

Use of Financial Instruments in the Czech Republic within the European Structural and Investment Funds in the Programming Period 2014-2020

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Abstract

During the programming period 2014-2020, the European Commission is seeking to extend its financial instruments in providing support from the European structural and investment funds. Also the Partnership Agreement between the Czech Republic and the European Commission declares the effort to use financial instruments in some operational programmes for financing viable projects. Since 2016, grant calls have been announced, yet the declared effort to distribute a significant proportion of aid with the use of financial instruments has not yet been fulfilled. The aim of the author is to evaluate the state of preparation for the use of financial instruments in those operational programmes where the use of the financial instruments has been planned since the beginning of this programming period.

Key words: financial instruments, European structural and investment funds, programming period, operational program

JEL Classification: H29, H81

1. Introduction

Among the key priorities of the European Commission in the programming period (PP) 2014-2020, there is a wider use of financial instruments (FIs) in the implementation of the European structural and investment funds (ESIF) in individual member states. An objective of the European Commission during the PP 2014-2020 is, for example, to double the volume of resources provided to small and medium-sized enterprises (SMEs) through FIs (European commission, 2014). The reason for using the FIs is to gain a number of benefits. Unlike the direct grant support, with the use of FIs, financial resources can be recycled to obtain sources of funding for a period when the support will no longer be available to a similar extent as in PPs 2007-2013 and 2014-2020 to some of the member states of the European Union (EU) currently receiving the support. Extending the support with FIs will also make the member states less dependent on external support from the ESIF and will combine financial resources with national, public and private sources. Besides the benefits, the use of FIs also has some limitations. Their application is only possible for viable projects, i.e. projects of an investment nature, which will generate sufficient income and are expected to have a good financial return, yet they cannot be financed or co-financed by common sources of financing due to the market situation.

Also, at the level of the Czech Republic (CZ), the Partnership Agreement for the PP 2014-2020 declares a plan to increase the use of FIs to ensure greater investment efficiency. It has been provisionally considered to use the FIs, for example, in the area of the SME support

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under the OP Enterprise and Innovation for Competitiveness, or in the area of research support under the OP Research, Development and Education (MRD CZ, 2014). It is therefore appropriate to assess to what extent the declared effort to use FIs in the current PP has reflected in practice on a more massive scale.

2. Literary Review

According to the Ministry of Regional Development (MRD CZ), the FIs represent a form of the use of ESIF funds in a repayable manner (MRD CZ, 2015). These instruments may take the form of a credit or loan, equity or quasi-equity investments, guarantees or other risk-sharing instruments and, where appropriate, they can be combined with subsidies (European Court of Auditors, 2016).

Within the EU, FIs were used in the PP 2007-2013 to a wider extent than in the previous PPs. During the PP 2007-2013, EUR 21.5 billion was earmarked for FIs at the EU level, and 25 EU member states used them, most notably Italy and Denmark, and the Baltic States as for the new members. By the end of 2014, support for these instruments was paid in the amount of about EUR 16 billion. Compared to EUR 1.3 billion allocated to these instruments in the PP 2000-2006, this is a significant increase. (European Court of Auditors, 2016)

In the Czech Republic (CZ), FIs have not been much used in the previous PPs. In the last PP, the FIs were used only in the Integrated Operational Programme in the form of a credit under the JESSICA programme. The programme was launched in 2013 and focused on the modernization and reconstruction of residential buildings and social housing with a total allocation of CZK 612 million. Under this programme, 153 credit agreements were concluded in a total volume of CZK 601 million. (Mazal, 2016) The overall assessment of the use of FIs in the previous PP accentuates the late commencement of preparations, a problematic procedure with the choice of the FIs manager, so some of the resources originally intended for distribution using FIs were provided in the end of the PP in the form of non-repayable financial aid due to the fear of under-use. (MRD CZ, 2014)

In the Czech Republic, the use of FIs in the PP 2014-2020 is mainly based on Government Resolution No. 85/2015. This resolution addresses the implementation of FIs at the national level, primarily in terms of the technical solution of the implementation itself. (Government of CZ, 2015) A working group for innovative financial instruments of the ESF Council was set up to prepare the rules for the use of FIs. The ESF Council working groups address compliance with strategies and achievement of synergies in their respective areas of focus. (MRD CZ, 2012) The working group for innovative FIs was designed to co-ordinate the use of FIs and their implementation in individual OPs but it is not significantly involved in the preparation of rules in individual OPs, so the assessment of the areas of support and the possible selection of FIs takes place at the level of the individual OPs.

The basic methodological guide for the use of FIs in individual OPs is the current second version of the Methodological Recommendation for the Implementation of FIs in PP 2014-2020, which entered into force on March 1, 2017. Within the framework of individual OPs, this methodical document recommends first to make an analysis, assess the possibilities of using the FIs and their added value, calculate the possible effects of FIs and assess the absorption capacity. Subsequently, in the case of OPs where it will be possible to expect a meaningful use of the FIs, to prepare an investment strategy, select areas of support, select appropriate FIs, a manager of FIs or financial intermediary, discuss the possibility of co-financing, and translate the conditions into the Financing Agreement and subsequently make use of the FIs in practice in the form of specific support programmes. (MRD CZ, 2016)

3. Methodology

The assessment of the current state of preparations for the use of FIs in PP 2014-2020 was carried out on the basis of study of available materials, interviewing of responsible staff of ministries, FIs managers and other interested institutions, publicly available data on ESIF, FIs, OPs and plans for use of FIs in individual OPs. The assessment also took into account data on the macroeconomic situation in CZ, research on interest in the use of FIs as well as related materials presented at the European level. Results of research for individual OPs are presented in Results and Discussion.

4. Results and discussion

Within the OPs, which declared the effort to use FIs at the beginning of the PP, the analysis has been made or is being prepared or is in progress, in line with the methodological recommendation. On the basis of this analysis in OP Transport, where the use of FIs for combined transport terminals was planned, they have withdrawn from using FIs due to the low absorption capacity (Kokeš, 2017). An analysis with a positive conclusion about the use of FIs has already been completed in the OPs: Enterprise and Innovation for Competitiveness, Integrated Regional Operational Programme and OP Prague – Growth Pole of the Czech Republic. The other OPs (Employment, Research, Development and Education, Environment and Rural Development Programme) analyses of the use of FIs are being made or prepared.

4.1 Operational Programme Enterprise and Innovation for Competitiveness

Under the OP Enterprise and Innovation for Competitiveness (EIC), extensive use of different types of FIs is planned. In March 2015, the results of an analysis by the Ministry of Industry and Trade CZ (MIT CZ) were presented in the document "Preliminary Assessment of the Financial Instruments of the Operational Programme Enterprise and Innovation for Competitiveness 2014-2020" (MIT CZ, 2015). This document shows that within the EIC the objective is to use the FIs under Priority Axes 1 - 3 for the following specific objectives (MIT CZ, 2015):

- 1.1 Increase innovation performance of businesses
- 1.2 Increase the intensity and effectiveness of collaborative research, development and innovation
- 2.1 Enhance the competitiveness of start-up and developing small and medium-sized enterprises (SME)
- 2.3 Increase business infrastructure exploitability
- 3.1 Increase the share of renewable energy production in gross final consumption of CZ
- 3.2 Increase the energy efficiency of the business sector
- 3.5 Increase efficiency of heat supply systems.

The market situation analysis confirmed the possibility of using FIs in all the EIC's specific objectives analyzed, with the exception of the specific objective 4.1 aimed at increasing high-speed access coverage where the potential was found to be inadequate. Approximately 10 percent of EIC allocations to FIs (total EIC allocation: CZK 117 billion) are anticipated. In the framework of the analysis, the FIs were divided into two groups, the so-called First Generation FIs, which represent credits and guarantees usable in all selected specific objectives, and Second Generation FIs, i.e. the new instruments to support capital inputs in SC 1.2 and 2.1 and junior loans for regeneration of brownfields in SC 2.3. For implementation of the First Generation FIs, the Czech-Moravian Guarantee and Development Bank (CMZRB)

was selected as an intermediary, and for the implementation of second-generation FIs, the National Innovation Fund (NIF), investment company, a.s. (MIT CZ, 2015). In Figure 1, there is a proposal to use FIs in specific objectives.

Figure 1: Proposal for the use of FIs within specific EIC objectives

Specific Objective	Support Programme	1st Generation FI	2nd Generation FI	Suggested FI allocation range (CZK million)
1.1	Innovation	Guarantees		1 400-1 800
1.2	Proof of Concept		Capital Inputs	550-1 100
2.1	Expansion	Soft Loans and Guarantees		8 850-12 000
	Risk Capital		Capital Inputs	800-1 600
2.3	Immovable Assets	Soft Loans	Junior Loans	0-5505
3.1	Sources of Renewable Energy	Soft Loans		400-600
3.2	Energy Savings	Soft Loans		550-2 000
3.5	Energy Savings in the Heat Supply System	Soft Loans		300-700

Source: (MIT CZ, 2015)

From the aforementioned planned support programmes using FIs, on June 1, 2017, the programme Expansion for SMEs was launched in cooperation with CMZRB. Under this programme, interest-free credits and financial contributions are provided for investment projects implemented throughout the Czech Republic except for the capital city of Prague (CMZRB, 2017). In addition, in cooperation with CMZRB, the Energy Saving Programme is being prepared for SMEs as well as large enterprises, expected to be launched in autumn 2017 (Rohličková, 2017). Other programmes are in preparation.

4.2 Integrated Regional Operational Programme

In the framework of the Integrated Regional Operational Programme (IROP), based on an analysis made, support is planned mainly in Priority Axis 2 in the specific objective 2.5 Reduction of Energy Intensity in the Housing Sector. This support is similar to that in the previous PP (JESSICA programme, see Chapter 2). The support is expected to be paid starting from the end of 2017 or at the beginning of 2018. Unlike the JESSICA programme in the previous PP, the current programme will only be used to reduce the energy intensity of apartment buildings, using FI Soft Loans with a reduced interest rate. The estimated allocation is CZK 2.1 billion. The soft loan will be provided through the FI manager - commercial partner. At present, the tender dossier for the public procurement contract is being prepared. Due to the current market situation where interest rates are very low, it is being considered to supplement the FI with a grant component or to finance the project preparation in the form of a grant. (Deloitte CZ, 2015; Mazal, 2016)

4.3 Operational Programme Prague – Growth Pole of the Czech Republic

Under the OP Prague – Growth Pole of the Czech Republic (GPCZ), the results of an analysis made were presented in October 2016: Preliminary assessment of the use of financial instruments in the OP Prague – Growth Pole of the Czech Republic under the Cohesion Policy 2014-2020. This analysis was to identify areas that could be supported with FIs. they were identified as areas with a certain potential in Priority Axis 1: Strengthening Research, Technological Development and Innovation, specifically in Specific Objective 1.1.1

Promoting activities contributing to the commercialization of research results through verification of feasibility and commercial potential and their introduction into practice - (“proof-of-concept”) and Specific Objective 1.2.3 Developing innovative companies at earlier stages of their life cycle. Within the two specific objectives, the use of FIs is considered in the form of a combination of subsidies and capital inputs, capital inputs as such or soft loans. Based on the results of the analysis in accordance with the type of support, the selection of the FIs manager was initiated. Negotiations with the European Investment Fund, the originally recommended manager, did not lead to any agreement. Negotiations are underway with the CMZRB and the Ministry of Industry and Trade CZ, which will be the founder of the NIF, and, due to the replacement of the originally planned FIs manager, it is foreseeable to initiate support with the help of FIs at the earliest in 2018. (Arthur D. Little, GmbH, 2016).

4.4 Operational Programme Employment

Within the OP Employment, selected for support using the FIs was the area of social entrepreneurship in Investment Priority 2.1 intended for active inclusion, including inclusion with a view to promoting equal opportunities and active participation and improving employability to meet Specific Objective 1 Increasing the employability of people at risk of social exclusion or socially excluded in society and on the labour market (MLSA CR, 2014). Support under OP Employment is financed from the European Social Fund and is intended for non-investment expenditure. Social entrepreneurship is supported not only within the framework of OP Employment, but also within the framework of the IROP in Priority Axis 2 Improving public services and living conditions for the inhabitants of the region; investment expenditures are then supported from this OP. In the IROP, however, the use of FIs for social entrepreneurship is not planned. In June 2017, an agreement was concluded between the Ministry of Labour and Social Affairs of the Czech Republic (MLSA CR) and a supplier for making an analysis of the use of FIs within OP Employment. The expected completion date for the analysis is September 2017. Based on the results, the implementation of the FIs into practise will be initiated if the usability of FIs is confirmed. It is anticipated that the FIs will be used in the form of soft loans and guarantees, but the final form is yet to be revealed in the analysis. The expected date of commencement of support is planned for the beginning of 2019. (Maršíková, 2017)

4.5 Operational Programme Research, Development and Education

Within the OP Research, Development and Education (RDE), the identification of the support areas is still ongoing. PWC prepared a preliminary analysis for the Ministry of Education, Youth and Sports CR on the use of FIs for the area of research, development and education (PWC, 2017). An analysis in line with the Methodological Recommendation for the Implementation of FIs in the PP 2014-2020 is yet to be made. Based on a preliminary analysis of the environment of research, development and education in the CZ and communication with individual types of OP RDE beneficiaries, PWC has identified four types of projects suitable for pilot verification in terms of implementation of financial instruments (PWC, 2017):

1. Under Priority Axis 1: Strengthening Capacity for Quality Research, Investment Priority 1.1 Strengthening Research and Innovation Infrastructure and Capacities to Develop Excellence in Research and Innovation and Supporting Professional Centres, especially those of Europe-wide Interest:
 - a. Purchase of new technologies and devices within the framework of the development of research organizations focused on cooperation with the application sphere, i.e. a project aimed at acquiring infrastructure, part of which would be pre-determined for use for contracted research.

- b. Implementation of research plans with potential for future use of the result in practice where pre-application projects that have the potential for commercialization are supported by follow-up support in the form of FN (i.e. in a returnable form).
2. Under Priority Axis 2: Developing higher education institutions and human resources for research and development, Investment Priority 1 Improving the quality and efficiency and access to tertiary and equivalent education, especially in disadvantaged groups, in order to increase participation and the level of education received:
 - a. Supporting postgraduate researchers to enable the system to fund talented young scientists and motivate them to achieve above-average results in their work.
 - b. Improving the quality of education at higher education institutions (support for foreign students) that would be supported in a returnable form of support, using the experience and mechanisms of the ERASMUS+ programme.

In the above areas of support, it is envisaged to use these types of FIs: credit, guarantee, quasi-capital and loans to individuals, and combinations with subsidies considered for all FIs. Therefore, the use of FIs within the OP RDE is still being prepared, the OP RDE managing body is preparing a selection procedure for the analysis of the use of FIs within the OP RDE in accordance with the Methodological Recommendation (MRD CZ, 2016), and it is thus not possible to set a timetable for the implementation of FIs and their availability in practice.

4.6 Operational Programme Environment

In the OP Environment, an assessment of the use of FIs was carried out, and then the preparation of support was started in the form of preferential loans, which the applicants could use in combination with subsidies. To provide support and manage the soft loans, the State Environmental Fund of the Czech Republic was chosen as a partner. The first planned step will be publishing a pilot call under Priority Axis 3 of OP Environment: Wastes and material flows, environmental burdens and risks and Specific Objective 3.5 To reduce environmental risks and develop systems for their management. The utilization of FIs is also envisaged in other OP priority axes where conditions for the support will be set according to the results of the pilot call. (Früblingová, 2017)

4.7 Operational Programme Rural Development Programme

Although the use of FIs under the OP Rural Development Programme (RDP) has been considered since the beginning of the PP, the analysis of the use of FIs within the OP has not yet been made. In general, in the agricultural sector, the possibility of using credits, securing credits or other forms of support through the Supporting and Guarantee Agricultural and Forestry Fund is available. Nevertheless, it is desirable to provide part of the support from the OP RDP in the form of FIs mainly in the form of credits. However, given the market situation, availability of funding sources and many other supports for farmers, their use in the coming years is not foreseen. (Tabery, 2017)

5. Conclusion

The FIs are still not used in the 2014-2020 PP to the extent planned so far and coordination has not been sufficiently applied in preparing the use of FIs across OPs (e.g. support for social entrepreneurship is addressed through IROP and OP Employment, the use of FIs in this area is only planned in OP Employment). It is possible to assume that due to the growth of gross domestic product in the CZ it will no longer be possible to obtain support in the other PPs to a similar extent as it has been. FIs are one of the means that can help to restore financial

resources for development in the future, but they are not sufficiently utilized in the current PP. This is due to the insufficient preparedness of the managing bodies of the respective OPs and the lengthy procedures for the analysis and implementation of the FIs in practice, see more in (Košťálová, Tetřevová, Paták, 2015). However, it is also necessary to mention the fact that the use of FIs is also significantly limited by macroeconomic conditions (low interest rates, high availability of standard sources of financing). It can therefore be assumed that half of the PP in 2018 will not achieve the planned objectives of the ESF-funded support with the use of FIs, and it will be problematic to achieve these objectives even at the end of the PP.

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