Access to credit and financial instruments in agriculture

SUMMARY

Agriculture is a strategic economic and societal sector for the European Union (EU): the agri-food sector adds an estimated €420 billion in value per year and provides more than 47 million jobs in the European agro-food sector (roughly equivalent to 7% of the workforce, making it a key employment sector). Additionally, it helps to manage more than 50% of EU territory and is the fourth-largest export sector in the EU economy. In the global context, the EU agri-food sector has huge potential to perform even better in the future. According to the European Commission, EU agricultural policies should be designed to maximise their potential to boost growth, jobs and the overall development of European rural areas.

For most EU small and medium-sized enterprises (SMEs), access to credit is a restraining factor. In particular, most EU farmers do not find it easy to get credit at the best rates. Banks regard potential loans to farmers and many other, especially smaller, rural businesses, as risky. Meeting the conditions to unlock sources of finance consequently becomes more difficult.

Without further investment, however, it would be difficult to cope with future challenges, such as food security, climate change and competitiveness and the chances of economic growth in the agricultural sector would be slim. The European institutions intend to promote a series of economic and financial support measures, in particular financial instruments funded via the EU or national budgets, to allow farmers to invest, with the support of credit institutions, thereby promoting sustainable growth within the EU’s agricultural sector.

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Financial Glossary

**Financial Instruments (FI):** European Union measures of financial support provided on a complementary basis from the budget in order to address one or more specific policy objectives of the Union. Such instruments may take the form of equity or quasi-equity investments, loans or guarantees, or other risk-sharing instruments, and may, where appropriate, be combined with grants.

**Loan:** an agreement which obliges the lender to make available to the borrower an agreed sum of money for an agreed period of time and under which the borrower is obliged to repay that amount within the agreed time.

**Equity:** all instruments and records acknowledging claims on the residual value of a corporation or quasi-corporation after the claims of all creditors have been met. Equity comprises equity securities and other financial instruments not classified as securities. An example of quasi-equity is a subordinated debt.

**Guarantee:** the act of underwriting funds to provide security for firms that are unable to obtain financing otherwise; an agreement to be responsible for someone else’s promise, especially a promise to repay a loan if the original borrower defaults.

**Longer-term interest rates:** the rates of interest or the yield on interest-bearing financial assets with a relatively long period to maturity, for which the yield on government bonds with a maturity of ten years is often used as a benchmark.

**Principal risk:** the risk that the seller of a financial asset will deliver, but not receive payment, or the risk that the buyer will pay, but not receive delivery. In such a situation, the full value of the securities or funds transferred is at risk.

Source: European Central Bank glossary and EU Financial Regulation

Background

Agri-food is a strategic EU economic and societal sector with the potential to perform even better in the future. Farming involves the equivalent of 10 million people directly employed full-time on farms, and 22 million people working regularly in agriculture within the EU, helping to manage more than 50% of EU territory. The sector accounts for 7% of employment and creates an estimated €420 billion a year in total added value. Additionally, the EU is the world’s leading agri-food exporter, with exports to the value of more than €129 billion in 2016.

According to the Commission, the EU should focus on maximising the sector’s potential to boost growth, jobs and the overall development of European rural areas. Agriculture could be a key driver of job creation, but these developments will require innovation and investment.

Access to funding is one of the most important components for good rural economic performance, but farmers - and young farmers in particular - do not always find it easy to get credit at the best rates. Banks regard potential loans to farmers and many other rural businesses – especially smaller ones – as risky. The conditions for obtaining a loan thus become more difficult to meet.

Although the Court of Auditors concluded that financial instruments had been partially unsuccessful in the rural development policy 2007-2013, it suggested that the programming period 2014-2020 is potentially promising, although it would be a considerable challenge to achieve the desired impact.
Financial instruments

Definition of financial instrument
According to the EU Financial Regulation, financial instruments are Union measures of financial support provided as a complement from the budget to address one or more specific EU policy objectives. Use of these instruments is growing. They may take the form of equity or quasi-equity investments, loans or guarantees, or other risk-sharing instruments and, may, where appropriate, be combined with grants. Financial instruments are implemented to support investments which are expected to be financially viable but which do not attract sufficient funding from market sources.

The specific provisions on financial instruments in agriculture are set out in Regulation (EU) No 1303/2013, laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development (EAFRD) and the European Maritime and Fisheries Fund. Other relevant provisions for financial instruments in agriculture (e.g. information on priorities/measures, co-financing, eligible expenditure), can be found in Regulation (EU) No 1305/2013 on support for rural development from the European Agricultural Fund for Rural Development (EAFRD). For the programming period 2014-2020, the EU allocated €99.6 billion for the 118 Rural Development Programmes (RDPs) in the Member States.

Figure 1 – Financial instruments can be implemented through the EAFRD and other ESI funds

In this context, implementation of financial instruments is intended to create some benefits, such as leverage of EAFRD resources and increase the impact of Rural Development Programmes (RDP). One of the main objectives is to attract private sector support (and financing) for public policy objectives through a wider spectrum of financial tools for policy delivery. The use of financial instruments may encourage investors to participate in projects which are not attractive to private investors, since such types of investment are considered too risky for normal private financial institutions. This is particularly significant for new farmers who are setting up, and have little collateral at their disposal, and thus generally no access to finance.
Farmers' access to financial instruments for agriculture

To allow farmers to access any financial instruments scheme, including guarantee instruments, Member States must first create and insert a financial instrument into their rural development programme (RDP). This can either be done from the start, or can be achieved at a later stage, through modification of the initial RDP. Once this is done and the financial instrument becomes operational, a farmer may apply to the financial institutions through which funding is channelled. The implementation mode should be decided by the Member State and according to the funding agreement between the national or regional Managing Authority and a fund manager (e.g. the European Investment Bank (EIB), the European Investment Fund, or a nationally operating financial institution).

Necessary proceedings for a loan application

For the national authorities, certain procedures are involved in the submission of an application to the EIB for actions related to supporting EU rural development policy. Member States are required to provide an exhaustive explanation of their financial and investment activities, i.e. a well-developed ex ante evaluation and business plan, to allow the EIB to assess whether the project adheres to EIB lending objectives. The Fi-compass platform provides useful stakeholder access to advisory services and practical know-how on financial instruments.

Initial contacts to discuss a proposed project can be informal, although for RDP Managing Authorities, a request to the EIB must be coordinated via the Ministry of Finance.

Agricultural or forestry businesses interested in EIB financing for projects with a value below €25 million can contact banks and other intermediaries involved directly with a detailed description of their capital investment together with the prospective financing arrangements to be sent to the EIB (see below).

Conditions for using financial instruments under a Rural Development Programme

According to Regulation (EU) 1303/2013, financial instruments supported by the European Structural and Investment Funds should be used to address specific market needs in a cost-effective way, in accordance with the objectives of the programmes, and should not crowd out private financing. The decision to finance support measures through financial instruments should therefore be determined on the basis of an ex ante assessment which has established evidence of market failure or sub-optimal investment and the estimated level and scope of public investment needs.

According to Regulation (EU) 1303/2013, financial instruments should be designed and implemented to promote substantial participation by private sector investors and financial institutions on an appropriate shared-risk basis. To be sufficiently attractive to the private sector, it is essential that financial instruments are designed and implemented in a flexible manner. Managing authorities should therefore decide on the most appropriate forms for implementing financial instruments, in order to address the specific needs of the target regions. Where applicable, such flexibility includes the possibility to re-use part of the resources paid back during the eligibility period, to provide for the preferential remuneration of private or public investors operating under the market economy principle.

A Rural Development Programme which did not include financial instruments at its launch may be modified later, if the authority responsible is convinced of the attractiveness of using these tools to increase programme impact.
European Investment Bank

The European Investment Bank (EIB), owned by the 28 EU Member States, supports public and private sector projects which help to further EU policy objectives. The EIB lending in 2015 amounted to €78 billion. During recent years it has provided €12 billion in loans to agriculture, forestry and fisheries production.

The EIB has established a range of finance solutions and can support up to 50% of total project cost. Loans can be granted directly to projects worth over €25 million while smaller projects are supported through a system of local partner banks in the EU.

The whole agri-food value chain is covered by the lending activities of the EIB, ranging from input and equipment supply to wholesale and retail networks. The EIB can also co-finance national and regional operational plans under the EAFRD. Indeed, to maintain and generate employment in rural regions, the EIB provides finance to national and regional governments implementing their rural development programmes. As a non-profit, multilateral bank owned by the 28 EU Member States, funding costs are lower than commercial banks.

**Figure 3 – EIB loan types**

<table>
<thead>
<tr>
<th>DIRECT LOANS</th>
<th>INDERECT LOANS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Large-scale Projects (more than €25 million).</td>
<td>Small and medium-scale projects (particularly to farmers and other rural SMEs) via national and regional intermediary banks.</td>
</tr>
<tr>
<td>Working with regional and national RDP Managing Authorities, financing elements of the RDPs.</td>
<td>Lending decision remains with the financial intermediary.</td>
</tr>
</tbody>
</table>

Source: EIB.

Loan conditions will vary from region to region, but according to the Commission, attractive terms are expected everywhere. It is possible, for example, to find loans with terms between three and ten years paying sometimes as little as around 1-1.5% for the guarantee.

**The guarantee scheme**

A guarantee scheme for farmers offers security for loans to be provided by banks – for up to 80% of the loan’s value. As soon as this guarantee is obtained, a business idea is much more likely to be put into practice, as bank support is easier to access. The EIB is available to assist, from large-scale capital investments to guarantee schemes for small farmers.

**Memorandum of Understanding**

In July 2014, the EIB and the European Commission signed a Memorandum of Understanding in the area of agriculture and rural development. It sets out the principles of cooperation and coordination between the two institutions regarding:

- EU rural development policy – funded by the European Agricultural Fund for Rural Development (EAFRD);
- The Commission research agenda in the field of agriculture, food and forestry – funded under the EU research and innovation framework programme, Horizon 2020.
Some of the activities covered by this Memorandum – such as EIB lending in support of agriculture and forestry and their related agri-food industries – are well-established. The Memorandum structures the cooperation between the Commission and the EIB, covering areas such as supporting and implementing the European RDP, or Horizon 2020 objectives in the agri-food sector. The ultimate beneficiaries under the Memorandum are the EAFRD stakeholders of each Member State.

In more concrete terms, the sort of instruments and operations that might be covered are investments, pilot and demonstration projects, and innovative projects transferring research results and knowledge-sharing.

The Memorandum of Understanding stresses the EIB’s potential role in financing public and private projects, as well as financing national and regional public contributions to rural development programmes.

As set out in the Memorandum, supporting farmers - especially young entrepreneurs - notably by facilitating access to economic resources through banking guarantees and lower interest rates, is of the utmost importance. The Memorandum also assigns crucial importance to the support of Rural Development Programmes and aims to drive more direct contributions for European players in the agriculture sector.

**European Commission**

The Commission has stressed that access to credit is a structural bottleneck for farmers' development. In practical terms, farmers have difficulties obtaining loans at favourable rates and they cannot rely on a steady income as a guarantee. In implementing the Memorandum of Understanding, the Commission works with the European Investment Bank (EIB) on options for establishing financial instruments (national or rural development allocations can be used for this). In this regard, the Commission and the EIB have prepared a model guarantee instrument which aims to help ease access to finance for farmers and other rural businesses. Member States and regions can adapt and use the model to set up financial instruments funded by their rural development programmes under the European Agricultural Fund for Rural Development (EAFRD) to secure loans for investments in farm productivity, processing and marketing, business start-ups and many other areas. Additionally, the Commission is working on designing financial instruments where repayment schemes are linked to commodity price developments (a proposal for a volatility-based, flexible financial instrument tailored to the agri-food sector).

In the coming months, the Commission is planning to review Regulation No 1303/2013, to facilitate the use of innovative financial instruments in agriculture, research and structural funds.

**Case studies – Romania, Italy and Latvia**

**Romania – financial instrument support for farmers**

Romania’s rural territory is of vital importance, as 70% of Romania’s poor live in the countryside. One third of the Romanian workforce is employed in agriculture and the sector has long been in need of restructuring. An analysis by the Romanian managing authority found that banks were reluctant to advance money to farmers or rural SMEs, even though resources were available. Banks perceived agri-sector players as risky, since most could not prove a solid financial record, did not possess sufficient material guarantees, lacked expertise and qualified personnel, or had lower profitability than other sectors. Typically, the banks required guarantees of 120-140% of the credit, as well
as a valuation of the assets offered as guarantee – which they usually undervalued. This market gap was a major reason for introducing an EAFRD financial instrument with the specific goal of increasing the use of EU funds in the rural economy.

To address this need for support, and given the unfavourable market conditions for farmers and rural SMEs, the managing authority decided to implement a guarantee scheme. This was carried out through a series of measures, including financial instruments, improving access to credit for farmers and aiming to increase the interest, confidence and investment levels of banks in the rural economy, by raising additional private funds.

**Figure 4 – Investment strategy of the financial instrument**

The European Agricultural Fund for Rural Development (EAFRD) guarantee instrument was designed, by the Romanian authorities, to pursue four measures:

- Modernisation of agricultural holdings;
- Adding value to agricultural and forestry products – including the corresponding state aid schemes;
- Support for the creation and development of microenterprises;
- Encouragement of tourism activities.

The Romanian RDP managing authority allocated €116.03 million which has been used to offer guarantees of €289.37 million (as of December 2013), with a leverage effect of 2.49. Guarantees for repaid loans were used to guarantee other loans, demonstrating the revolving aspect of the instrument. The initial allocation of €116.03 million helped produce loans of €425.53 million for farmers and rural SMEs.
ITALY – ISMEA

The Italian government agency, Instituto di Servizi per il Mercato Agricolo Alimentare (ISMEA), is involved in the collection and processing of economic data on rural markets, preparing and publishing financial and economic reports on developments in the rural economy in Italy and providing financial and insurance services to farmers. Its rural credit loans and guarantees scheme activities are supervised by the Ministry of Agriculture and Forestry Policies. Most Italian agricultural holdings are small or medium-size farms, with few opportunities to access commercial credit directly. To solve this problem, ISMEA provides a set of services to farmers and banks: direct loans, guarantee schemes and equity schemes.

The guarantee scheme provides security for firms that are unable to obtain financing by other means, repaying the remaining bank loan if the farmer defaults. The guarantee can be provided to small and medium enterprises (SMEs) up to 70% of the requested loan. In case of a young farmer under 40 years old, the guarantee can be increased to up to 80% of the loan. The ISMEA guarantee cannot exceed the limit of €1 million for micro and small enterprises and €2 million for medium enterprises.

**Figure 6 – Maximum direct guarantee limits**

<table>
<thead>
<tr>
<th>Type of holdings</th>
<th>Farmers</th>
<th>Young farmers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Micro and small enterprises</td>
<td>70%</td>
<td>80%</td>
</tr>
<tr>
<td></td>
<td>€1 000 000</td>
<td>€1 000 000</td>
</tr>
<tr>
<td>Medium enterprises</td>
<td>70%</td>
<td>80%</td>
</tr>
<tr>
<td></td>
<td>€2 000 000</td>
<td>€2 000 000</td>
</tr>
</tbody>
</table>

Source: ISMEA.
The following figure shows the cost of the guarantee for the farmers and for the banks.

**Figure 7 – Guarantee fees, in % of the loan guaranteed**

<table>
<thead>
<tr>
<th>Scope and duration</th>
<th>Fees for the farmers</th>
<th>Fees for the banks</th>
</tr>
</thead>
<tbody>
<tr>
<td>Length up to 18 - 60 months</td>
<td>0.30-0.50%</td>
<td>0.05%-0.20%</td>
</tr>
<tr>
<td>Length more than 60 months</td>
<td>0.75%</td>
<td>0.05%-0.15%</td>
</tr>
</tbody>
</table>

Source: ISMEA.

Farmers may benefit from ISMEA guarantees for loans earmarked for agricultural activities to improve the overall performance and sustainability of the agricultural holding, for tractors and other machinery, for infrastructure related to the development, modernisation or adaptation of agriculture, land consolidation and improvement of the supply and saving of energy and water, for processing, marketing, and/or development of agricultural products.

In line with the Commission’s state aid guidelines in the agricultural and forestry sectors and in rural areas 2014 to 2020, ISMEA has defined specific loans for young farmers setting up for the first time. The scheme provides young farmers with up to €70 000 in interest-rate subsidies for a loan up to €2 million. The young farmer setting up for the first time has to submit a sustainable business plan, including the acquisition of the farm, the means of production, the modernisation plan for the farm and an explanation of the economic sustainability of the project. The interest rate cannot be lower than the base rate fixed by the Commission and in any case not less than 0.5%. According to ISMEA, public support helps farmers to access credit and to reach the higher leverage effect of public money.

**Latvia – The Latvian credit fund**

The monetary crisis of 2008 created a large gap between the demand for loans to finance investment projects and the availability of such financing on the market. To encourage new projects, the Ministry of Agriculture, as managing authority, proposed a new financial instrument – the Latvian Credit Fund.

This Fund, was introduced as a supplement to the EAFRD investment grants to solve liquidity problems faced by potential grant recipients. It addressed the lack of loans on the market by lending at reduced interest rates, ensuring the funds to implement projects. A state-funded guarantee instrument for the recipients existed alongside the Credit Fund.

The Credit Fund had been working with banks on a daily basis, and national regulations enacted in 2010 allowed all banks in Latvia to participate in the implementation of the Credit Fund. Three banks expressed an interest and became financial intermediaries accepting the conditions of the scheme. However, most banks had little interest in implementing the financial instrument due to the relatively modest remuneration in comparison to workload and also due to the required uniform interest margin for all debtors, regardless of their credit risk.

Thanks to the Credit Fund, loan interest rates were, on average, 2% lower than commercial rates. Under this financial instrument, banks were required to have uniform...
interest margins for all debtors regardless of their credit risk. The Credit Fund also offered repayment periods of up to 15 years, which is much longer than for commercial loans.

Financial intermediaries bear the full risk of loan defaults: whenever a loan or part of a loan is not paid back, financial intermediaries do not receive any compensation from the Credit Fund. Instead, they must take credit risk into account before granting loans. The interest rate they receive, therefore, reflects this risk premium.

According to the case study, implementing these programmes was not easy and farmers' associations therefore play an important role in raising awareness, since they publish information regarding Credit Fund loans, among others.

A practical example of a dairy farm supported through financial instruments

A Latvian farmer, rearing about 100 cows in an old stable, sold milk to a local enterprise. The premises were neither sufficiently large to increase the number of cows nor adequate to ensure optimal living conditions. As a consequence, milk production was below maximum potential. The farmer therefore decided to build a new, modern, stable in line with EU standards, using RDP funding to cover a substantial part of his investment costs. To implement the project, since grants could be paid only after the project's completion, he needed a start-up loan. As he was unable to obtain a commercial loan from the banks, it was only after receiving a Credit Fund loan of €1 million through a financial instrument, that the farmer was able to build a modern stable, in compliance with EU standards.

European Parliament

On 12 November 2015, addressing the EP Committee on Agriculture and Rural Development, EIB Vice-President Pim van Ballekom, who has taken over responsibility for agriculture in the EIB, presented an overview of the wide range of the EIB’s agriculture-related activities. He also gave a detailed account of lending conditions, the range of projects, advisory service and financial tools the EIB offers to the agricultural sector and in support of the implementation of the Juncker investment plan. In the ensuing debate, some Members stressed that access to credit remains difficult for individual farmers, especially for young farmers without a credit background, and that, even if they obtain a loan for a long term investment, the bank interest rate is still too high. Others called for new financial instruments to stabilise farm margins and noted that further work is still needed to better use and implement financial instruments in agriculture.

European Fund for Strategic Investment – Juncker Investment Plan

Although not directly related to agriculture, the European Commission expects the Investment Plan to mobilise at least €315 billion in additional investments in Europe over the next three years. The project types to be supported and eligible for financing include energy efficiency, precision farming and the bio-economy. Combating market failures and developing rural infrastructure are also considered for support under this measure. In fact, the EFSI is a very flexible instrument and fully demand-driven, there is no sectorial or geographical pre-allocation. So far, the total expected investment triggered accounts for €115.7 billion.

Outlook

For the period 2014-2020, about €99.6 billion in rural development grants is currently planned, while only around €430 million is envisaged for financial instruments. The European Commission's goal of doubling the use of financial instruments compared to the 2007-2013 period is still very modest. Moreover, the Court of Auditors’ special report
Are financial instruments a successful and promising tool in the rural development area?

– considered the use of financial instruments in the rural development programming period 2007-2013 to have been only partially successful. The Court recommends that the Commission encourage Member States to establish a single financial instrument which is able to provide both loans and guarantees, thus increasing its activity and critical mass.

While the Memorandum of Understanding signed by the European Commission and the European Investment Bank is a first step, the guarantee scheme and the direct loans for commercial banks are not so easy to implement through the rural development programmes.

A study drawn up for the European Parliament suggests that stakeholders still face several challenges concerning these instruments:

- **Negotiation and set-up period:** although dependent on the amount of experience with using FIs; the length of time it has taken to design, negotiate and launch FIs has been emphasised as a major impediment by many of the authorities involved.

- **Regulations:** considered to be complex and difficult to implement in real market situations. Sometimes, rigid state aid rules constrain effective use of FIs. More worryingly, while FIs arguably cover the investment risks with public resources, regulations preclude support for enterprises facing economic difficulties.

- **Know-how and experience:** partly due to public actors’ lack of knowledge and experience of commercial practices and, vice versa, insufficient understanding of EU regulations amongst financiers, FIs are reportedly difficult to set up and implement.

**Figure 8 – Lessons learnt on financial instruments from 2007-2013**

- FIs used only by 7 Member States
- Only €363 million paid to FIs by end 2014
- No venture capital funds supported by EAFRD
  - THE MOST POPULAR WAS THE GUARANTEE
- Low performance in most cases
- Declining interest in some of the FIs as financial markets returned to viability

In agriculture, financial instruments cannot be the only solution to scarce budgetary resources or be expected to replace grants as a delivery tool, but they will play an enhanced role in the future.

**Main references**

- Guidance for Member States on Article 42(1)(d) CPR – Eligible management costs and fees
- Are financial instruments a successful and promising tool in the rural development area? – special report, 2015, European Court of Auditors.
Endnotes

1 According to Article 37.2 of Regulation (EU) No 1303/2013, the requirements of the ex ante assessment must include:

– An analysis of market failures, suboptimal investment situations, and investment needs for policy areas and thematic objectives or investment priorities to be addressed with a view to contributing to the achievement of specific objectives set out under a priority and to be supported through financial instruments. That analysis shall be based on available good practice methodology;

– An assessment of the value-added of the financial instruments considered for support from the ESI Funds, consistency with other forms of public intervention addressing the same market, possible state aid implications, the proportionality of the envisaged intervention and measures to minimise market distortion;

– An estimate of additional public and private resources to be potentially raised by the financial instrument down to the level of the final recipient (expected leverage effect), including as appropriate an assessment of the need for, and level of, preferential remuneration to attract counterpart resources from private investors and/or a description of the mechanisms which will be used to establish the need for, and extent of, such preferential remuneration, such as a competitive or appropriately independent assessment process;

– An assessment of lessons learnt from similar instruments and ex ante assessments and evaluations carried out by the Member State in the past, and how these lessons will be applied in the future;

– A specification of the expected results and how the financial instrument concerned is expected to contribute to the achievement of the specific objectives set out under the relevant priority or measure including indicators for that contribution.

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