Closure of 2014-20 & Launch of 2021-27 Programmes of Cohesion Policy in the Area of Financial Instruments

Márk Bató*

ABSTRACT:

The transition between programming periods (based on the multiannual financial frameworks (MFF) of the EU budget) is always a key issue in the implementation of EU cohesion policy. Lack of proper management of this change can result in unjustified interruption of development programmes and projects. This possible interruption can cause serious macroeconomic consequences if the weight of these interventions is significant in the national economy (this is the case in several recipient Member States of EU cohesion policy). Although, the practical problem is generally the interruption of programmes because of the changes of these circumstances, the unchanged continuation of development programmes is not a real alternative, because experiences of implementation are to be taken into account and necessary adjustments shall be done. The proper management of cohesion policy has to find the right balance between these two contemporaneus requirements: stability and improvement.

The paper collects the main factors determining national implementation of EU cohesion policy in the period of transition between programming periods (such as requirements of the closure of 2014-20 programmes and pre-conditions of launching the 2020+ programmes). In order to avoid periodical shortages in financing, both the Commission and national governments have to make preparatory steps for the provision of a smooth transiton from one MFF programming period to the following one. Our suggestions on how to react on this typical and significant challenge of EU cohesion policy implementation will be based on the comparison of regulatory backgrounds of the two periods. Furthermore, the essential requirements of closure of 2014-20 programmes will be reviewed and analysed from the point of view of smooth transition. Finally, the necessary preparatory steps of the new 2020+ programming period will be also analysed following the same, smooth-transition-principle.

As a sum-up of the conclusions of the analyses listed above, the paper intends to suggest some general cornerstones for national governments in the area of national implementation of EU cohesion policy with the aim of a smooth transition that helps to correct former bottlenecks in implementation, but does not result in an unneccessary interruption of development programmes. The paper focuses on a specific area of cohesion policy interventions: on the area of financial instruments.

POINTS FOR PRACTITIONERS:

The paper synthetizes the influencing factors of the transition from the 2014-20 European Union cohesion policy programmes to the 2021-27 ones. While the cohesion policy requires ongoing interventions, the set-up of the EU budget is based on seven year-long cycles. The provision of a smooth transition between budgetary periods is a key success factor for cohesion policy. We point on those areas where the management of the European Structural and Invesment Funds has to put special attention in the forthcoming years in order to provide a smooth transition.

KEYWORDS:

cohesion policy, European Structural and Investment Funds, financial instruments, smooth transition

* Chief advisor of the ESIF Regulatory Department in the ESIF Coordinating Body, Hungary (Prime Minister's Office). The views expressed are personal and do not necessarily reflect the position of the Ministry.

INTRODUCTION

A special challenge in the implementation of EU cohesion policy is the transition between multiannual financial frameworks and programming periods. This specific challenge covers the closure of the foregoing programmes together with the launch of the forthcoming ones. The so-called Visegrad countries under the last Hungarian presidency have put emphasise on the requirement of smooth transition[1], that means the continuity of the development programmes also when a new multiannual financial framework starts. This article focuses on the upcoming change of financial framework from the 2014-20 programmes to the 2021-27 ones. First, the main conceptual differences of these two programming periods will be presented. In the following part, the key challenges of closing the implementation of the 2014-20 programming period will be analysed. Finally, the main preparatory steps of the 2021-27 period on national level will be gathered. The essay plans to produce a comprehensive overview about the tasks of national administrations of EU cohesion policy when they face these challenges. The principle followed by the article is the provision of smooth transition, that does not cause a break or a stop in implementation of cohesion policy. Cohesion policy is an important factor of national development in several Member States, therefore its uninterrupted functioning is crucial. Transition should be done in a way that helps to provide adequate circumstances for all interested actors under that their activity does not suffer any suspension, but at the same time necessary modifications based on past experiences must prevail. Our study focuses specifically on the area of financial instruments.

I. CONCEPTUAL DIFFERENCES OF THE PROGRAMMING PERIOD 2014-20 AND 2021-27

In order to be successful in the transition period, the key differences have to be carefully considered. Co-legislators have already finalized the regulatory framework also for the 2021-27 period, therefore both regulatory frameworks are now available in an official form[2] for our comparison.

From the point of view of financial instruments the following factors are to be taken into account.

1. Financial instruments are planned to be even better integrated with other –mainstream- types of implementation

The most visible element of this integration is the reporting system. There will be no more separate annex linked to the annual implementation report, instead of this the data about financial instruments will be part of the main report. We expect that as a result of this modification, increasing attention will be given to the content of the report. The separate annex has been managed usually by some financial instrument specialists. Although the methodology applied theoretically was harmonized with the general reporting principles of ESI Funds and as a consequence also with the reporting practice of other Member State, but in practice the national reports did not prove to be comparable in many cases due to the different method applied. Commission has organized several workshops in order to bring closer to each other these national methods, but these efforts have not resulted in the expected convergence. The annual implementation report has a more standardized methodology as well as quality assurance

[1] Joint Statement of the Visegrad Group (Czech Republic, Hungary, Poland, Slovakia) and Croatia. Budapest, 2nd February 2018. http://v4.gov.hu/download/5/00/12000/20180201_V4%2B1%20Joint%20Statement%20on%20Cohesion%20Policy.pdf

[2] European Union: Regulation 2021/1060 of the European Parliament and of the Council of 24 June 2021 laying down common provisions on the European Regional Development Fund, the European Social Fund Plus, the Cohesion Fund, the Just Transition Fund and the European Maritime, Fisheries and Aquaculture Fund and financial rules for those and for the Asylum, Migration and Integration Fund, the Internal Security Fund and the Instrument for Financial Support for Border Management and Visa Policy. Official Journal of the European Union L 231, Volume 64, 30 June 2021.: 159-706.

system, therefore this modification will likely bring the financial instrument report closer to the required content in terms of data quality.

2. **Combination of financial instrument with grants will be a more attractive option due to simplification**

A likely trend of the future is the strengthening of combination of different support forms. We have already analysed the advantages of combination.[3] For the 2020+ period a significant improvement has been achieved in the regulatory environment: combination of different support forms under one set of rules has become possible following a persistent request from the Member States. After this modification, combination is not only an effective support form, but also more easily managable. Without going into the details –as it was already done in our preceding article- the present article recalls an important advantage of the combined support scheme. In several Member States the cohesion policy is traditionally grant based also for enterprises, which is generally not the most effective support form for them, but because of political reasons the change to financial instruments is hard to implement. The combined support scheme can offer an attractive transitional form in this situation.

3. **System of management costs and fees will be simplified**

Management cost and fees are a specific eligible cost item in case of financial intruments. Their special role is often discussed when the functioning of cohesion policy is assessed, because these costs are not spent directly on development, but they finance the related work of financial institutions. The meticulous methodology applied in the current period in order to limit the use of cohesion policy resources for the purposes of management costs and fees (thresholds) takes each and every aspect into account, but in practice it results in a huge administratitve burden because of the complicated calculation methodology. The new method is planned to be much simpler. The regulation contains a similar calculation basis as in the current period: funds disbursed to final recipients. The threshold is to be defined by a simple percentage instead of the complicated formula of the current programming period. Of course, the performance shall be kept as a key aspect when the level of management costs and fees is determined. But, the link between performance and threshold will not be prescribed with full particulars, Member States will have the room for manouvre to elaborate the most convenient and efficient method.

4. **Further developed model for rules on payments**

The phased payment introduced in the 2014-20 period with the aim to avoid parking funds in financial intermediaries has already gone through the first test. Although, the above-mentioned original goal was successfuly achieved, new challenges have been emerged. This system punished the better performing intermediaries, because the Member State is able to request money from the Commission only when an average performance level is achieved, therefore better performing intermediaries cannot get further payments until the worse performing intermediaries do not reach the required disbursement level. The adjusted system proposed by the Commission would apply this prepayment system only for the first tranch, thereafter Member States could request payments on the normal way, on the basis of effective payments to final recipients. The first prepayment should be covered by effective payments to final recipients until the end of the final accounting year. It is expected, that this model can continue to provide liquidity for the financial intermediaries, but will not punish better performing financial intermediaries, because on the basis of their disbursement performance further payment to them will be possible.

5. **Harmonization of the duration of cohesion policy programming periods with the duration of financial instruments**

Duration of the EU budget and consequent programming periods for ESI Funds have been designed to the specific features of the EU budget (predictability and flexibility simultaneously). The lifecycle of financial instruments is not necessarily the same, eg. an equity fund generally requires a 10-15 year-long implementation period. In the current period, this mismatch is managed by a specific extension of eligibility, while after 2020 a more flexible transition to the following programming period will be provided. The reason for the modification is the lack of

[3] Bató, M. and Gyürkés, A.: Combined Support Schemes in Hungary: A Promising Way of Development for Cohesion Policy. [2018] European Structural and Investment Funds Journal (2), 133-135.

possibility for effective controll under the current rules, as in this model use of the funds could be possible also after closure of the programmes. The proposed solution can eliminate this problem, but preserves the different implementation period for this kind of financial instruments.

Paralel to the presentation of the conceptual changes, we have to take into account also areas where no change can be observed, although it would be needed and it was requested repeatedly by Member States.

+1. Selection of the financial intermediaries

While in some areas the conceptual changes were realized, from other aspects cohesion policy takes along implementation deficit from the past. One of the most discussed issues is the selection of financial intermediaries. The Common Provisions Regulation (CPR - regulatory background for the use of the ESI Funds) does not deal with this issue, according to DG Regio it belongs to the competence of public procurement rules. Although several Member States have called the attention on the non-convenient rules in this regard, the responsible DG of the Commission (DG Grow) has not taken yet on agenda the selection process of financial intermediaries. At the beginning of the 2014-20 programming period there was an intensive debate about these rules, but it has focused on the selection of the fund of funds manager, the next step of the selection procedure (selection of the specific fund managers) was not handled. As regards the 2021-27 period, the Commission is not eager to continue this work, the new CPR takes along the previously approved regulatory background, that does not solve the question of the selection of specific fund managers.

The situation is not only not resolved yet, but on the basis of the regulatory proposal, it has even deteorated. While the 2014-20 rules has provided guidance for the case when a Member State concluded that public procurement rules do not concern a specific case, the 2021-27 regulation does not care with this option at all. The 2014-20 rules –in line with the similar provision of the Financial Regulation- envisaged a selection process for financial intermediaries on the basis of open, transparent, proportionate and non-discriminatory procedures, avoiding conflicts of interest. The 2021-27 regulation misses the opportunity for providing a similar provision.

The Financial Regulation in force contains the relevant provision, according to that financial intermediaries shall be selected with due account to the nature of the financial instrument to be implemented, the experience and the financial and operational capacity of the entities concerned. The regulation adds that the selection shall be transparent, justified on objective grounds and shall not give rise to a conflict of interests. The relevant provisions are missing from the CPR 2021-27. In its opinion concerning the CPR proposal also the European Court of Auditors calls the attention on this deficit. In its recommendation to the Commission and the legislators for consideration the ECA explicitly mentions the introduction of the requirement for selection of financial intermediaries.

The selection of financial intermediaries was a key issue also in the 2014-20 period, the uncertainities hindered a lot the timely launch and implementation of financial instruments. If these regulatory bottlenecks remain uncleared, the repetition of a significant delay at the starting point can happen again. Regulations shall cover all possible implementation methods in a transparent matter, otherwise longlasting discussions and negotiations on the interpretation of the regulations will follow, and thus the regulatory background will be the major barrier of timely implementation.

Another issue in the area of financial intermediary selection beyond the need for a coherent and transparent regulation is the process itself, the real content of the regulations. The approach of the Commission during the negotiations of the CPR regulation suggested that the normal procedure for this selection is public procurement. A different approach is the practice of the European Investment Bank, in that case an open call is applied without the detailed prescriptions of public procurement. This selection type is a clear reference point for selection of intermediaries of financial instruments. If the EIB can successfuly applies this selection procedure, simply from an implementation point of view it is not understandable why the same procedure can not be accepted for another fund manager in case it is a national actor. The regulatory circumstances have an artificial influence on the competition among potential bodies implementing financial instruments, and because of this artificial difference, not necessarily the most competitive body will be chosen for implemetation.

Beyond the explicit influences stemming from the regulatory requirements, some soft influences can be observed, too. In the framework of the shared management a longlasting attempt from the Commission side is the centralization of financial instruments of the EU budget. This could be observed in the SME Initiative (CPR 2014-20), in the different incentives for combination of ESI Funds with EFSI resources (Omnibus). The latest attempt in this direction is the creation of the InvestEU programme and the related Member State compartments, into that the Member States can transfer a certain amount from their dedicated national ESIF resources. The InvestEU plans to merge under one umbrella all centrally established EU financial instruments, while the Member State compartments of this programme could be used solely for the benefit of the interested Member States. An important difference between the current EFSI and the subsequent InvestEU is the fund manager. In the InvestEU it will be possible also for national promotional banks to become an implementing body. This modification could be a real advantage for Member States, as in cooperation with a national body, they could be more eager to choose this option.

II. CHALLENGES OF CLOSURE FOR THE 2014-20 ESIF FINANCIAL INSTRUMENTS

Approaching the end of the programming period, the Managing Authoritites are facing several typical challenges in implementation of financial instruments. The following factors are the most common ones.

1. Opposite to the requirements of request for payment, at the end of the eligibility period it is not enough any more to transfer the money to the financial intermediares, the whole sum of the financial instruments has to be disbursed to final recipients.

At the beginning of a programming period the absorption indices of financial instruments could be well ahead of grant absorption indices, because of the special rules on request for payments. Due to the same reason, the case is the opposite at the end of the programming period, because the better spending indices do not necessarily mean better absorption. For full absorption at the end of the period, all resources transferred to the financial intermediaries have to be disbursed, too.

2. The complicated regulatory background of management costs and fees also puts a significant burden on implementation, amount to be disbursed to final recipient may need to be recalculated.

As not only the real fees, but also the regulatory limitations depend on performance, the need for the recalculation can reach a perceptible level. If the management costs and fees cannot reach the originally planned level, then the disbursable part of the financial instrument can grow and the original disbursement plan has to be adjusted. Now, in the second half of the implementation period this could be well observed, the effective absorption management requires prompt intervention.

3. Outcome of the performance reserve exercise may also require an active management in case of financial instruments.

If FIs are affected by related programme modifications, fund managers have to be prepared to handle the positive or negative change of available resources. There is no real experience in this regard, the next months are expected to be decisive for this specific task.

4. The first bigger wave of revolving funds can also appear at this stage of implementation, its management must be not only effective, but also harmonized with the management of original OP resources.

Revolving funds are a brand new resource for national development policies: the scale of their use is more limited then in case of simple national resources, but not as strictly regulated as in the case of OP resources. Another important feature of these funds is the gradual formation, its availability depends on the implementation of the original OP financial instruments. Coordination with the use of OP financial instruments is crucial, because the lighter conditions can result in a crowding-out effect, that can threaten the absorption of OP resources.

III. NATIONAL PREPARATORY STEPS FOR THE TRANSITION

1. Revolving funds

Programmes for the forthcoming period have to take into account not only the payment schedule from the 2014-20 financial instruments to financial recipients until 2023, but also the appearance of revolving funds that are expected to enter into the market at an increasing rate.

A potential and also rationale use of revolving funds is the formation of a supplement to the OP financial instruments with the aim of making sure full absorption. On the basis of the supplement, over-commitment becomes possible, and if some projects prove to be non-eligible, then they might be financed from the supplement because of the less strict rules in case of revolving funds. This supplement can offer an effective solution to the trap when some projects prove to be ineligible in a final phase of implementation and no substitution is possible with new projects.

Of course, above a certain quantity this supplement will not demand the whole sum of revolving funds. At that point, strategic decisions about the use of revolving funds have to be done. Two, sometimes conflicting aspects shall be considered in parallel: undermining of the OP financial instruments with similar revolving financial instruments shall be avoided, because absorption can be endangered if competing instruments with more flexible conditions appear on the market. At the same time, the increase of the funds available for development purposes can be maximized by the quick re-use of the revolving funds, without longlasting parking of the money.

2. Shared management

The principle of shared management requires a close cooperation between the interested parties, the European Commission and the individual Member States. Therefore not only the Member State influences the content of the operational programmes, national plans have to be coordinated with the plans of the European Commission. High priority at the beginning of the 2014-20 programming period was given by the Commission to the expanding use of financial instruments. The Investment Plan (a key programme document of the Commission) recommended concrete percentages for the use of financial instruments in the different intervention areas. The CPR contains concrete provision for a ten percentage point allowance in national co-financing if the use of financial instruments is fixed at the beginning of the programming period in a stand-alone priority axis of an operational programme.

This quantitative pressure from the Commission is not so strong now, the focus has been shifted toward the reinforced cooperation with the central EU financial instruments under the umbrella of InvestEU. The regulatory proposal contains a specific provision for this option in Article 14, the Commission puts great emphasize on the dissemination of this implementation form. It is expected that the increase of the share of this form will be the priority for the Commission in the course of the negotiations on the programmes of the 2020+ period.

3. Implementation form

The choose of the optimal implementation form is crucial at the beginning of a programming period. In case of financial instruments, the preparatory period is generally more time-consuming, because the institutional system has to be established first. As the modification of this system is likewise time-consuming, any mistake in the formation of the initial system could seriously endanger the timely absorption.

The key options are the following:

- cooperation with a fund of funds manager

The involvement of a fund of funds manager can ease a lot the burden of implementation of this special support form, if a well-prepared partner is available on the market. Standard methods and schemes are already developed for financial instruments, managing authorities can exploit them, if they can choose an adequate partner with the required knowledge.

- direct cooperation with financial intermediaries

There are certain circumstances under that the inclusion of a fund of funds manager does not have high added value. Eg. a brand new support scheme on the market or the opposite case, when a well functioning institutional system is readily available on the market.

- cooperation with the EIB Group

Advantages -such as better knowledge of the EU financed support schemes-, and also disadvantages -such as less influence on implementation- emerge also from this option.

Beside the functionability of the chosen option, the flexibility is of similarly high importance. Due to the complex process of the creation of an implementation system, the interim set-up of a new sytem should be avoided. Of course, the experiences of implementation can require during the cycle some adjustments. The set-up of a mixed implementation structure at the beggining of a programming period can provide the possitibility of exploiting all of the above-mentioned advantages. If the consequences of the disadvantages reach an intolerable level, the option to regroup resources among the different forms will remain a real alternative. Although the costs can be somewhat higher because of the existence of parallel systems, but the risks will be limited to a great extent. The potential risk of being stuck to an under-performing option can be eliminated.

Table 1: Determining factors to be taken into account in preparation for a smooth transition between the 2014-20 and the 2021-27 programming period – financial instruments

Conceptual changes	Better integration of FIs with other types of support	Simplification for combination	Simplified management costs and fees	Rules on payments - modified	Harmonized duration of FIs with programming periods – modified	Selection of financial intermediaries*
Challenges of closure	Full disbursement to final recipients	Handling changes in effective management costs and fees thresholds	Management of changes resulted from the performance reserve exercise	First wave of revolving funds	-	-
National preparatory steps	Systemic use of revolving funds	Cooperation with COM under shared management	Implementation form	-	-	-

**Remains unchanged despite several requests for modification.*

Source: Author’s own compilation.

IV. HUNGARIAN EXPERIENCES AND CONCLUSIONS

An organically developed composition of support forms can be observed in Hungary. To the originally used traditional grant support, financial instruments (loans, equity, guarantee) were added in the 2007-13 period. A combined support form of grant and loan was also introduced in order to answer the strong demand on grants, but in the same time to provide a smooth step toward the more effective financial instruments. The next step ahead of us is a stronger incentive for cohesion policy results. For this sake, the wide use of the repayable assistance form is under consideration. In this support form it is possible to transform a repayable assistance into a non-repayable one if certain conditions are met. This support form can make possible a more intelligent intervention, through that different objectives can be incentivized in a transparent manner.

If we place the repayable support on the support map, it seems to be very similar to the combined support form, because in practice it is a combination of a grant with a loan, but the proportion of the two support forms will be finalized only at a later stage. This uncertainty causes an obvious disadvantage to the repayable assistance, because the state aid regulation can not manage it currently. State aid is calculated on the basis of the maximum possible support in the moment of the decision. As the combined support scheme is fixed and the repayable support is varying, the aid intensity will be most probably higher in case of combined support scheme, the repayable assistance will suffer a handicap. A special form of repayable assistance is the so-called repayable advance, when the repayment is required in case of successful implementation. State aid regulation can manage this case by providing an additional ten percentage point aid intensity. In the opposite case, when the repayment is required in case of non-success, the uncertainty is not compensated by higher aid intensity. Because of this reason the repayable assistance can not compete with the combined support scheme at the moment. A more wide-spread use of this promising support scheme has to be preceded by the above-mentioned adjustment in the state-aid regulatory background.

According to our assessment, the conditions for closing the 2014-20 programming period and the start of the new one are adequate for providing a smooth transition for Member States. The general framework regulatory system created for the 2014-20 period has been preserved and the necessary corrections were also done. The integration with the grant support form has been continued, the choice between these two support forms can really rely on the coherence with the development goal and will depend less on the different regulatory background.

The guiding principle from the Commission side is expected to be the strengthening of centrally managed financial instrument of the EU, that will be put together under the Invest EU umbrella. This new principle will replace the current principle that points mainly on the quantitative expansion of financial instruments, the increasing proportion of financial instrument to the traditionally applied grants.

The amount of revolving funds in many Member States will reach a level, that will make this element a significant resource for the next programming period. Preparations in these Member States should take into consideration the utilization of the revolving funds when the programmes for the next period will be under discussion.

Experiences show that a beatific, generally applicable solution or implementation model does not exist. Almost all alternative solutions can have certain advantages, therefore the least risky option from the management point of view is the diversification among the different options if the amount of the planned FI resources is high enough to make this possible. Flexibility is a key advantage in implementation, because the programming period is relatively long, the need for adjustments is probable. Flexibility is a real option only when the alternative implementation frameworks are in place and avialable for managers of the programme. This is the major reason for the creation of a diversified, but not fragmented implementation system.