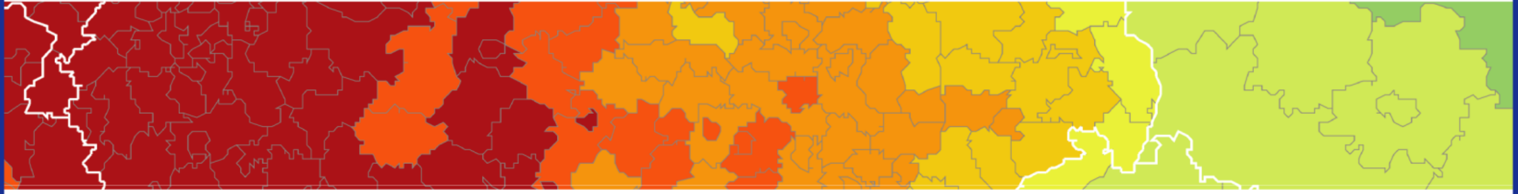
ESPON

EUROPEAN UNION

Co-financed by the European Regional Development Fund

Inspire policy making by territorial evidence



Financial Instruments and Territorial Cohesion

Applied Research

Synthesis Report

30/08/2019

This applied research activity is conducted within the framework of the ESPON 2020 Cooperation Programme, partly financed by the European Regional Development Fund.

The ESPON EGTC is the Single Beneficiary of the ESPON 2020 Cooperation Programme. The Single Operation within the programme is implemented by the ESPON EGTC and co-financed by the European Regional Development Fund, the EU Member States and the Partner States, Iceland, Liechtenstein, Norway and Switzerland.

This delivery does not necessarily reflect the opinion of the members of the ESPON 2020 Monitoring Committee.

Authors
Fiona Wishlade, Rona Michie, European Policies Research Centre (UK)
John Moodie, Oskar Penje, Gustaf Norlen, Nordregio (Sweden)
Willem Korthals Altes, TU Delft (Netherlands)
Chiara Assirelli Pandolfi, Ana de la Fuente Abajo, Red2Red Consultadores (Spain)

Advisory Group
Project Support Team: Cristina Wallez Cuevas, General Commission for Territorial Equality, France; Adriana May, Lombardia Region, Italy; Joerg Lackenbauer, European Commission

ESPON EGTC: Zintis Hermansons (Project expert) and Akos Szabo (Financial expert)

Information on ESPON and its projects can be found on www.espon.eu.

The web site provides the possibility to download and examine the most recent documents produced by finalised and ongoing ESPON projects.

This delivery exists only in an electronic version.

© ESPON, 2019

Printing, reproduction or quotation is authorised provided the source is acknowledged and a copy is forwarded to the ESPON EGTC in Luxembourg.

Contact: info@espon.eu

ISBN 978-99959-55-97-7

Financial Instruments and Territorial Cohesion

Introduction

This is the Synthesis Report for the applied research project on Financial Instruments and Territorial Cohesion. This report focuses on the main results of the applied research and policy recommendations.

There has been a significant and sustained increase in the use of repayable financial instruments (FIs) in Cohesion policy over the 2007-13 and 2014-20 programme periods. Repayable instruments are relatively new tools in the European Structural and Investment Funds (ESIF), particularly under the ESF, EAFRD and the Cohesion Fund. What does the increasing shift to using financial instruments imply for territorial cohesion? What evidence is there on the effectiveness of using financial instruments as a complement to grants, in terms of added value for territorial development?

The objective of this ESPON study is to provide a territorial analysis of the impacts of ESIF financial instruments in 2007-13 (and where data allows, 2014-20). To assess the evidence and undertake the analysis, the study has involved a literature review, an extensive data collection and regionalisation exercise, data analysis and mapping, development of a methodology for measuring the value-added of financial instruments and the analysis of the territorial value-added and impact of FIs. Five case studies provide an in-depth picture of selected financial instruments implemented in regions in Italy, Spain, Poland, Sweden and Norway.

Definitions and rationales

Financial instruments have had a high profile in Cohesion policy in the 2007-13 and 2014-20 programming periods. However, they remain a comparatively small policy tool. For 2007-13, the amount of Structural Funds committed to FIs at closure was just under €11.5 billion, equivalent to about 3.7 percent of total commitments. Even if ambitions for 2014-20 are realised, FIs would still account for less than six percent of total ESIF commitments.

Financial instruments comprise very diverse financial products - loans, guarantees and equity – which are implemented in different ways. These products have many variants and have little in common with one another, save the principle that the capital is repayable (unlike grants). FIs are used to address a range of different geographies and policy targets. In 2007-13, the main policy targets addressed using ESIF financial instruments were enterprise support, urban development projects and energy efficiency/renewable energy projects.

The main rationale for public intervention in economic development policy is to support activities that the market will not undertake alone or at all. In this context, publically-funded financial instruments are a niche policy tool which are only suitable in certain circumstances: for a limited range of policy objectives; where they generate enough revenue or savings to repay the capital advanced, and where commercial funding would not cover any or all of the cost.

Evidence suggests that financial instruments can add value and complement grants in a variety of ways:

- FIs generate a legacy that be used in the region again; in some countries that have used ESIFs FIs since 2000-06, this legacy is still being recycled.
- FIs can help generate better quality projects than grants alone, partly because the project promoter or entrepreneur shares the risk.
- FIs can help address a 'subsidy culture' among businesses. Reflecting this, a number of countries are moving away from domestic grant support for SME development.
- They can provide an important signal to the private sector and sometime trigger private sector investment that would not have happened otherwise.
- They can help develop regional capital markets and business angels.
- In the specific context of the crisis, FIs were valuable in sustaining investment in businesses that could no longer access bank finance.

Main findings – territorial distribution of FIs

The increasing emphasis on financial instruments under the Structural Funds has a number of implications for territorial cohesion. This partly arises because Cohesion policy now extends to all regions, so Structural Fund financial instruments can be offered in all regions. At the same time, many of the obstacles to development in more disadvantaged regions also make the implementation of financial instruments more challenging. This includes lower quality of government and lack of administrative capacity, as well as limited regional economic dynamism and the absence of a thriving business ecosystem. The tendency for the banking sector to become more centralised and more reliant on automated credit rating systems has also had direct implications for the quality of local knowledge in the sector, as has a decline in 'relationship' banking, especially in rural areas.

Little has hitherto been known about the spatial incidence of FIs in Cohesion policy. Financial instruments have more complex reporting and operational structures than grants, with implications for data availability. Analysing the regional distribution of financial instrument spend is complex because the geography and governance of FIs varies and regional data is not always available.

Twenty-five Member States used Structural Fund financial instruments in 2007-13. Some €17 billion in OP contributions was committed to FIs (including €11.5 billion of Structural Funds), of which €15.2 billion reached final recipients. Italy accounted for almost 30 percent of all contributions to financial instruments in 2007-13. The use of financial instruments also varies widely between countries (and within them) in terms of scale, product types, policy objectives and governance.

On average, EU Member States committed €426 million (EU amounts) to financial instruments in 2007-13, amounting to 3.4 percent of total Cohesion policy allocations, 0.013

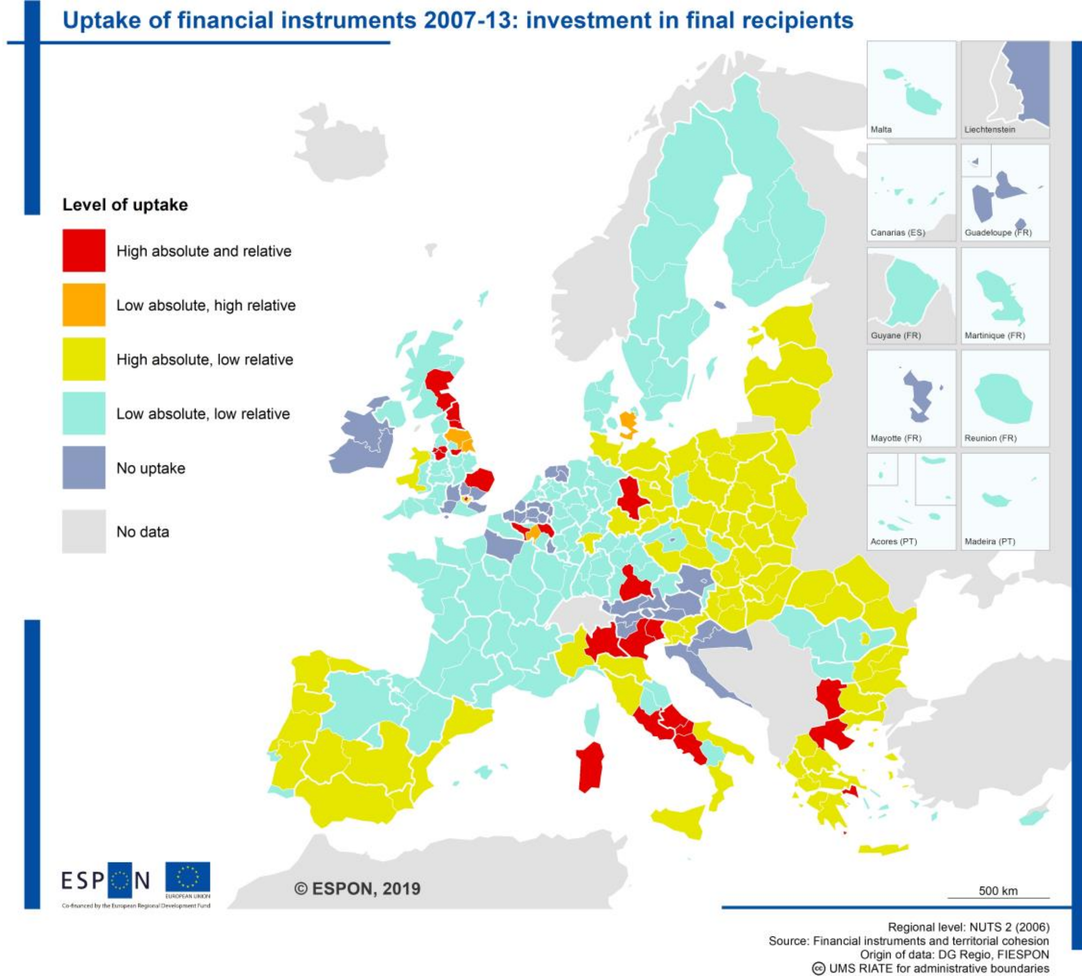
percent of GDP and €23 per head. There are wide variations around these averages: Italy committed over €3 billion in Structural Funds to FIs, amounting to over 10 percent of its Cohesion policy allocation; in Lithuania, FIs amounted to around 0.2 percent of GDP in 2007-13.

This study has mapped the use of Structural Funds financial instruments in the 2007-13 period at a subnational level. This mapping shows substantial variations in the use of co-financed financial instruments in different countries. **Comparing FIs to grants, regions within Italy, Belgium, Denmark the UK and Greece invested the largest shares of Structural Funds in the form of FIs** (but there are marked internal differences within these countries). **There are marked differences between regions in levels of investment in enterprises, with, in general, much higher levels in the Convergence regions than elsewhere (not including co-financing)**. Investment in **urban development and energy projects accounts for only a small proportion** (about 15 percent) of overall FI expenditure, and is concentrated in a few countries.

In terms of the use of different financial products, countries and regions differ in their choices, with some offering all three types (loans, guarantees and equity). In general, there is a **dominance of loan finance in central and eastern Europe, the Baltic countries, Belgium Denmark, Greece and Spain; a dominance of equity in Portugal and Sweden; a mix of loans and equity in the UK; a mix of all three product types in Germany, and France; and a mix of loans and guarantees in Italy**.

In terms of FI 'uptake', **there are 'pockets' of high absolute and high relative uptake in a number of regions in Italy, the United Kingdom, Belgium, Greece, Bulgaria and Germany** (see Map 0-1). By contrast, **the regions where there is low absolute and low relative uptake are extensive, covering France, Sweden, Finland, much of Germany and Denmark, as well as parts of Spain and Romania**.

Map 0-1: ‘Uptake’ of financial instruments – investment in final recipients (EU amounts)



Source: authors. Note: The thresholds used to identify regions as high or low absolute and relative uptake are €20 million and 10 percent of OP expenditure, respectively

The geographies of finance and of administrative capacity are important to the understanding of the territorial dimension of FIs - financial systems are inherently spatial, characterised by complex institutional geographies that both reflect and influence their functioning. This, in turn, affects the ability of entrepreneurs to access finance, typically to the disadvantage of peripheral regional economies. This implies the need for policy explicitly to focus on regional disparities in access to finance. However, under many FIs there is evidence to suggest that **pressure to spend within the lifecycle of the Operational Programme (governed by ESIF rules) is a more important driver of spend than regional equity**.

There are numerous models of governance for financial instruments, partly reflecting the scope of the OPs that offer them, but also involving more complex arrangements than grants. Financial instruments have been implemented through a wide variety of institutional structures at national and subnational levels. In most countries, **FIs are offered from a (sometimes overlapping) mix of national, multiregional and regional OPs**. In some regions, financial instruments are offered within the region from up to five different OPs, often for similar purposes.

A key issue for the study has been to gain insights into the territorial distribution of national and multiregional financial instruments. This is an important issue for territorial cohesion since it raises the question of whether the incidence of expenditure on FIs is simply demand-led (by the regional presence of SMEs) or whether FIs proactively seek to address regional disparities in access to finance. The latter seems comparatively rare and may be partly related to pressures to spend within the lifecycle of the Operational Programmes. In general, **it does appear that FIs are mainly demand-led**. However, the governance structure for financial instruments can help offset this tendency by, for example, seeking to ensure the involvement of regional and local intermediaries.

Among ESIF managing authorities (MAs) that opted not to use FIs, **the drivers for this decision are not primarily territorial, but related to the content and scale of their Operational Programmes and decisions about the relationship with domestic policy**. Conversely, other MAs justify the use of FIs on the basis of the limited budget and the importance of generating a legacy. Other key factors in the decision are also not necessarily territorial, and include perceived obstacles such as culture, lack of experience, complexity, administrative capacity, lack of critical mass, domestic competition and a view that existing commercial finance provision is adequate.

Main findings – added value and impact of FIs

The added value of financial instruments relates to criteria such as sustainability, efficiency, quality, development of local financial markets and the impact on a subsidy culture. This is different from impact, for which the two most commonly reported indicators are jobs created and numbers of firms supported. However, it should be noted that within the existing data, even some basic measures of spend are unreported or implausible and the level of expenditure almost everywhere is too small to lend itself to econometric analyses of its effects. Moreover, collection of quantified data related to the impact of financial instruments is not consistent between managing authorities. Many MAs do provide data on job creation (this is the most common impact indicator recorded), but definitions of this diverge even within countries. Beyond job creation (where relevant), the vast majority of MAs do not collect any data on FI implementation other than that which had to be reported to meet regulatory requirements (and even this is often incomplete and inconsistent). In short **there is no basis on which to build a wide-ranging comparative assessment of the impacts and value-added of financial instruments**.

To analyse differences in added value and impact for this study, a typology of European NUTS 2 regions was developed on the basis of eligibility for Structural Funds, financial systems, quality of government and urban/rural categorisation. This has found that FIs were used in 28 different types of NUTS **2 region in 2007-13. The relative share of FIs in relation to ERDF and ESF funding was the highest in urban regions with a market based financial system, the lowest is in rural regions with a market based financial system**. This strong urban-rural gradient is not found in regions with bank-based or former-

socialist financial systems. A total of 77 percent of all Structural Funds contributions to final recipients through FIs was allocated in Convergence/Phasing Out regions. **About 16 percent of all Structural Funds invested in final recipients through FIs is accounted for by a single Convergence region type – low QoG, bank-based financial system, urban – comprising three regions** (Campania, Sicilia and Attiki).

The geography of fund managers differs widely between EU Member States, varying between highly centralised and more regionalised. There is a **concentration of fund management in urban areas. Legacy (the repayment of funds to be used again) is higher in regions with a lower quality of government**. This may be because financial markets work less well in these regions and FIs are financing less risky project than in areas with high quality of government. In areas with a low quality of government, more final recipients are reached by the same investment, than in regions with a higher quality of government, largely owing to the wider use of guarantees and loans.

Job creation data reflects national differences in reporting, and is often of doubtful quality and thus is of limited value in assessing impact. At the same time, it is worth noting that job creation is anyway often not a key objective of financial instruments so that while job creation data is more widely available than other indicators, it does not really capture the impact that FIs can have. Regions which have a high uptake of FIs are more efficient in relation to management costs and fees and have higher rates of return than low uptake regions. In most types of regions, high uptake of FIs results in larger investments in relatively fewer final recipients.

Main findings - Insights from practice

The study provided insights from the operation of FIs in five case study areas: Lombardia, Mellersta Norrland, Andalucía, Wielkopolskie and Norway. Most of the FIs generated a positive impact in terms of **diversification of sources of financing** both for firms and urban projects, especially in those regions that suffered from strong financial constraints during the financial crisis. Demand outstripped supply in most cases, but particularly for loan and guarantee products. There is no evidence of cannibalisation effects, either with other public or private sources of finance.

Governance and administrative arrangements were found challenging in the case study regions during the implementation and execution phases in 2007-13. Here **financial intermediaries and international financial institutions such as the EIB/EIF have played an important role**. The process of selecting, screening and managing the relationship with intermediaries has proven to be a key element for the success of FIs. FIs appear to be more effective where Financial Intermediaries have a clearly focused investment strategy, fully coherent with the FI targets. There is an opportunity for skills to be transferred between more and less experienced actors, for example, between national promotional banks or the EIB/EIF and local actors.

The case studies highlighted the trade-off required between different targets of FIs: absorption capacity, promotion of innovation and sophistication of economic activity, and territorial cohesion within the regions, and noted that these are not always compatible. Most of the instruments placed **less emphasis on territorial factors** within the region than on other priorities. The outcome is that **FIs were concentrated in zones with better economic performance**. It can be concluded that FIs have not contributed to overcoming territorial imbalances, raising the question as to whether this is coherent with regional policy objectives.

It is notable that there is an almost **universal lack of ex post evidence** of territorial and economic impact measured using quantitative and systematic evaluation methods within the case study regions. Only the Norwegian case carried out continuous econometric impact evaluations. Field and econometric impact evaluation practices are crucial in order to continuously improve the performance and impact of FIs.

However, one of the key positive outcomes found is the **generation of innovative and entrepreneurial culture and know-how transfer among the actors involved**. While this immaterial capital is difficult to measure, the case studies highlighted this effect as one of the most positive ones, which can be relevant to the long-term economic performance of the regions.

Policy proposals for the debate on financial instruments in EU Cohesion policy post-2020

These conclusions and policy proposals draw on the data analysis and the case studies carried out for this project, as well as the wider literature and discussions held during the EWRC events in October 2018. Before turning to these, some general remarks are in order.

A first general point to emphasise is the ***heterogeneity of financial instruments***. Financial instruments in Cohesion policy have come to be referred to *en bloc* – largely because specific regulatory arrangements apply to them. In reality, the commonalties across the range of policy tools classed as FIs are few. *The single shared characteristic is that financial instruments involve repayable funds.* Beyond this, the scale of intervention ranges from measures exceeding €500 million and operating over wide geographical areas, to those with budgets as low as €10,000 operating very locally. The instruments discussed in the case studies exemplify this range – from the two co-investment funds in Mellersta Norrland with combined assets of €33 million, to the allocation of nearly €400 million to the JEREMIE fund in Andalucía. Governance arrangements involve diverse institutions and structures, from the EIB group and national promotional banks, to public financial institutions at the regional level, private intermediaries and associations such as chambers of commerce. For enterprises, financial products range from large scale generic business loan schemes, to small-scale equity funds focused on specific activities, sectors or classes of enterprise; urban development and energy efficiency FIs can involve complex integrated financial packages to upgrade particular districts, but also simple householder loan schemes to improve residential insulation. This diversity is featured in the case studies – even within regions FIs funded very

different projects: in Andalucía typical JEREMIE projects involved expanding SMEs and improving their performance, with a special focus on start-ups and tech firms, while JESSICA projects mainly involved large-scale pubic infrastructure facilities.

Financial instruments are also diverse in territorial terms. Cohesion policy FIs differ widely in scope, partly linked to the OPs through which they are financed. They may cover a single regional OP corresponding to NUTS 2 and a population of a few hundred thousand, several NUTS 2 regions under a multiregional OP or a national OP covering a population of several tens of millions. Moreover, as the study shows, up to five OPs may offer Cohesion policy FIs in the same region, often for quite similar purposes. These disparate geographies and overlapping jurisdictions complicate any analysis of the distribution of spend.

Another important territorial dimension to the diversity of FIs is the spatial focus. **Most financial instruments are ostensibly spatially neutral**; however, in practice, this means that they are demand-led, with investment tending to be concentrated in the more economically-developed areas within their territory. By contrast, a few FIs explicitly seek to offset regional or local disadvantage, such as the Regional Risk Loan in Norway. From a *national* perspective, the separate regional co-investment funds in Sweden can also be viewed as seeking to address regional disadvantage, by using a regional breakdown to provide an element of ring-fencing. In the main, however, financial instruments are demand-led and a spatial focus is rare.

Financial instruments **differ widely in domestic importance**. In some instances co-financed FIs are an additional credit line in an existing institution so that ESIF essentially reinforces existing domestic budgets for the same purpose (this is the case for some FIs operated by German *Lander*). Elsewhere, they are operated as free-standing new instruments, sometimes on a pilot or experimental basis to maximise the use of modest OP budgets (as in the London Green Fund). Alternatively, cofinanced FIs may account for a significant share of public repayable finance for SMEs, as in Lithuania, for example.

A second key point to highlight is that ***financial instruments are only suitable for some policy objectives and where the investment will generate revenues and cost-savings*** enabling the initial capital advanced to be repaid. The use of financial instruments varies according to the wider economic context – the case studies for Andalucía and Lombardia show how important Cohesion policy FIs were in the aftermath of the financial crisis; similarly, the Norway case study noted how the Regional Risk Loan supported the fishing sector when commercial banks were unwilling to. In this sense, publicly-backed FIs can address a gap in access to finance that may vary over time, as well as (partially) replacing grants as a mechanism to promote investment. The heterogeneity of FIs is therefore a strength since a mix of financial products can respond flexibly to local conditions. That said, even in policy areas such as SME development where financial instruments are prevalent and their role is self-evident, grants often have an essential part to play. The data analysis highlights how

small a proportion of Cohesion policy spend FIs represent, even in policy areas where they might be considered most relevant.

A third general point concerns **the quality of the evidence base**. A major challenge for the study has been the collection of relevant data. The data gathering process exposed both the paucity of the data available and its lack of comparability. These shortcomings are a significant obstacle to a fine-grained assessment of the added value and impact of FIs. Moreover, the different 'forms of finance' reported by managing authorities do not map directly to financial instruments, and the policy priority codification in the Implementation Regulation do not correspond to the policy targets addressed by financial instruments in 2007-13. As a result, it is in most cases impossible to assess the complementarity of grants and financial instruments. The role of data gathering and reporting is given further consideration below.

Moving on to **policy recommendations**, a key theme that emerges is that of managing the tensions between potentially conflicting objectives: should the bureaucracy surrounding FIs be 'lighter touch' than for grants given that the sums are (in principle) repayable? Should reporting on FIs be less onerous with a view to encouraging their use, or does data gathering for audit and evaluation take precedence? How important is the performance of an FI in terms of using the funds available and generating returns and how is this balanced with taking risks that strictly commercial investors will not? And, in the present context, how do these tensions play out in territorial terms?

There is a need to ensure that administrative requirements are not a disincentive to use FIs rather than grants.

The regulatory framework for FIs in Cohesion policy has been challenging for the Commission and managing authorities alike. The issues have been documented in detail elsewhere and centre on the complexity of the rules, especially in relation to State aid and public procurement, the status of guidance in the context of audit and wider concerns at the extent of reporting.

There are additional layers in the 'chain of command' for ESIF FIs compared to purely domestic financial instruments *and* compared to ESIF grant schemes. This means that the implementation of ESIF FIs requires a degree of commitment on the part of managing authorities, and/or a conviction that the potential wider benefits of using financial instruments instead of grants will indeed materialise. Research on the uptake of financial instruments in 2014-20 suggests that even in the area of SME support, EU regulatory issues are a significant reason for MAs *not* to use FIs (European Commission, 2017a). It is worth noting, however, that the adoption of the Omnibus Regulation during the 2014-20 period introduced a

number of simplifications and the draft regulations for the 2021-27 period propose additional simplifications; both were generally welcomed by managing authorities.[1]

Care should be taken to ensure that regulatory requirements do not undermine policy objectives.

Some regulatory requirements have the potential to undermine the effectiveness of financial instruments. The combination of the short programming period and the N+3 requirements can conspire to make managing authorities more risk-averse. In operating ESIF there is considerable emphasis on actually disbursing funds in order to ensure they are not lost. This can result in the prioritisation of “shovel ready” or “safe” projects rather than riskier investments. This may perversely encourage a situation where co-financed financial instruments are more likely to crowd-out private funding because fund managers have an incentive to support ‘easy’ projects rather than insist that funds be restricted to projects that had been rejected by commercial funders.

The seven-year programming period also impedes the operation of FIs; this timescale is arbitrary and short, especially given the delays involved in the planning and approval of operational programmes – progress in implementing FIs has been slow in 2014-20, even among managing authorities with longstanding experience of operating FIs. From an economic development perspective, there is no logic to the need to close funds at the end of the programming period, and retender for fund managers. The management of the Norwegian Regional Risk Loan offers some lessons here. In particular, the loss fund budget provided by the Ministry (KMD) to back the scheme is not reimbursed or clawed back, but rolled over from one year to the next on a continuous basis. As such, there is no incentive to use up year-end monies and because Innovation Norway requires that applicants have exhausted commercial funding options before approaching it for support, this promotes a more policy-focused use of funds, rather than one driven by absorption pressures.

There is a need to ensure that financial instruments do not reinforce existing disparities in access to finance, with potential negative consequences for territorial cohesion.

Partly related to the above, financial instruments have the potential simply to reinforce existing spatial disparities in access to finance because of the pressure to disburse budgets and avoid decommitment. Perhaps as a result (and also due to the absence of delineated assisted areas for ESIF since 2000-06), there are few examples of FIs that proactively target disadvantaged areas. In the current ESIF period, the JESSICA programme for Rotterdam is one such example, focused on deprived urban areas through an ITI (Integrated Territorial Investment); in 2007-13 the BRUSOC fund in the Brussels region targeted entrepreneurs in

[1] Michie R, Mendez C and Gal F (2018) Results, Review and Reform: Delivering programme objectives while preparing for the post-2020 Cohesion policy, IQ-Net Review Paper 43(1), European Policies Research Centre Delft.

the former Objective 2 areas. Outside the EU, the Norwegian Regional Risk Loan is restricted to designated aid areas, and even within these, seeks explicitly to target funding outside the main population centres. By contrast, the Wielkopolskie case study showed that ambitions to focus on deprived areas can in practice be stymied by wider regulatory complexities and the pressures of short timescales with the result that positive discrimination in favour of disadvantaged areas is diluted or lost.

The ex ante assessment is an important innovation in the 2014-20 Regulations and has generally been welcomed by domestic policymakers for giving greater clarity to policy objectives and better insights into funding requirements. In the context of territorial cohesion there is a need to be clear about what the policy objectives actually are, and potentially accept that there may be a trade-off between a focus on disadvantaged regions and some of the benefits of financial instruments e.g. FIs may be more costly to implement in more remote regions. In short, publicly-backed FIs should not largely replicate what the private sector can do, but rather intervene where it cannot or is unwilling to at the scale required.

It is also worth bearing in mind that during 2007-13, the focus of FIs was restricted to SME support, and to a much lesser degree urban and energy efficiency projects. This may have a bearing on the location of investment. The widening of thematic coverage of FIs in 2014-20 may change investment patterns, though early indications from Commission reporting on the 2014-20 period suggest that implementation in areas other than SME support has been very slow.

Policymakers point to the importance of policy learning, experience and progressing from simple to more sophisticated financial products.

Co-financed financial instruments tend to follow one of two models. First, an existing domestic mechanism is provided with an additional block of funding (for instance, a national promotional bank establishes an additional credit line), which is essentially disbursed along the same or similar lines as existing domestic funding. Second, a bespoke fund is established in response to specific identified needs. The first option might be regarded as somewhat mundane since ESIF FIs are simply supplementing domestic funding streams, but this is not only a relatively quick and “safe” route to implementation, it also takes advantage of existing institutional and administrative capacity. The second approach is considerably more risky from the managing authority’s point of view, and more time-consuming, though the outcome might be more innovative. It may also be necessary, since there may not be an existing domestic vehicle to which it can be linked. The Commission's ex post evaluation of 2007-13 FIs found that those which performed best were those that were able to draw extensively on the experience either of existing systems and structures, or past programmes, while committing funding allocations that could realistically be absorbed. In similar vein, policymaker debates at the 2018 EWRC stressed the value of 'starting simple' – beginning with straightforward and standardised financial products that use existing structures and moving to more complex forms of intervention as experience grows.

Since the period under study (2007-13), administrative capacity has been a focus of attention within the debates on Cohesion policy implementation more generally. Specifically relevant to financial instruments, EU level Technical Assistance platforms such as *fi-compass* have been introduced in 2014-20, and made significant efforts to increase capacity within the field of financial instruments.

Consideration should be given to the role of data collection and reporting for financial instruments to improve the understanding of policy effects and added value.

The scale and complexity of reporting on financial instruments is a source of frustration to many managing authorities. However, in spite of the administrative burden involved in data collection, it still yields insufficient information to enable an assessment of the effectiveness of financial instruments as a policy instrument.

The quality of the data collected on financial instruments, even in mandatory annual reporting, is poor: the information is often incomplete, error-prone or cannot easily be reconciled with other indicators. Reporting of voluntary information is even more sparse. Few managing authorities collected *any* performance-related data on the operation of financial instruments. The most common indicator collected is job creation, but the definitions vary between countries (sometimes within them) and it is unclear to what extent jobs can *genuinely* be attributed to the FI, thus precluding any credible assessment of impact on employment. This raises the wider issue of the relationship between reporting, accountability and impact. It can be argued that the delegation of implementation to financial intermediaries requires *more and better reporting* of information in order to ensure that investments are made in line with OP priorities. Conversely, as financial instruments are repayable, it can be argued that *reporting should be less onerous* for FIs than for grants, except in cases where the capital advanced is not recovered or guarantees are called in. This is not to suggest that losses *per se* should be a source of concern – if public FIs are targeted appropriately they are likely to incur losses since they are targeting investments rejected by commercial investors – but simply that the loss of public funds should be justified and subject to appropriate audit procedures.

That said, it remains clear that FIs ***do have positive effects***. Although frequently used for working capital rather than to fund investment, FIs have helped mitigate the impact of financial crisis in many regions. There is also evidence that they have led to a more sophisticated and diversified financial market for SMEs, generated substantial leverage and legacy for reinvestment and enabled knowledge transfer and capacity building. The wider literature also shows the importance of time and experience in policy evolution, and how that carries through into policy performance (European Commission, 2016).

Governance structures need to combine financial expertise and local knowledge if they are to address territorial cohesion.

Implementation of ESIF financial instruments typically involves a steep learning curve for managing authorities. The case studies have emphasised the key role which national and

regional promotional banks and financial intermediaries with local knowledge play in successful implementation. However, local expertise may not always be present. In some central and eastern European countries – notably Hungary – there has been an explicit strategy to involve local financial intermediaries in Cohesion policy FIs, contributing to the building-up of local financial markets, but in others, such as Romania and Bulgaria implementation is more centralised. A potentially growing challenge in the centralisation of the commercial banking sector and the decline local branch networks, especially in remote and rural areas. In Norway the regionalised network of Innovation Norway offices seeks in part to compensate for this trend and is testament to the importance of long-term strategies to address access to finance in remote regions. More generally, other case studies also emphasise the building of trust and confidence between actors as key to success in FI implementation.

Given the focus of this report, it is appropriate to reflect on **what can be said about the contribution of Cohesion policy financial instruments to territorial cohesion**. Major complications in addressing this question arise from the heterogeneity of financial instruments described at the start of this chapter. Nevertheless, there are some insights from the territorial distribution of FIs, the analysis of added value and the case studies.

It is clear that most financial instruments are 'spatially-blind', in other words there is generally no geographical focus to intervention within the jurisdiction in which they are available. This means they have the potential to reinforce existing spatial disparities in access to finance within a country or region, which tends to disadvantage rural and remote regions. It may well be that this is even more likely in the context of financial instruments than grants - if financial intermediaries are risk-averse or have limited incentive to develop markets beyond the main urban centres, investment may be disproportionately concentrated - but there is insufficient data to substantiate this.

Few financial instruments proactively target disadvantaged areas. Such FIs typically involve more effort, more risk and higher costs: it may be more difficult to find financial intermediaries willing and able to target disadvantaged regions, so management costs may be higher; projects may be riskier, leading to poorer returns on the investment and smaller legacies; and it may simply be harder to identify viable projects against the time pressures imposed by the OP schedule, which tends to prioritise absorption of funds. In short, while there is evidence that FIs which target disadvantaged regions can work well, there *may* be a trade-off between a focus on disadvantaged regions and some of the benefits of using FIs in terms of costs and legacy.

Factors such as Cohesion policy eligibility, quality of government, financial context and geography have an impact on the patterns of uptake of financial instruments. However, these factors are interrelated and, fundamentally, are influenced by both the scale of Cohesion policy funding and, related, the presence or absence of domestic FIs.

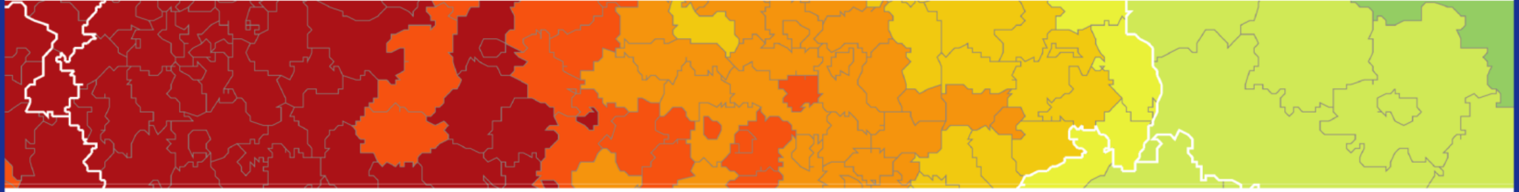
- In terms of **financial context**, regions in market-based financial systems spend a **higher share** of Structural Funds through FIs than those in bank-based or former socialist countries. However, this pattern is partly a function of lower absolute levels of Cohesion policy funding in these regions and the relative absence of OP priorities (such as basic infrastructure) for which FIs are not suited.
- Uptake of FIs in absolute terms is highest in regions with a **low quality of government**; this is mainly because quality of government is quite closely linked to levels of economic development, and poorer regions qualify for larger Cohesion policy allocations.
- The 'reach' of FIs, measured in terms of numbers of financial recipients, is also greatest in regions with **low quality of government**. This is primarily a function of the choice of product type, which tends to be loans or guarantees rather than equity.

Caution should be exercised in drawing conclusions from these patterns which can easily be influenced by the impact of high spend on FIs in just a few regions; differences between regions often just reflect different policy choices. For example, a managing authority may opt to assign a large part of it budget to FIs, because the budget is small, but will generate a legacy; conversely, a managing authority may eschew the use of FIs because the budget is small, so the administrative effort is considered disproportionate. Of key importance here, this study has only considered Cohesion policy FIs – and these typically represent only a very small part of the overall economic development funding jigsaw.

Last, it is interesting to note that the **relationship between financial instruments and territorial cohesion is very much on the current policy agenda**. Commission proposals for financial instruments in 2021-27[2] do not *substantially* alter the framework for Cohesion policy FIs, but tend in the direction of simplification and continuity, which has broadly been welcomed by managing authorities; however, one innovation is the scope to allocate ESIF funds to the new InvestEU initiative. Proposals for InvestEU involve a significant reshaping of the current EU level FI landscape. The geography of EU level FIs has been a matter of some debate in the past, and in recent negotiations the European Parliament, the Committee of the Regions and some domestic stakeholders have expressed concern at the link between ESIF funds and the new InvestEU programme, and at the spatial targeting of InvestEU itself. This has emphasised the need for newer and smaller promotional banks to play a larger role and for the efforts of more and less experienced financial institutions to be combined in order to improve geographical diversification. It remains to be seen how and whether the scope to allocate ESIF funds to InvestEU will be taken up, and what the territorial implications of this will be.

---

[2] See Scientific Annex for discussion of these proposals.



ESPON 2020 – More information

ESPON EGTC
4 rue Erasme, L-1468 Luxembourg - Grand Duchy of Luxembourg
Phone: +352 20 600 280
Email: **info@espon.eu**
www.espon.eu, **Twitter**, **LinkedIn**, **YouTube**

The ESPON EGTC is the Single Beneficiary of the ESPON 2020 Cooperation Programme. The Single Operation within the programme is implemented by the ESPON EGTC and co-financed by the European Regional Development Fund, the EU Member States and the Partner States, Iceland, Liechtenstein, Norway and Switzerland.