Brief overview of the implementation of crisis measures of the Rural Development Foundation

Overview of the National Audit Office for the Riigikogu Tallinn, 29 September 2020

Brief overview of the implementation of crisis measures of the Rural Development Foundation

Summary

What did we analyse?

The brief overview has been prepared within the framework of the audit "Economic effect of crisis measures" and explains the motives and the purpose of selecting these crisis measures of the Rural Development Foundation for implementation, shows which results have been achieved in five months, and whether the funds have been used purposefully when providing further alleviation to the crisis caused by the coronavirus through the supplementary budget.

Cooperation with the representatives of the Ministry of Rural Affairs upon developing the primary alleviation measures in the crisis worked very well and was prompt. At the proposal of the Ministry of Rural Affairs, the Cabinet of Ministers approved measures aimed at ensuring the liquidity of rural enterprises to help them cope with changes in the supply chain and export markets caused by the crisis. In the materials submitted to the government, the Ministry of Rural Affairs emphasised the need to ensure cash flow for companies through banks and other financial institutions.

For the same purpose – to resolve liquidity problems – the Government of the Republic submitted on 2 April 2020 to the Riigikogu the draft legislation of the Supplementary State Budget 2020 Act, which the Riigikogu passed on 15 April 2020. The explanatory memorandum explicitly specifies a working capital loan with a total volume of 100 million euros as a loan measure. According to the Supplementary Budget Act, measures intended for alleviating the crisis associated with the coronavirus may be implemented only for the purpose and to the extent provided for in the Supplementary Budget Act.

On 8 April 2020, before the Riigikogu had adopted the supplementary budget, the Rural Development Foundation approved by their decision a financial measure aimed at helping rural undertakings to resolve problems arising from the coronavirus that prescribes working capital and investment loans in place of clearly targeted working capital loans. This has significantly expanded the original content and scope of the measure. However, the supplementary budget procedure at the Riigikogu continued without changes and 100 million euros were allocated for working capital loans as had been requested.

On 7 May 2020, the Government of the Republic authorised the Ministry of Rural Affairs to enter into a financing agreement with the Rural

Development Foundation, pursuant to the terms and conditions of which the purpose of the loan measure is, unlike the decision made at the Riigikogu, to grant working capital and investment loans. Why the terms and conditions of the measure intended for overcoming the difficulties caused by the coronavirus were changed, which problem was subject to resolution or what goal was set, and according to which criteria the efficiency of using the funds can be assessed has not been explained. No document nor the financing agreement entered into with the Ministry of Rural Affairs provides an answer.

As a result of the coronavirus, liquidity problems may have been the reality for many companies, but it is highly possible that the problem could have been resolved better through other state measures proposed, for example, by the Estonian Unemployment Insurance Fund as well as the Tax and Customs Board even before the Rural Development Foundation revealed its measures.

As a result, there is a high demand for the measure offering investment loans under favourable conditions – already in June the volume of applications exceeded the financial possibilities, and before responding by changing the terms and conditions of receiving loans on 16 June 2020, several large and a number of smaller loan agreements foremost aimed at investments and not working capital loans had been decided on.

Although the loans offered by credit institutions, the average interest terms of which have remained unchanged even during the crisis, are returning to pre-crisis volumes, the Rural Development Foundation continues to offer favourable long-term investment loans.

What did we notice as a result of the overview, in summary?

The main observations of the National Audit Office

- It appears to the National Audit Office that funds are being allocated through several measures that do not correspond to the objective approved by the Riigikogu. According to the documents of the supplementary budget, the plan was to grant working capital loans to rural undertakings to resolve liquidity problems caused by the coronavirus, but the financing agreement entered into between the Ministry of Rural Affairs and the Rural Development Foundation allows both granting new working capital and investment loans to undertakings as well as refinancing existing loans.

- In the opinion of the National Audit Office, an answer should be found for a question of how to strengthen cooperation between institutions upon the establishment and implementation of crisis measures as well as the approval of various measures. For example, the original objective of the crisis measure of the Rural Development Foundation – to contribute to resolving the liquidity problem – may have been appropriate, but the implementation thereof took time, which is why other state measures helped to achieve the same objective faster and were therefore more expedient.

- It is also not clear what prompted the change of the measure into a long-term investment loan according to the instructions of the Council of the Rural Development Foundation at the last moment before the commencement of the implementation thereof, what result and effect is intended to be achieved, and how does this relate to the problems caused specifically by the coronavirus that private credit institutions would not be able to resolve.

Such activities may bring about the risk that the state has not resolved the crisis through the crisis measures but is acting with short-sightedness in the name of the crisis without having a significant effect or perhaps even having an adverse effect, given that companies are not being treated on equal grounds. The funds of the Rural Development Foundation are running out, having been used primarily for long-term investment loans, the potential positive effect of which can be expected in the distant future. All this reduces the state's ability to resolve current problems related to the crisis at the present time.

Response of the Minister of Rural Affairs: The Ministry of Rural Affairs is of the opinion that under the crisis conditions, it is important to respond to the crisis quickly and flexibly. According to the Minister, the measures of the Rural Development Foundation correspond to the objective and scope of the crisis package, they are in accordance with the supplementary budget, resolve the market failure present on the market that has escalated due to the crisis, and help the undertakings to cope with crises better in the future.

Comment of the National Audit Office: The National Audit Office agrees that speed and flexibility are important. The Minister of Rural Affairs justifies the offering of favourable long-term investment loans with the better preparedness of undertakings for future crises. However, the supplementary budget in question has allocated funds specifically for dealing with the present crisis. It was clear already in spring that the crisis could end up having several stages, and it may therefore be necessary to quickly resolve short-term liquidity problems again in the coming months.

Linking investment loans to ensuring liquidity in the more distant future is related to the crisis very loosely and is a costly solution in terms of the budget that reduces the state's ability to help undertakings facing liquidity problems as the current crisis develops. In Estonia, current problems related to the coronavirus crisis are once again topical and demand attention right now.

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Measures proposed by the Ministry of Rural Affairs and approved by the Cabinet of Ministers were designed to resolve the liquidity problems of rural undertakings, and it was emphasised that cash flow should be ensured for undertakings through banks and other financial institutions

1. The Ministry of Rural Affairs responded to the crisis promptly, and a meeting took place on 16 March 2020 where organisations representing production companies discussed issues related to the emergency situation and food security in Estonia. The meeting was attended by the representatives of the Central Association of Estonian Farmers, the Association of Estonian Food Industry, the Estonian Chamber of Agriculture and Commerce, the Estonian Association of Fishery, the Estonian Association of Horticulture, the Estonian Chamber of Commerce and Industry, and Estonian Traders Association.

For your information

The task of the Rural Development Foundation is, among others, to participate in the establishment of the investment fund, including for equity investments, as well as in the **establishment of the crisis fund** and, if necessary, the management of such funds.

Source: Clause 2.2.3 of the Articles of Association of the Rural Development Foundation; the Articles of Association were updated on 22 April 2020 by the decision no. 1.3-1/4 of the person exercising the right of the founder.

2. Two major agencies for producers – the Central Association of Estonian Farmers and the Estonian Chamber of Agriculture and Commerce – as well as the Association of Estonian Food Industry highlighted difficulties with the availability of labour in agriculture, transnational disruptions in the supply of goods, setbacks in the supply chains of the accommodation and catering sectors, and the decrease of the buying-in price of certain agricultural products below the production cost as the main concerns. Support was also given to measures planned through the Rural Development Foundation for alleviating the liquidity crisis.

3. The Ministry of Rural Affairs submitted to the meeting of 19 March 2020 of the Cabinet of Ministers the analysis of the situation and proposals on how to alleviate economic difficulties faced by the Estonian agricultural and food industry and rural undertakings caused by the coronavirus outbreak. According to the information presented to the government, the design of crisis measures was based on the lessons learned by the Rural Development Foundation from previous crises.

Ministry of Rural Affairs: The main problem of the crisis is that rural undertakings will face liquidity difficulties

4. In the materials submitted to the government, the Ministry of Rural Affairs has outlined the need to resolve the lack of working capital of rural undertakings as the main issue:

> "The emergency situation affects all companies – small, medium and larger companies alike, many of whom face liquidity problems. In these circumstances, it is important to ensure cash flows for companies through banks and other financial institutions. In addition to liquidity, companies suffer significant losses that affect their viability. In this situation, it is important to ensure the availability of measures that help maintain liquidity, reduce damages, and continue with the economic activities of companies."

5. Pursuant to this, the Ministry of Rural Affairs proposed to the Cabinet of Ministers to implement five measures with a total volume of

223 million euros through the Rural Development Foundation. These measures are the following:

- Working capital loan to undertakings (100 million euros). According to the explanation, it was estimated that the need for working capital loan is inevitable, because banks do not grant new loans in an unforeseeable situation, not even with a guarantee. To ensure the survival of family businesses that are predominantly micro-enterprises and self-employed persons, it is essential to provide them with flexible working capital loans (with a flexible payment schedule and, if necessary, partially secured loan, because the price of real estate in the crisis situation is unclear).

- Subordinated liability (20 million euros). According to the explanation, it is a loan subordinated to other loans, i.e. it is repaid after the bank loan has been paid. Subordinated liability helps to raise financial resources from the bank as it strengthens the company’s equity capital.

- Capital injection (10 million euros). According to the explanation, capital injection functions both as a subordinated liability as well as support for the company’s equity capital. The maximum amount of capital injection is 200,000 euros.

- Fund for specific purposes Rural Capital (50 million euros). According to the explanation, the measure of the fund for specific purposes Rural Capital is planned to be the sale and lease-back transactions for land (financial lease). The measure enables mobilising necessary resources in the crisis situation to alleviate the shortage of working capital of agricultural producers or to provide investments.

- Guarantees for loans granted by the bank (43 million euros).

In particular, the government approved measures for alleviating the shortage of working capital, incl. working capital loan

6. The government made its choices during the discussions and at the Cabinet Meeting of 19 March 2020 approved the measures related to the coronavirus to be offered to rural undertakings through the Rural Development Foundation. These measures are the following:

- Guarantee in the amount 50 million euros
- Working capital loan in the amount 100 million euros
- Rural capital in the amount 50 million euros

Overviews by the Bank of Estonia also showed the need for working capital loan

7. The monthly overviews by the Bank of Estonia of the turnover of loans and leases granted to companies by credit institutions confirm that the objective to grant working capital loan set in the spring was correct: from March to May, short-term financing decreased by 100–150 million euros per month (for example, 745 million euros of short-term loans were granted in March, while 592 million were granted in May). From June, short-term financing is once again on an upward trajectory, but the difference with the level of 2019 is still 100 million and more as at the end of July.

The decrease in the investments of undertakings may have been caused by the uncertainty and unpredictability of the future, not the lack of funding options

8. During the same period, long-term financing decreased by 50–100 million euros per month, but the volume of bank loans granted more or less returned to the pre-crisis level by July. According to the Bank of Estonia, the decrease in lending was primarily caused by the uncertainty about the future, and this reduced the need and desire of companies to raise loan funds for investments at the beginning of the crisis. At the same time, the average interest rate on loans granted to companies did not increase during the crisis months, remaining, on average, at the level of 2.6–2.9%.

The Riigikogu supported the Government's proposal to respond quickly and provide additional funding to the Rural Development Foundation foremost to resolve the liquidity problems of rural undertakings

9. On 2 April 2020, the Government of the Republic submitted to the Riigikogu the draft legislation of the Supplementary State Budget 2020 Act, pursuant to which 200 million euros are allocated from the budget of the area of government of the Ministry of Rural Affairs to financing transactions related to the crisis.

10. The explanatory memorandum of the draft legislation of the Supplementary Budget Act explicitly states that the following specific measures will be developed to mitigate the negative impacts of the crisis:

- Loan guarantee, total budget 50 million euros. Loan guarantees for loans issued by commercial banks are granted to the agricultural and food industry and rural undertakings.
- Working capital loan, total budget 100 million euros. Working capital loan is offered to undertakings operating in rural areas[1].
- Rural capital, total budget 50 million euros. Owners of arable land are offered purchase and sale-back transactions of arable land (financial lease) to overcome liquidity problems caused by the spread of the coronavirus.

11. On 6 April 2020, at the first reading of the draft legislation of the Supplementary Budget Act at the Riigikogu, the Minister of Finance highlighted the following:

> "Similarly to KredEx, we support agriculture and rural life through the Rural Development Foundation. Extensive loan guarantees are offered to the agricultural and food sector and to rural undertakings. Working capital loan is offered to companies operating in rural areas. Rural capital is

[1] Appendix 1 to the explanatory memorandum describing the impact on the budgetary position of the governmental sector in 2020 also includes the line: "Working capital loan and investment loan for undertakings (MES) – 30 million euros".

developed for owners of arable land for purchase and lease-back transactions to improve liquidity."

According to the Supplementary Budget 2020 Act, funds allocated from the supplementary budget may only be used for the purpose prescribed by law

12. Pursuant to subsection 5 (1) of the Supplementary State Budget 2020 Act passed by the Riigikogu on 15 April 2020, support funds allocated from the supplementary budget may only be used for the purpose – to alleviate the crisis related to the coronavirus – and to the extent prescribed by the Supplementary Budget Act.

The Council of the Rural Development Foundation approved the terms and conditions of crisis measures before the Riigikogu approved the supplementary budget

13. On 8 April 2020, the Council of the Rural Development Foundation approved the terms and conditions of the financial measure for rural undertakings facing difficulties due to the coronavirus. In addition to amending the terms and conditions of the previous measure, the following new measures were approved: “guarantees for loans issued by the bank; working capital and investment loan for undertakings, and financial lease of arable land”.

14. The purpose of using the funds authorised in the explanatory memorandum of the supplementary budget pending at the Riigikogu had changed – a very clearly targeted working capital loan had been converted into working capital and investment loans. At the second reading (13 April 2020) and third reading (15 April 2020) of the draft legislation of the Supplementary Budget Act, the support measure continued to be heard as a working capital loan.

15. Although after the adoption and announcement of the supplementary budget, the Ministry of Rural Affairs expressed in its press release of 17 April 2020 that the measures of the Rural Development Foundation to be implemented are in accordance with the adopted supplementary budget, preparations for the loan measures approved by the Council of the Rural Development Foundation continued at the operational level.

Working capital loans authorised in the supplementary budget became a measure for new working capital and investment loans and refinancing the existing working capital and investment loans

16. According to the Government’s decision, all the more detailed terms and conditions of crisis measures were to be submitted to the meeting of the Cabinet of Ministers for approval. In the description of crisis measures submitted to the Cabinet of Ministers of 24 April 2020 of the Ministry of Rural Affairs, the measure is no longer presented as granting of working capital loan, but as a loan measure that also enables granting an investment loan in addition to the working capital loan to bio and rural economic operators.

For your information

One of the objectives of the Rural Development Foundation is to support and rejuvenate business in the Estonian rural areas by creating better opportunities for access to the funds and improving the competitiveness of rural entrepreneurship.

Source: Clause 2.1 of the articles of association of the Rural Development Foundation

For your information

A number of crisis measures intended for helping undertakings facing difficulties were commenced with already in March, for example:

- For example, wage compensation offered by the Estonian Unemployment Insurance Fund from which more than 17,500 institutions have received help with a total amount of compensations over 250 million euros
- Measure for the postponement of tax arrears and interest exemption of the Tax and Customs Board

Source: Tax and Customs Board, Estonian Unemployment Insurance Fund

As at 18 September 2020, the Rural Development Foundation had issued working capital loans in an amount two and a half times lower than investment loans

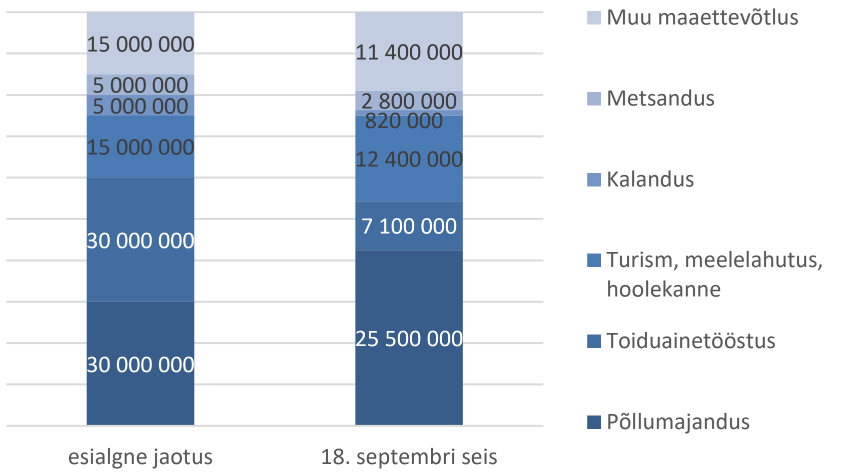
17. On 7 May 2020, the Government of the Republic authorised the Ministry of Rural Affairs to increase the foundation capital of the Rural Development Foundation and to enter into a respective financing agreement. If the supplementary budget approved by the Riigikogu specified the implementation of the working capital loan measure as the objective, the loan agreement was given the following purpose in accordance with the draft financing agreement appended to the draft legislation:

- New working capital and investment loans for overcoming losses caused by the COVID-19 outbreak
- Refinancing of existing working capital and investment loans (excl. owner's loans) the need for which is due to the COVID-19 outbreak

18. As offering favourable investment loans and refinancing existing loans came to the fore, working capital loans have been granted in an amount two and a half times lower (17.1 million euros) than investment loans (42.9 million euros) as at 18 September 2020. However, liquidity problems caused by the crisis should have been resolved foremost by grating working capital loans, because the Riigikogu had allocated funds with the supplementary budget for this precise purpose. The need for a working capital loan is also confirmed by the overviews prepared by the Bank of Estonia, which analyse the turnover of loans and leases issued to companies by credit institutions.

19. Compared to the normal situation, active application for money took place due to the more favourable loan conditions. Compared to the approximate industry-based distribution of loan funds that the Ministry of Rural Affairs introduced at the committees of the Riigikogu and to the Government of the Republic, the circle of borrowers is very wide and the largest recipients of investment loans are related to tourism, entertainment and welfare services (see Figure 1).

Figure 1. Total loan decisions (investment and working capital loan), in euros



Source: Rural Development Foundation

For your information

Before the Ministry of Rural Affairs tightened the terms and conditions of the loan measure of the financing agreement no. 121 of 16 June 2020, several major loan agreements had already been entered into:

- Tulik Invest 3.4 million euros
- Liikva Päikesekodu 2.5 million euros
- DGM Shipping AS 1.92 million euros
- Kingstor AS 1.26 million euros

EMTAK – Classification of Estonian economic areas of activities

20. As at 18 September 2020, the largest recipients of investment loans were, in addition to bioeconomy, also related to sports activities as well as amusement, recreation and entertainment undertakings (4.8 million), welfare institutions (2.5 million), accommodation establishments (3.7 million), energy companies (2 million), wood processing companies (1.8 million euros) (according to the EMTAKi classification).

21. At the same time, few working capital loans were issued in these fields. In the food industry, there are twice as many investment loans as working capital loans (4.5 million and 2.4 million euros, respectively), and in agriculture, decisions on the working capital loan have been made to the extent of 8.6 million euros and on investment loans to the extent of 17.1 million euros.

Upon using financial instruments offered by the state, the general principle is that loans are primarily offered when the state's guarantee is not sufficient or not available, but in the case of the measure of the Rural Development Foundation, the emphasis is on offering the loan

22. The wording of the explanatory memorandum of the Government of the Republic Regulation of 28 April 2020 "General terms and conditions of support measures for alleviating the impact of the crisis related to the spread of the coronavirus causing the COVID-19 disease and the emergency situation arising therefrom" gives rise to the interpretation that the implementers of financial instruments should be guided by the principle that the state itself offers loans only when the state's guarantee is not sufficient.

For your information

According to the Tax and Customs Board, there were more than 140,000 taxpayers in the second quarter of 2020.

According to the Ministry of Finance, more than 23,000 persons have received crisis support, of whom more than 17,000 have received help from the measure of the Estonian Unemployment Insurance Fund.

To date, 196 persons have been supported through the Rural Development Foundation.

23. There is also a real reason for this, as the state's financial means and ability to intervene in the economy are limited. The explanatory memorandum of the Regulation referred to specifies the following:

> „In order to make state support available to as many undertakings in the target group as possible, instruments must be used in an order that ties up public resources as little as possible. Therefore, where appropriate, the first measure of state support should always be a guarantee or security. If the undertaking is not able to receive a loan with the guarantee or security of an organisation representing the state at reasonable terms, loans may be implemented as the next support measure in line."

24. The explanatory memorandum also emphasises the following:

> "The state must also make sure that it does not crowd out private sector financiers or harm the market with its instruments. To this end, the implementer of the measure must be satisfied that the applicant has made use of all the reasonable opportunities to finance their activities as normal. State intervention may also be justified in a situation where the contribution of traditional financiers only partially covers the financial needs of the applicant and the state participates in the co-financing jointly with the private sector. As it is

very difficult to predict the duration of the economic crisis caused by the emergency situation and the spread of the COVID-19 disease in the world and the time needed to recover from the crisis, it is also very difficult to establish the correct periods for financial instruments. At the same time, the users of financial instruments should be fully encouraged to return to traditional financing measures."

For your information

Receiving long-term loans recovered in July, and lending did not become more expensive for companies during the crisis.

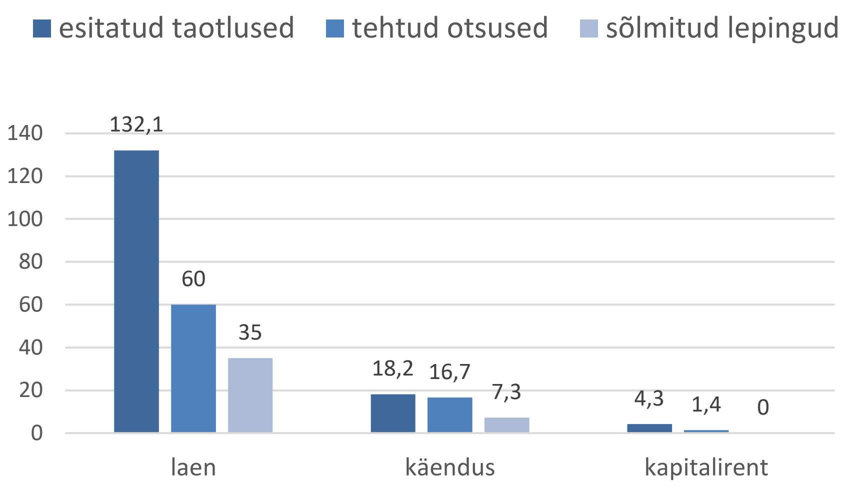
25. Contrary to the concept of the explanatory memorandum of the general regulation of the Government of the Republic, the Ministry of Rural Affairs and the Rural Development Foundation indicated that, in addition, loans to be issued pursuant to the Rural Development Plan will also become more favourable for undertakings to alleviate the impact of the coronavirus, both in the case of loan agreements that have already been entered into and new loan agreements.

26. At the same time, the overview of the monthly turnover of loans and leases prepared by the Bank of Estonia shows that loan volumes in trade and agriculture have remained the same or have even increased (excl. annual comparison of June), but a greater decrease in turnover (2–3 times) compared to the time before the crisis and the previous years can be seen in the transport sector, industry, and other sectors. As of July, the volume of turnover has increased sharply in all sectors compared to the previous period.

The volume of loan applications considerably exceeds the budgetary opportunities granted to the Rural Development Foundation

27. As a result of all this, as at 18 September 2020, considerably more loans have been applied for from the Rural Development Foundation than funds available in the budget for this purpose (see Figure 2). The 50 + 50 million euros intended for guarantees and financial leases have been used to a lesser degree.

Figure 2. Loan applications submitted, decisions made, and agreements entered into as at 18 September 2020, in millions of euros



Source: Rural Development Foundation

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Response of the Minister of Rural Affairs to the overview of the National Audit Office and comments of the National Audit Office

On 23 September 2020, the Minister sent their response to the overview of the National Audit Office.

Response of the Minister of Rural Affairs to the overview of the National Audit Office and comments of the National Audit Office

The brief overview of the National Audit Office has been prepared within the framework of the audit “Economic effect of crisis measures” and explains the motives and the purpose of selecting these crisis measures of the Rural Development Foundation for implementation, which results have been achieved in five months, and whether the funds have been used purposefully when providing further alleviation to the crisis caused by the coronavirus through the supplementary budget.

We are hereby drawing the attention of the National Audit Office to the following topics raised in the brief overview:

1. Purposefulness of the crisis measures of the Rural Development Foundation

In its brief overview, the National Audit Office has taken the position that the purpose of measures intended for alleviating the crisis is resolving liquidity problems based on the supplementary budget and that according to the Supplementary Budget Act, measures intended for alleviating the crisis related to the coronavirus may only be implemented for the purpose and to the extent prescribed in the Supplementary Budget Act.

According to the explanatory memorandum of the draft legislation of the Supplementary Budget Act initiated by the Government of the Republic,
“*the Government of the Republic approved at the meetings of the Cabinet of Ministers of 19 March and 1 April the economic measures related to the spread of the coronavirus* ***with the objective of mitigating losses, stimulating the economy, and accelerating recovery from the crisis***“. **Thus, the objective of the crisis measures approved by the Government of the Republic is broader than just resolving liquidity problems**; in addition to adapting to the crisis, rejuvenating the economy and recovery from the crisis is considered important.

> **Comment of the National Audit Office:** In its response, the Ministry of Rural Affairs has referred to the introduction of the explanatory memorandum of the Supplementary Budget 2020 regarding the preparation of the draft legislation. In the same paragraph of the introduction, it is stated that a 2 billion euro package of measures, which includes both grants of KredEx, Enterprise Estonia, Rural Development Foundation, and the Estonian Unemployment Insurance Fund as well as sickness benefits and tax incentives, is intended for the implementation of the objective specified by the Minister of Rural Affairs. Every institution and measure certainly plays a role in resolving problems caused by the crisis with their specific objectives and budgets. In its overview, the National Audit Office narrowly addresses the area of government of the Ministry of Rural Affairs, regarding which explanations are provided in the section of the explanatory memorandum concerning the Ministry of Rural Affairs, which provides an overview of the amounts to be allocated to the Ministry from the supplementary budget and the purpose of using thereof. This section clearly sets out the purpose of using the funds of the supplementary budget – recovery from the crisis as quickly as possible and alleviating the negative impacts of the crisis – by offering both working capital loans and a rural capital measure for overcoming liquidity problems caused by the coronavirus.

2. Extent of the crisis measures of the Rural Development Foundation

According to the overview, funds are being allocated through a measure that does not correspond to the objective approved by the Riigikogu. The National Audit Office is of the opinion that according to the documents of the supplementary budget, the plan was to grant working capital loans to rural companies to resolve liquidity problems caused by the coronavirus and according to the financing agreement entered into between the Ministry of Rural Affairs and the Rural Development Foundation, the original content and scope of the measure has been significantly extended by granting working capital and investment loans instead.

A detailed list of crisis measures by areas of government is provided in appendix 1 to the explanatory memorandum of the supplementary budget, according to which the following measures are implemented in the area of government of the Ministry of Rural Affairs:

Area of government of the Ministry of Rural Affairs / Rural Development Foundation

- Guarantees for loans issued by banks, increase of the guarantee reserve, and reduction of guarantee fees (Rural Development Foundation)
- Working capital loan and investment loan for undertakings (Rural Development Foundation)
- Sale and lease-back transactions of arable land (financial lease) Fund for specific purposes Rural Capital (Rural Development Foundation)
- Replacement service for agricultural producers

As such, the granting of working capital and investment loans in the area of government of the Ministry of Rural Affairs corresponds to both the objective and scope of the supplementary budget.

> **Comment of the National Audit Office:** The section “Budget of the area of government of the Ministry of Rural Affairs” of the explanatory memorandum of the supplementary budget specifies the measures allocated to the Rural Development Foundation in the total amount of 200 million euros as follows:
>
> 1. Loan guarantee, total budget 50 million euros. Loan guarantees for loans issued by commercial banks are granted to the agricultural and food industry and rural undertakings.

2. **Working capital loan, total budget 100 million euros.** Working capital loan is offered to undertakings operating in rural areas to overcome liquidity problems caused by the coronavirus.

3. Rural capital, total budget 50 million euros. Owners of arable land are offered sale and lease-back transactions of arable land (financial lease) to overcome liquidity problems caused by the coronavirus.

The breakdown is exhaustive, and in addition to the working capital loan, no other purpose has been referenced with regard to the budget allocated to the Ministry of Rural Affairs, nor has appendix 1 to the explanatory memorandum been referred to. The Minister of Finance also said when introducing the budget at the session of the Riigikogu that the funds would be used for working capital loans. Appendix 1 to the explanatory memorandum provides budgetary technical information regarding the impact of various measures on the budgetary position, and the name of the measure provided therein is “working capital loan and investment loan for undertakings (Rural Development Foundation) with an impact of 30 million”. The title of the measure provided in appendix 1 includes the term “investment loan” in addition to working capital loan, but according to the explanation of the section of the explanatory memorandum regarding the budget of the area of government of the Ministry of Rural Affairs, no funds are intended for investment loans.

The National Audit Office points out that we are not saying in our overview that using the funds for purposes other than those specified in the explanatory memorandum is illegal. This is because the explanatory memorandum is not legislation. We are pointing out that the Riigikogu has been misinformed in the budgetary process and the use of the funds may not be in accordance with the understanding or intention of the Riigikogu.

3. Market failure in financing agricultural, food industry and rural companies

According to the overview of the National Audit Office, it is not clear what outcome and what impact is intended to be achieved with the measures of the Rural Development Foundation and how is this related specifically to the problems caused by the coronavirus that private credit institutions would not be able to resolve. In its overview, the National Audit Office refers to the face that loan interests remained during the crisis period and the recovery of loan volumes from the middle of the year.

Various surveys* confirm that the financing of agricultural, food industry and rural companies faces a market failure in Estonia even under normal conditions. **The experience of implementing crisis measures by the Rural Development Foundation shows that the current market failure has intensified under the crisis conditions.** Great interest in the loans of the Rural Development Foundation confirms the existence of a market failure – banks are not willing to grant loans, which is why the burden falls on debt facilities. Insofar as banks are very conservative in issuing loans under the crisis conditions, the demand for the guarantee of the Rural Development Foundation has also been lower.

* Preliminary assessment of the financial instrument of “Strategy Plan for Common Agricultural Policy 2021–2027” and “Implementation Plan of the European Maritime and Fisheries Fund 2021–2027”

* Financial needs in the agriculture and agri-food sectors in Estonia.

Comment of the National Audit Office: In its response, the Ministry of Rural Affairs is correctly pointing out that there are difficulties in financing rural undertakings even under normal conditions. However, it must be acknowledged that the market failure has not been general for rural business under normal conditions, either. For example, the strategy of the Rural Development Foundation for 2020–2030 approved at the beginning of 2020 provides that there are sufficient loan funds available on the market and the Foundation would therefore not be significantly developing their loan activity nor would it compete with banks in financing undertakings. As provided in the strategy of the Foundation, they are required to intervene where necessary, but do so with a very clear focus – whom to support and what activities to support by offering loan products. In the present case, the investment loan under favourable conditions has been made available to everyone without establishing more detailed and more thought-out criteria.

In its overview, the National Audit Office is emphasising that the state’s ability and opportunity to bring about real changes in the economy solely by involving the funds of the state budget is limited. Even more so, activities, particularly in crisis management, should be focused. It is clear even now that there is little ability to resolve such longer-term problems – this is evidenced by the small number of recipients of loan in comparison with the actual number of active undertakings, while the loan funds of 100 million euros allocated for the crisis through the Rural Development Foundation are running out and there is no clear plan regarding what will happen in the future.

Thus, the impact on resolving longer-term problems has not been achieved, and the alleged difficulties in financing companies will, in fact, remain the same as before. At the same time, a new wave of the crisis is on its way and the number of people who need assistance is likely to increase – in this current situation, it can be said that the crisis may also remain unresolved, i.e. positive impact may not be achieved. The fact that the crisis could have several waves and that it could last longer than just through the spring period was known already when the 100 million were planned for working capital loans in the supplementary budget.

4. Economic policy choices

The National Audit Office is of the opinion that investment loan may bring about the risk that the state has not resolved the crisis through the crisis measures but is acting with short-sightedness in the name of the crisis without having a significant effect or perhaps even having an adverse effect, given that companies are not being treated on equal grounds and the state’s ability to resolve subsequent crises is being reduced.

Liquidity means the “*ability of an economic agent to meet existing and new obligations*“ (Bank of Estonia). **The Ministry of Rural Affairs cannot agree that the crisis is being resolved with short-sightedness through investment loans.** On the contrary, the ability of companies to better cope with crises in the long run improves through investment loans. We have developed the measures based on the assumption that in addition to adapting to the situation, measures should help the companies to successfully recover from the crisis. While working capital loans help companies to cope with issues with cash flows caused by temporary difficulties and lack of working capital, **investment loans help companies to make their production more effective**

or change their business model and thereby reduce their cost base in the long run. This, in turn, ensures the liquidity of companies in the long term.

The current trend in Estonian business policy has been to prefer financial instruments to direct aid. As such, money is not distributed to companies through the measure of the Rural Development Foundation and instead, loans are issued or guarantees are given for loans. **This is repayable aid**, and the state can support companies and resolve crises in the future with the funds received back.

Comment of the National Audit Office: Well-targeted and intended investment loans certainly contribute to the development of the company, but linking investment loans to ensuring liquidity in the more distant future is related to the crisis very loosely and is a costly solution in terms of the budget that reduces the state's ability to help undertakings facing liquidity problems as the current crisis develops. In Estonia, current problems related to the coronavirus crisis are once again topical and demand attention right now.

The National Audit Office does not question the trends of business policy described by the Minister of Rural Affairs. Like the overview of the National Audit Office, the activities to be funded in the supplementary budget are aimed at resolving the crisis caused by the coronavirus. In its overview, the National Audit Office does not consider whether state support should be distributed as non-repayable aid or through financial instruments. In times of crisis, action must be quick and precise, using the most appropriate instruments for various target groups. It is important for the state to keep focus – if we try to resolve both short-term and long-term problems in the name of the crisis, we may end up with both unresolved.

In conclusion, the Ministry of Rural Affairs is of the opinion that under the crisis conditions, it is important to respond to the crisis quickly and flexibly. The measures of the Rural Development Foundation correspond to the objective and scope of the crisis package, resolve the market failure present on the market that has escalated due to the crisis, and help the companies to cope with crises better in the future.

Specification of the brief overview

Purpose of the brief overview

The brief overview has been prepared within the framework of the audit "Economic effect of crisis measures" and explains the motives and the purpose of selecting these crisis measures of the Rural Development Foundation for implementation, shows which results have been achieved in five months by implementing crisis measures, and whether crisis funds have been used purposefully by finding solutions for the crisis.

Scope and approach of the brief overview

The brief overview has been prepared using information submitted to the Government of the Republic by the Ministry of Rural Affairs that is available in the Supplementary Budget 2020 Act and explanatory memorandum submitted to the Riigikogu and using public information available on the websites of the authorities.

Date of completion of the brief overview:

18 September 2020

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Electronic copy (pdf) of the brief overview is available on the website www.riigikontroll.ee.

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