prawie dwóch dekad. Są one również stosowane w WPR. Jednak nie zyskały dotąd dużej popularności ze względu na ich nowość w WPR oraz z uwagi na złożoność ich wdrażania. Jednak z uwagi na spadek środków przeznaczonych na WPR, staną się one ważną część wsparcia, gdyż dzięki efektowi dźwigni pozwalają na oferowanie wsparcia dla większej liczby beneficjentów niż granty. Wyniki analizy pokazują, że szersze stosowanie instrumentów finansowych w ramach WPR 2020+ w porównaniu z obecnym okresem jest nieuniknione. Istnieją jednak poważne bariery, które należy przezwyciężyć, aby wdrożenie tych instrumentów stało się sukcesem. Wymaga to starannego zaplanowania stosowania tych instrumentów i edukacji beneficjentów.

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