

TRANSITION FINANCING IN AGRICULTURE: BALTIC COUNTRY CASE STUDY

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Abstract

The sector of agriculture is one of the most crucial in the context of ensuring food security as well as in the care for sustainable development. The food security can be improved through several aspects, one of them being the agriculture system transition, implementing more and more regenerative measures. From the agriculture transition, due to the efforts needed to achieve the expected level of green transition, farmers themselves are expected to benefit less than the future society and nature in a whole. Yet both financial institutions and agriculture companies have not reached a common understanding, what requirements should be in place to establish mutually beneficial financial products to achieve the expected level of transition in a timely manner. The aim of this study is to evaluate funding options for agriculture transition in Baltic countries – Latvia, Lithuania, and Estonia. In total, for screening purposes, 29 different Banks operating in the Baltics were identified. The analysis of the financial product purposes provides a high-level perception, that loans, even if not indicating signs of support for green transition, may still support the improvements of overall country and society sustainability. The expert judgement was used to find potential links with the United Nations Sustainable Development Goals (UN SDGs) identifying the potential SDGs that could be tackled when providing the financing to the specific purpose. Only two banks are observed to provide financial products that can be assessed as focused on green transition, and this research shows that financial products for agriculture companies willing to transition to sustainability are not broadly available.

Key words: agriculture transition, sustainable financing, transition financing.

Introduction

With global trends for greenhouse gas emission (GHG) reduction, enforced by global targets like Paris Agreement, the GHG reduction is expected to be cascaded further across countries and sectors. In the European Union (EU), European Council has enforced a Climate Law within European Green Deal, providing a binding GHG emission reduction target to each member state (European Commission, 2019; European Parliament; European Commission, 2021).

To steer the sector of finance towards a greener and Paris aligned operations, European Central Bank (ECB) in 2020 published an ECB Guide on climate related and environmental risks (ECB, 2020), expecting banks to evaluate and implement measures focused on building banks' credit portfolios to be more resilient to potential climate and environmental risk materialization through their clients (ECB, 2020).

The sector of agriculture is one of the most crucial in the context of ensuring food security as well as in the care for sustainable development (Giller, Hijbeek, Andersson, & Sumberg, 2021). The food security can be improved through several aspects, one of them being agriculture system transition, implementing more and more regenerative measures (Bosma, Hendriks, & Appel, 2022). From the agriculture transition, due to the efforts needed to achieve expected level of green transition, farmers themselves are expected to benefit less than the future society and nature in whole (Bosma, Hendriks, & Appel, 2022; Reidsma *et al.*, 2023). It is recognized that the government-steered transition of large-scale agriculture system to sustainable and environmentally friendly practices, such as regenerative agriculture, cannot happen without private funding when scaled down on a company level transition (Green Finance Institute, 2023) as such a transition requires increased farmer knowledge, changes in used inputs, time

dedicated to implement transition measures and building resilience, and even the use of herbicides until a field-appropriate level of cover crop use is found by farmer (Bosma, Hendriks, & Appel, 2022; Mapanje *et al.*, 2023). Yet both financial institutions and agriculture companies have not reached a common understanding on what requirements should be in place to establish mutually beneficial financial products to achieve the expected level of transition in a timely manner (Green Finance Institute, 2023).

There have been several financial mechanisms offered together with loans from financial institutions to provide benefits to agriculture companies, such as lower interest rate margin or delayed pay-back time (Green Finance Institute, 2023), to help de-risk the transition period from the financial aspect, but even in these cases financial institutions expect agriculture companies to provide outputs on the same level as for conventional agriculture (Howard & Maness, 2022).

Another option to enable agriculture transition with the help of financial institutions would be to create specialized agriculture transition loans through the framework of sustainability-linked loans (SLL) that are specially developed in order to improve companies environmental, social and governance performance (LMA, APLMA, & LSTA, 2019; Orden & Calonje, 2022). In case sustainability-linked loans would be offered to agriculture companies for their business model transitions, farmers with credit institutions can agree on key performance indexes (KPIs) directly linked to the funded project, allowing the agriculture companies to set the KPIs they are confident about, meanwhile fulfilling all SLL requirements. Stemming from the nature of SLLs, this financing tool for agriculture transition more likely would be used in the first phases of agriculture transition, driven by farmers keen on implementing sustainable practices (Bosma, Hendriks, & Appel, 2022).

As the need for green transition in agriculture becomes more crucial, the offers for transition focused funding should start to appear. To build a base knowledge about offered funding options for agriculture transition in Baltic countries – Latvia, Lithuania, and Estonia – authors have gathered and analysed publicly available information about offered private funding possibilities from credit institutions in Baltics as of January 2024 focused on agriculture companies and their transition to low-carbon economy. The aim of this study is to evaluate funding options for agriculture transition in Baltic countries – Latvia, Lithuania, and Estonia.

Materials and Methods

The study was focused on financial institutions in Baltic countries. The list of credit institutions (hereinafter Banks) that are accredited to provide financing was obtained from Bank of Latvia, Bank of Lithuania, and Finance Inspection of Estonia (Finantsinspeksioon, n.d.; Latvijas Banka, 2018; Lietuvos Bankas, 2023).

In total, for screening purposes 29 different Banks operating in Baltics were identified, with a split between countries provided in Table 1. Four of the banks were identified as operating in all three Baltic countries, while three banks were identified as operating both in Latvia and Estonia.

Each bank indicated as operating in any of the Baltic countries were screened for the financial products offered to the banks business customers. The banks that are operating in more than one Baltic country, were screened for products in each of the country it is operating to ensure inclusion of country-specific financial products for agriculture companies if such differences were identified. The screening of the financial products was performed on 18th of January and 31st of January. Throughout the screening process authors were assessing the offered products through answers on the following questions:

1. Does the bank have a financial product focused on agriculture customers?
2. What is the focus of the financial product to agriculture customers (what are the main topics of the offered financial product)?
3. If financial product focused on agriculture

customers, is this product focused on company transition?

4. Does the product description indicate (also indirectly) that the product could be classified as SLL?
5. Are there listed any specific requirements that need to be fulfilled before granting the loan or throughout the period when loan is active?

The obtained data is summarized and quantified. After the screening of the first question, for further analysis from the initial number of 29 banks, 22 were excluded as it was not indicated that the bank provides a financing product dedicated specifically for agriculture companies. In total, 8 financial products of 7 banks were screened further for the questions two to five. Information for the second question was gathered for all financial products. The information about each financial product gathered through the second question is used as an input basis to obtain answers for questions three and four. If through questions three and four any indications, even partial, are gathered that the financial product is or might be focused on transition or the financial product could be classified as SLL or focused on green transition, answers to the fifth question shall be obtained. Only three financial products were screened for the final question. The screening results are represented separately for each Baltic country to cover the full scope of financial product availability for agriculture companies.

The obtained screening results are summarized based on two groups: i) results on available financial products with a focus on green transition or the product that can be classified as SLL and ii) results of focus or theme of the financial product.

The expert judgement was used to find potential links with the United Nations Sustainable Development Goals (UN SDGs) identifying the potential SDGs that could be tackled when providing the financing to the specific purpose.

Five experts from five different fields: banking sector; agricultural sector; science and research sector; food processing sector and local municipality, were involved. For each financial product the SDG were included in the list if at least three experts mentioned this SDG.

Table 1

Credit institutions operating in Baltic countries				
Country or geographic coverage	Total number of Banks	Number of operating only in this country	Number of banks operating in two Baltic countries	Number of banks operating in three Baltic countries
Lithuania	13	9	0	4
Latvia	14	7	3	
Estonia	13	6		

Results and Discussion

In the study, 29 financial institutions operating in Baltic countries were screened, in total, identifying eight financial products offered by seven financial institutions

focused specifically on agriculture customers. From the identified products none of them were country-specific; therefore, further all identified financial products for agricultural customers were assessed as unique, even if

offered in all three Baltic counties, see 'Figure 1'. When screened if the financial product could be dedicated to green transition or if the product could be classified as sustainability linked only three products were identified as showing signs, even partially, of being dedicated to green transition. The availability of specialized financial products for agriculture was found to be three times lower

compared to initial list of financial institutions screened for the study. Eight financial products are available in all three Baltic countries with five or six possible agriculture financial products per country. In the Baltics, during the time of the study only two banks were offering in total three financial products for agricultural transition.

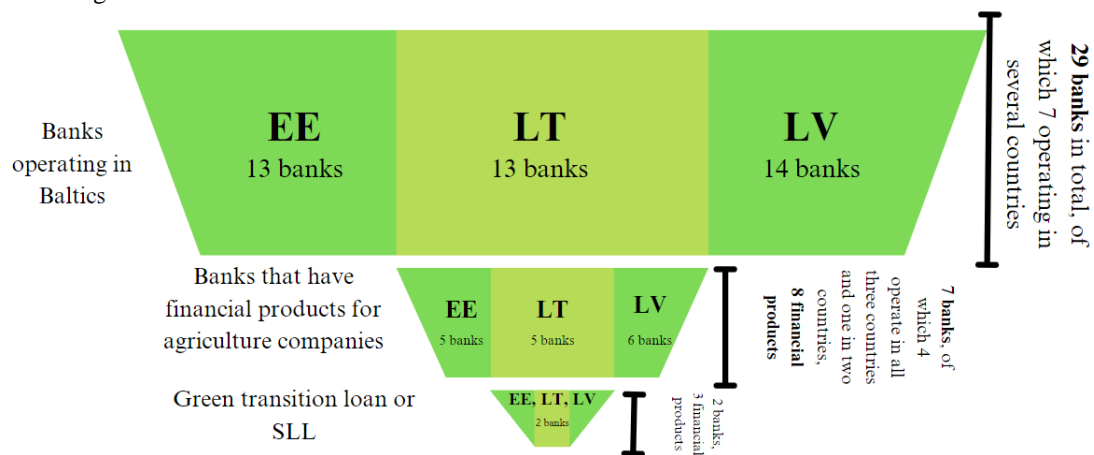


Figure 1. Financial product availability for agriculture customers in Baltics.

The country specific split of agriculture financial products focused on green transition and other financial products for agriculture companies is provided in 'Figure 2'. Even more, from these three loans only one financial product requires to provide additional information to financial institution to receive the loan, yet no information in available resources identified if there are requirements in place

to report KPIs throughout the period, when loan is active.

The loan purposes, collected from information about financial products in Baltics dedicated to Agriculture customers, indicate that these loans still could tackle issues covered by UN SDGs. The analysis shows that agriculture financial products can be granted for seven different purposes as indicated in 'Figure 3'.

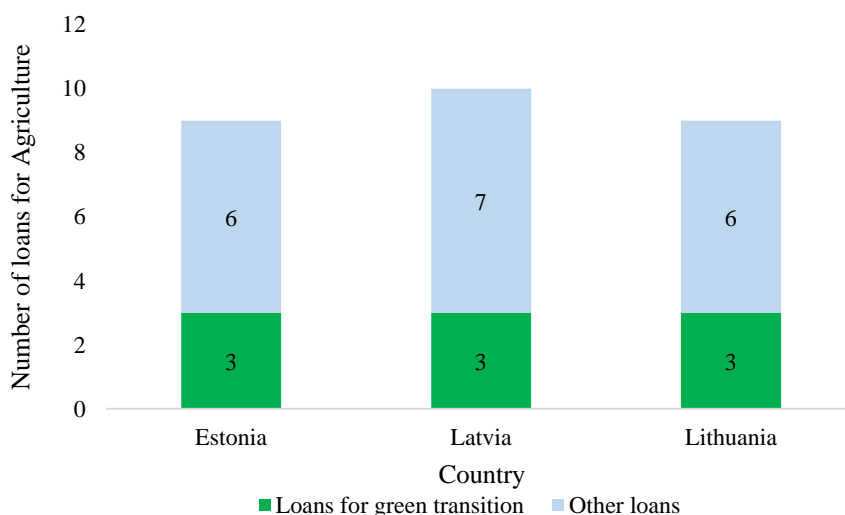


Figure 2. Availability of green transition financial products compared to other agriculture financial products per Baltic country.

The study identified that the offered financial products potentially could tackle in total thirteen out of seventeen SDGs, even though these links cannot be observed in the product offering (except for financial product for afforestation where clear green transition loan offering is observed). Zhao and Duan (2023) in their research highlight key governmental elements: involvement of

the modernization and expansion of the financial system, the revision of national efficiency measures, and the establishment of a technological long-term infrastructure marketplace (Zhao & Duan, 2023).

The results obtained through the study show that although the green transition loans or SLLs in agriculture sector are not broadly accessible at the time

the study was conducted, the financial products available for agriculture companies still do tackle the issues regarding transition to green or more sustainable business models and wider improvements regarding sustainability in the society. Further research is needed to analyse the available financial products more thoroughly in order to gain greater understanding of the real coverage of transition financial products. Additional research is needed to investigate the need of agriculture companies for green transition financial products, more concrete transition financial product

purpose and what requirements they would like to see in the transition products to enhance the achievement of their set goals through provided financing. The performed study in future can be compared to offered products both at the time the next study is performed as well as the products available at the time of this study performance, to conclude, if the offering of green transition and other financial products for agriculture companies meets the user demand, and what, if any changes, can be observed in the financial product offering to agriculture companies.



Figure 3. Financial product purposes and the SDGs they tackle.

Conclusions

1. The topic of green transition is still relatively new. Although there have been studies performed to understand the principles of SLLs, less research has been performed studying SLLs when financing transition in agriculture.
2. About one third of Baltic financial institutions offer specialized financial products for agriculture companies, yet only two banks are observed to provide financial products that can be assessed as focused on green transition, ensuring that financial products for agriculture companies willing to transition is not broadly available.
3. The analysis of the financial product purposes provides a high-level perception that loans, even not indicating signs of support for green transition, may still support the improvements of overall country and society sustainability.
4. Further research is needed to understand the demand for green transition needs in agriculture sector, the potential requirements agriculture companies would agree to and compare to the current offering of the green transition and other financial products for agriculture companies.

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