

FINANCIAL INSTRUMENTS OF EUROPEAN UNION STIMULATING RURAL DEVELOPMENT

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Abstract: *This paper reviews the importance of using Financial Instruments by the EU to stimulate economic activity and development in agriculture, forestry, human capital, as well as in the rural development. The main focus is representing the effectiveness of FIs compared with Grant financing. There are also mentioned about the importance of the usage of FIs by the European Agricultural Fund for Rural Development during a period 2014-2020. Furthermore, it is necessary to specify the effective use of financial instruments in the new period as a main impulsive force for rural development.*

Keywords: *financial instruments, rural development, the European Agricultural Fund for Rural Development, cost-effectiveness*

INTRODUCTION

Financial engineering instruments (often known as 'financial instruments') financed by the European Agricultural Fund for Rural Development (EAFRD) are a steady and effective source to invest in the growth and progress of businesses and resources in the agriculture sector as well as in the rural economy.

Financial instruments were first applied to agriculture in the 2000–06 programming period and were broadened to 2007–13 period with the aim to helping farmers and rural SMEs to receive private funding for rural investment programs [5].

Financial instruments (FI) used by EAFRD are implemented in many different ways. They include Loan Funds, Guarantee Funds, Venture Capital Funds, Equity Funds and Interest Rate Subsidy systems. An important factor in these instruments is that they ensure an alternative choice to grant funding and at the same time they can all recycle the initial distribution of money used to set up the funds and thereby promote further development of agriculture [3].

These instruments can contribute to the wide range of development objectives to the benefit of a broad range of recipients. The EAFRD is the financial tool of the second Pillar of the Common Agricultural Policy of the European Union and one of the European Structural and Investment Funds and seeks at developing the EU's agriculture, forestry sector and in general rural areas.

The main advantages of using FIs for stimulating economic activity are as follows: [3]

- FIs are planned to address market imperfections in the availability of capital. State financed FIs are justified on the two main market imperfection. First is information asymmetry, that certain types of projects (such as start-ups) lack appropriate information for potential investors. The second one is that commercial estimations of returns in investment do not inevitably capture all positive externalities or social benefits. For example, the absence of access to financial resources may limit investment in R&D and innovation.

- Policymakers may affirm that the use of FIs will increase the cost-effectiveness of public funds since disbursements, including interests and dividends, create a rotating

legacy that can be reinvested and that financial instruments create mechanisms for attracting private sector funds.

- It is important to emphasize that repayable financial sources improve the quality of investments (compared to those in obtaining of grant funding) owing to the obligation to repay the investment and the due diligence involved in assessing investment offers.

MATERIALS AND METHODS

In this article, the methods used were analysis, synthesis, comparison method, deduction, and induction. The data used were taken from the statistics of the European Commission (Eurostat) and statistics from various national and international publications, on which we made analysis and own interpretations.

RESEARCH RESULTS

The 2007-13 period drew a significant emphasis on the use of financial instruments as measures for implementing Cohesion policy. In the 2007-2013 period, only new investments and start-ups in enterprises had been realized. As for the 2014-2020 planned period, their framework has been broadened substantially by covering all types of investments (including infrastructure) for all potential beneficiaries. In period 2007-2013, the rules for using EAFRD funds in financial instruments were set out in Articles 50-52 of Regulation (EU) No 1974/2006. In the planned period 2014-2020 the relevant rules for the development and implementation of financial instruments are defined in Title IV of the Common Provisions Regulation (CPR) (Regulation (EU) No 1303/2013).

In total, the planned EAFRD budget volume for 2014-2020 is estimated to be 149.6 billion Euro (data from the European Structural and Investment Funds). The following chart data (Figure 1) shows the distribution of the EAFRD budget allocated by theme.

Almost all Member States (except Ireland, Luxembourg, Croatia) practiced these FIs during the 2007-2013 programming period. Nevertheless, the use of FIs, the chosen implementation model and development policy objectives differ widely across the Member States. The differences between countries are especially manifested to country size and the overall scope of Cohesion policy funding (which also complicates immediate comparisons).

For most of the investigations (e.g. Bulgaria, Slovenia, Italy, Romania), FIs are considered to increase the performance of Cohesion policy in terms of reaching objectives and obtaining outcomes when compared to grants. This is mostly related to their revolving nature, which is an important positive factor, making FIs very attractive to the Member States when budgetary constraints are increasing [7].

As already mentioned, in 2014-20 period, the role of financial instruments is intensified: they can be used for any thematic investment. By the European Commission, FIs are considered as a sustainable and effective way for investing EU funds in the growth and development of businesses, human capital, forestry, and agriculture sectors as well as in the rural economy. They can support a wide range of investment objectives with the potential for funds to be reused for further investments. In 2014-2020 period they have become the key policy tools for attracting and investing new resources into the EU economy, nevertheless, grants continue to dominate in the EU / CAP spending. Through the advantages proposed by financial instruments for Rural Development Program (RDP), the greater attention is expected to pay attention to financial instruments in the next EAFRD programming period (between 2014 and 2020). Therefore, the interest level in EAFRD financial instruments at Member State has continued to grow during 2014-2020 period [4].

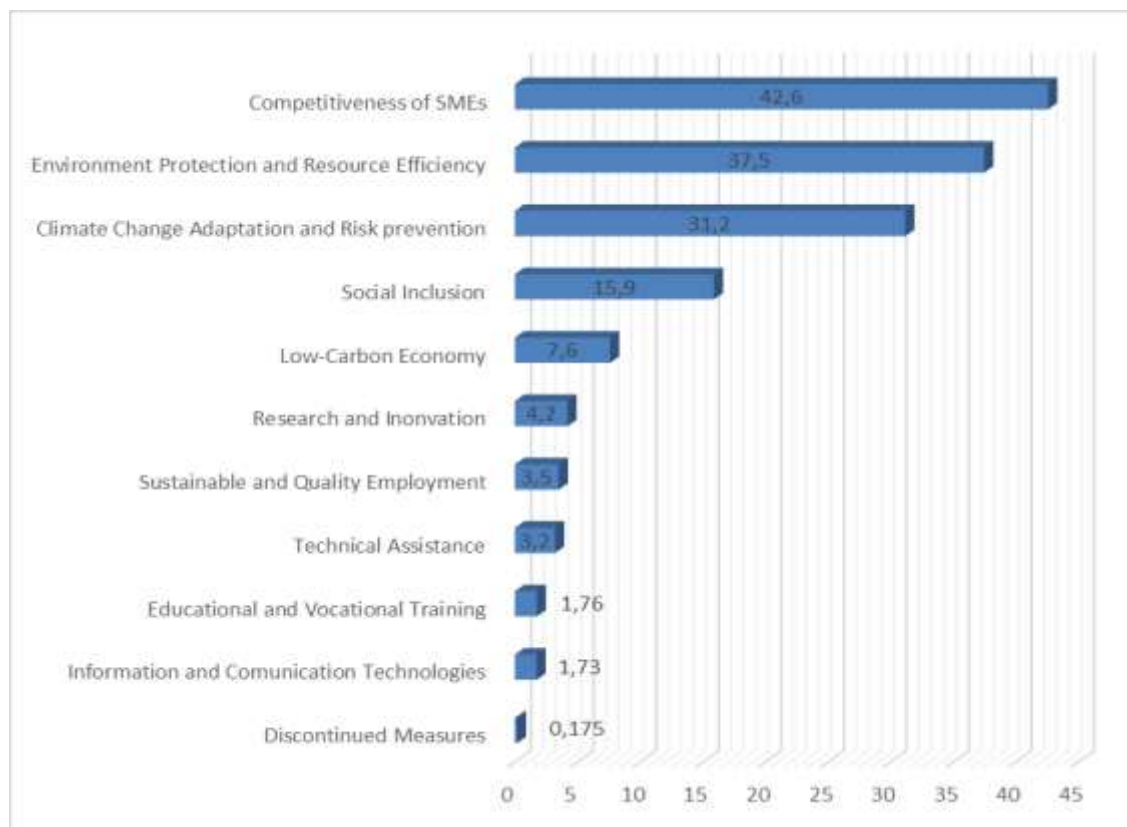


Figure 1. Total Budget by Theme: European Agricultural Fund for Rural Development, (EUR billion)

By the end of 2013 at the EU level, notes that 91 percent of these financial instruments were sent to business development (usually to SMEs), 6 percent to the urban development projects, and 3 percent to the energy efficiency and renewable, with 93 percent of resources were aimed at support for enterprises (data from the 2014 European Commission Summary Report) – Figure 2.

The 2015 Summary Report on the realization of FIs describes the situation up to end 2014. This point out that: [7]

- 25 Member States had implemented-financed FIs¹⁸ (Croatia, Ireland, and Luxembourg had not);
- by the end of 2014 were operating 73 holding funds (HF) and 952 specific funds (438 outside a holding fund – NHF; and 514 within a holding fund -SHF);
- of the specific financial funds, 879 were directed to business development (i.e. enterprises – typically SMEs), 47 to urban development projects, and 26 to energy efficiency and renewables;
- all Member States using FIs for financing and developing enterprises, but only 11 Member States use FIs for urban development and 11 use FIs for energy efficiency;
- FIs mainly allocated in the form of loans and guarantees with a small proportion in the form of equity finance: by the end of 2014, some 234,644 financial products had been served to final recipients, of which around 94 percent were in the form of loans and guarantees.

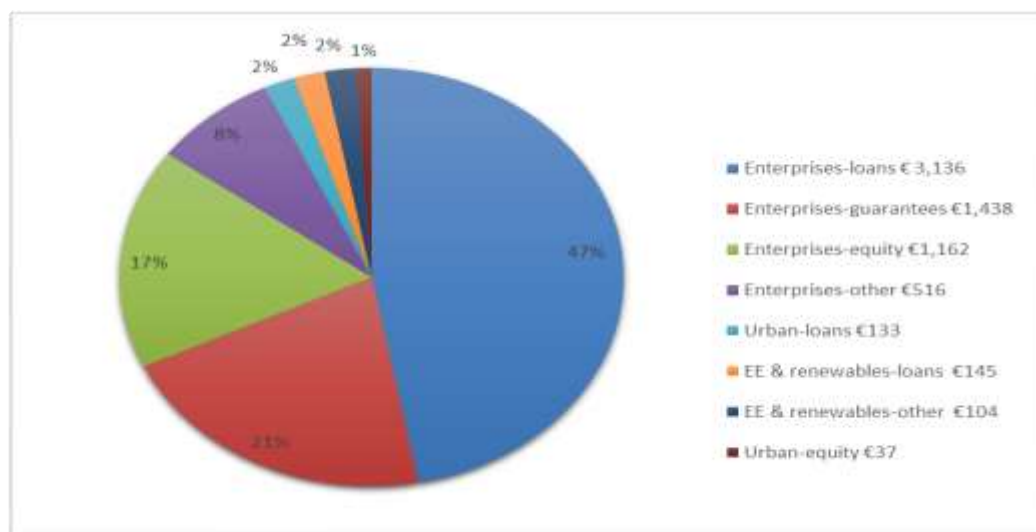


Figure 2. Amounts disbursed to final recipients by type of FI and target (€m and % of total)

There is an important rule for designing EAFRD financial instruments that needed to follow by Member State authorities and they should follow a number of key steps to set up a new fund. First and foremost, it is important to lead internal discussions to identify the demand for a new fund, and adopting the necessary policy for this approach. There may be required amendments to the national Rural Development Program (RDP), as well as to national or regional rules concerning administrative procedures of EAFRD, etc.

An investigation held by the European Network for Rural Development (ENRD) in 2012 identified some of the obstacles, to a wider use of financial instruments in the current EAFRD programming period. The fact is that RDP Managing Authorities think that financial instruments were seen as requiring additional management skills and resources, and there was concern about the complexity of additional control that would need to be applied. Concerns were also related to the risk of incurring financial corrections and budget cuts if the financial instruments were not driven correctly, and some Managing Authorities suppose that demand for financial instruments was not strong because the commercial market was able to satisfy rural SMEs' investment needs [3].

Another fact which is worth to mention is that under the current EAFRD regulation it is difficult to combine RDP grants with support from financial instruments and this can act as an additional obstacle for Managing Authorities.

The demand for financial instruments of EAFRD supporting the European rural SMEs is growing at a steady pace, while an information gap about the options to use these financial resources still exists for them. In rural areas of some Member States SMEs are excluded from this financial support, therefore, as a result determining "a rural financing gap". The main characteristic of the rural economy is that it contains mainly small and medium-sized enterprises (SMEs), with a high share of self-employment. These rural SMEs represent a huge potential for financial instruments. Also, they can play a crucial role in the recovery from the economic crisis and have a big potential to create employment. Thereby, access to financial resources for rural SMEs is considered as an important element for economic growth and development of rural areas.

In the Member States, an expansion of financial instruments of the EAFRD provided to rural businesses could play a valuable impact in solving this challenge.

The implementation of these measures proceeds from the three objectives of the Cohesion Policy: Convergence (supporting regions lagging behind in terms of economic development), Regional Competitiveness and Employment (supporting regions other than

those lagging behind as development level, and European Territorial Cooperation (promoting a balanced development of the entire Community territory by encouraging cooperation and exchange of best practices between all EU regions) [2].

A review of the data shows that Member State practices vary extensively, with further variety at the subnational level. For some members, FIs are a basic delivery system for Cohesion policy, for others, they have a slight role. However, it is difficult to compare countries for using FIs by the very different policy contexts. For the many Member States there are accepted practices of providing finance through business development banks, private funds: sometimes in these countries, the Cohesion policy create a small added value. For other members, Cohesion policy provides a significant supplement to the domestic policy or provides a type of support that did not exist before [1].

Taking into consideration the above-mentioned factors, we can conclude that FIs provide an effective way for the implementation of the Cohesion policy objectives, especially in a time of economic crisis and limited financial recourses. Considering their rotating nature and the involvement of private sector funds and human resources we can assume that it adds substantial value in the promotion of economic growth.

Nevertheless, FIs are a wide term to shield a wide range of different types of instruments. Though, assessment of the productivity and capacity of these instruments and deciding on their use for specific projects needs a more thorough and deep case-by-case analysis, linked to a specific regional economy or target group.

CONCLUSIONS

Financial instruments financed by EAFRD can promote the long-term growth and diversification of the agricultural sector and facilitate investments in it and stimulate the development of commercially-vital programs, thus disclose new market opportunities and ways of improvement. They can also create opportunities for the market of financial intermediaries.

The determination and implementation of appropriate FIs is a complicated procedure and include many actors and interests, which requires a detailed and professional coordination and a clear legal framework in order to achieve the implemented policy goals.

In 2014-2020 period is considered that the use of advantages of financial instruments is extended to all thematic fields and expected further strengthening due to the improved and flexible implementation tools.

Access to financial resources has usually been costly and difficult for firms in the agriculture, especially for rural SMEs. In the many Member States, the agricultural sector is considered by banks and financial institutions as high risk in terms of for money lending and access to credit. However, some innovative ideas can become more attractive for investors due to public sector support of financial instruments and related risk-sharing.

Many Member States have a long domestic practice in working with FIs and a number of lessons can be learned from this.

Selecting the right type of financial instrument to help fill the rural SMEs financing gap requires careful analysis and planning, and consideration of the following points.

- Member States need to encourage attention to the shift from grants to FIs in view of strengthening the competitiveness of agriculture and agro-food sectors;
- All proposed measures for the planning of financial instruments must be properly justified by an assessment of demand to the specific needs of the target groups (SME and/or other organizations);

- Every financial instrument requires a reliable and competent monitoring and evaluation system, and be able to accurately inform reporting and auditing processes.

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