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05 | 2014

The Investment Plan for Europe

Leveraging three Facts to five Recommendations

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On November 26th 2014, the EU-Commission presented a € 315 billion Investment Plan for Europe, which is to boost growth and create jobs within the next three years.

This cep**Input**

- identifies 3 facts on the question whether private and/or investment in Europe (and especially in the Eurozone) is suboptimal;
- analyses the Investment Plan for Europe, as proposed by the EU-Commission in late November 2014 and
- formulates five recommendations to be taken into account when further specifying the Investment Plan for Europe in the months to come.

Essentials

Investment Plan for Europe:	With its "Investment Plan for Europe", the European Commission intends to trigger investment of up to € 315 billion. The plan is based on three pillars: (1) The establishment of a European Fund for Strategic Investments (EFSI) (2) The establishment of an investment advisory hub" at the European Investment Bank (3) Greater regulatory predictability.
Fact1:	Net private investment cannot said to be low in all Member States of the Eurozone. Moreover, in a number of Member States levels of investment have been unsustainably high, causing high indebtedness, which now needs correction. Falling net public investment mirrors public budget constraints, after very high levels of public spending in some countries.
Fact 2:	We know very little about the current state of Member States' capital stock and infrastructure. Typically used investment data does not allow us to diagnose upfront the need for investment.
Fact 3:	The starting point of the Commission's Investment plan is the assumption of an "investment gap" in Europe. However, there is no such thing as an "optimal investment ratio". Given many unknown factors and interdependencies and due to large differences between Member States in terms of economic maturity or structure, calculating "investment gaps" is pretending to be in possession of knowledge which is simply not available.
Recommendation 1:	Policy makers should earmark € 8 billion in the EU-Budget to serve as EU-guarantee to the EFSI.
Recommendation 2:	Policy makers should attempt to limit potential losses of the EFSI to max. € 21 billion[1] by paying special attention to the use of EFSI guarantees. However, there is only one way to avoid EFSI losses affecting Member States' budgets in all cases: The EIB should issue bonds with a contract clause entailing that creditors will be serviced only as long as EFSI losses do not exceed € 21 billion.
Recommendation 3:	The EU-Commission should self-commit itself to fully apply EU-state aid law both to investment projects which profit from EFSI support only and to projects profiting from additional national financial support.
Recommendation 4:	An investment advisory hub at the EIB might add to investors' efforts in identifying useful investment projects. The "credibility label" for European investment projects risks becoming non-credible when the label is a precondition for EFSI-financing.
Recommendation 5:	It is indispensable to increase legal certainty in European and Member States' regulation. This is a cheap and very effective way of removing barriers to investment.

[1] Alternatively, to max. € 13 billion, if recommendation 1 has not been accepted.

Kernpunkte

Investitionsplan für Europa:	Die Kommission hat einen "Investitionsplan für Europa" vorgelegt, der Investitionen von 315 Mrd. Euro auslösen soll. Der Plan basiert auf: (1) Die Einrichtung eines Europäischen Fonds für strategische Investitionen (EFSI) (2) Die Einrichtung einer Investitionsberatungsstelle bei der Europäischen Investitionsbank (3) Die Verbesserung des Investitionsklimas.
Fakt1:	Die privaten Nettoinvestitionen können nicht in allen Euro-Staaten als niedrig angesehen werden. Darüber hinaus waren Investitionen in der Vergangenheit in einer Reihe von Mitgliedstaaten nicht nachhaltig, was zu einer hohen Verschuldung geführt hat, die jetzt einer Korrektur bedarf. Abnehmende öffentliche Nettoinvestitionen spiegeln die Grenzen öffentlicher Haushalte wider, nachdem die öffentlichen Ausgaben in einigen Ländern sehr hoch waren.
Fakt 2:	Wir wissen sehr wenig über den aktuellen Zustand des Kapitalstocks und des Infrastrukturbestands der Mitgliedstaaten. Gängige Investitionsdaten erlauben es uns nicht, ein eindeutiges Urteil über die Notwendigkeit von Investitionen zu fällen.
Fakt 3:	Ausgangspunkt des Investitionsplans der Kommission ist die Annahme einer "Investitionslücke" in Europa. Allerdings gibt es keine "optimale Investitionsquote". Angesichts vieler unbekannter Faktoren und Zusammenhänge und aufgrund der großen Unterschiede zwischen den Mitgliedstaaten bezüglich ihrer wirtschaftlichen Reife oder Struktur, geht die Berechnung von "Investitionslücken" von Wissen aus, das schlicht nicht existent ist.
Empfehlung 1:	Politische Entscheidungsträger sollten die 8 Milliarden Euro, die als Garantie der EU für den EFSI dienen sollen, im EU-Haushalt reservieren.
Empfehlung 2:	Entscheidungsträger sollten versuchen, die potenziellen Verluste des EFSI auf max. 21 Mrd. Euro[2] zu begrenzen, indem sie das Aussprechen von Garantien durch den EFSI kritisch verfolgen. Allerdings gibt es nur einen Weg um zu vermeiden, dass Verluste des EFSI auf die Haushalte der Mitgliedstaaten durchschlagen: Die EIB sollte Anleihen mit einer Vertragsklausel begeben, die vorsieht, dass Gläubiger nur so lange bedient werden bis die Verluste des EFSI 21 Mrd. Euro übersteigen.
Empfehlung 3:	Die EU-Kommission sollte das EU-Beihilferecht vollständig anwenden, und zwar sowohl für Investitionsprojekte, die nur von EFSI-Unterstützung profitieren, als auch für Projekte, die zusätzlich national unterstützt werden.
Empfehlung 4:	Die Investitionsberatungsstelle bei der EIB kann Investoren bei der Identifizierung nützlicher Investitionsprojekte helfen. Das „Glaubwürdigkeitslabel“ für europäische Investitionsprojekte droht aber unglaubwürdig zu werden, wenn das Label zu einer Vorrausetzung für EFSI-Unterstützung wird.
Empfehlung 5:	Es ist unbedingt erforderlich, die Rechtssicherheit in einer Vielzahl europäischer und nationaler Vorschriften zu stärken. Das ist eine kostengünstige und sehr effektive Art und Weise, um Hemmnisse für Investitionen zu beseitigen.

[2] Wird Empfehlung Nr. 1 nicht umgesetzt, sollte der Betrag maximal 13 Mrd. Euro betragen.

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1 Introduction

Already in the run-up to the European elections, Jean-Claude Juncker committed to putting in place an investment plan for Europe, amounting to over € 300 billion. Haven taken up the office of President of the EU Commission, he commissioned Vice-President Katainen to put forward such an investment plan as soon as possible.

Following the European elections, the European Council confirmed in June 2014 the "overdue investment needs in transport, energy and telecom infrastructure as well as investments in energy efficiency, innovation and research, skills, education and innovation". [3]

The discussion on additional investments in the European Union reached its peak with France addressing Germany to invest more to speed up the stalling economy. The Eurozone's finance ministers expressed confidence that Germany will use its fiscal possibilites for additional public investments. Eurogroup President Jeroen Dijsselbloem uttered the wish for financially sound Eurozone-members like Germany to increase their public investments.[4] Wolfgang Schäuble, the German Finance Minister, subsequently announced an additional € 10 billion investment plan between 2016 and 2018 in Germany.[5] Sigmar Gabriel, the German Minister of Economic Affairs, proposed to invest this amount in infrastructure projects and in tax incentives for private investments.[6] Within the context of the G-20 meetings in Australia in Mid November 2014, US Treasury secretary Jack Lew warned European policy makers to do more to avoid a "lost decade" with very low economic growth. Especially Germany and the Netherlands are urged to invest more and save less to mitigate the risk of a long term downturn of the European economy.

This cepPolicyContribution (1) looks into the question whether private and/or investment in Europe (and especially in the Eurozone) is suboptimal; (2) analyses the Investment Plan for Europe, as proposed by the EU-Commission in late November 2014 and (3) formulates five recommendations to policy makers to be taken into account when further specifying the Investment Plan for Europe in the months to come.

[3] https://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/143477.pdf, Page .3.
[4] http://uk.reuters.com/article/2014/11/06/uk-germany-economy-schaeuble-idUKKBN0IQ25R20141106.
[5] http://uk.reuters.com/article/2014/11/06/uk-germany-economy-schaeuble-idUKKBN0IQ25R20141106.
[6] https://www.boersen-zeitung.de/index.php?li=1&artid=2014214027&titel=Spart-Deutschland-Europa-kaputt?

2 The Problem: Too Little (Infrastructure) Investment in Europe?

2.1 Clear Figures

2.1.1 The Eurozone as Problem Area

Total gross investment (in constant prices) in the European Union has not recovered from the decline it experienced during the financial crisis in the year 2007 (see Figure 1). Using a very simplistic linear regression, the level of 2014 gross investment seems to be about € 220 billion below the expected level. More interesting than these numbers however is the fact that any **lack of investment seems to be a Eurozone phenomenon**. Non-Eurozone investment is stable, if not growing. The 2014 level of non-Eurozone investment is in line of historical expectations.

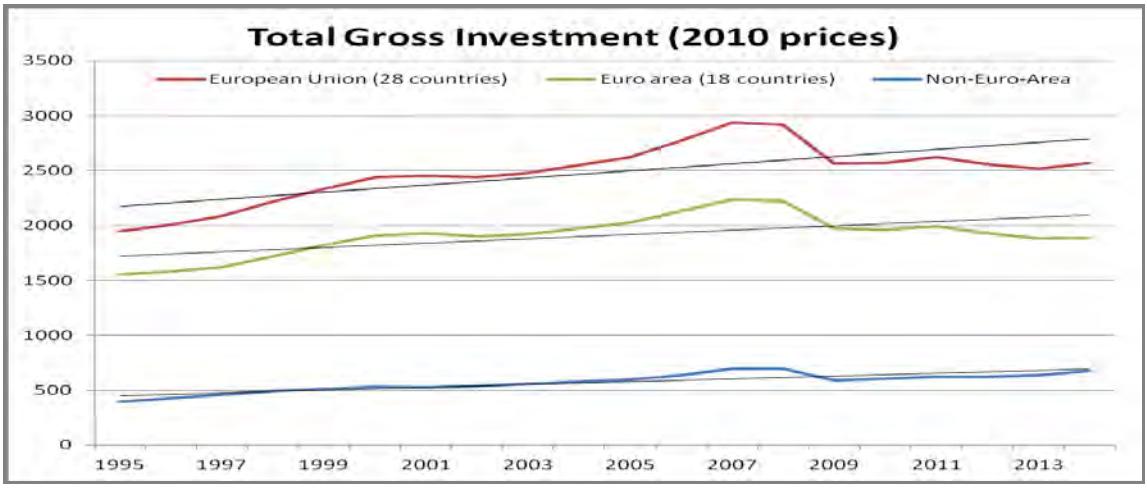

Figure 1: Total Gross Investment in the EU
(Source: Ameco)

Focusing on the Eurozone and relating gross investment to GDP, we see that **gross investment in the Eurozone is stable** at about 20 % of GDP since 2009 (Figure 2), with private investment being roughly five times as big as public investment. **Gross public investment is stable** in recent years, whereas gross private investment has steeply fallen in 2008 and has not fully recovered since.

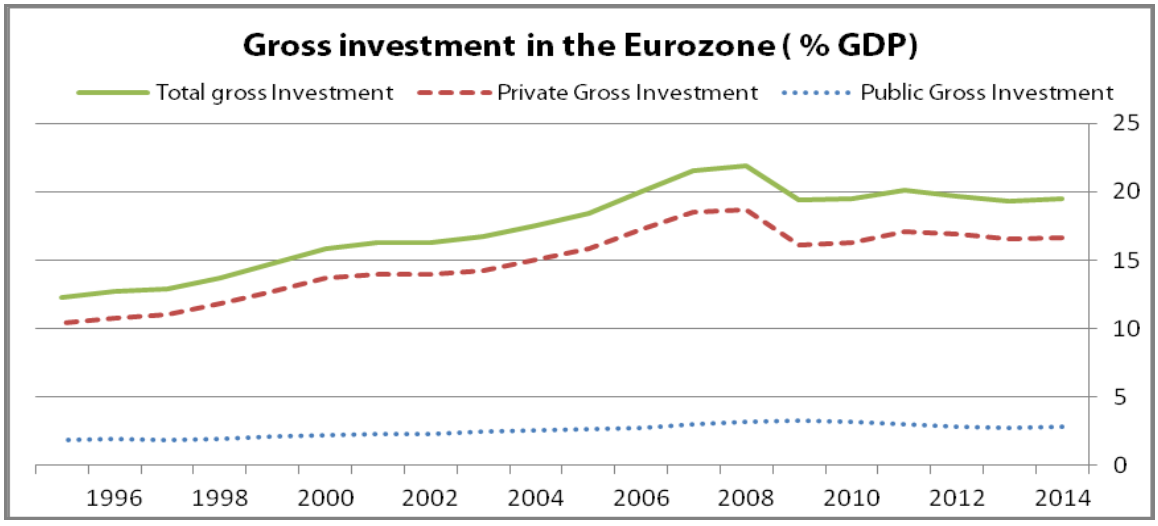

Figure 2: Total gross investment over time, Eurozone
(Source: Ameco)

Total net investment, taking account of the depreciation of the existing capital stock (Figure 3), gives us a more differentiated picture. In the Eurozone, both private and public net investment has plummeted since 2007 (for private) and 2009 (public) and **is still falling**. **Eurozone net public investment is close to negative**, meaning a real disinvestment by governments. **Net private investment currently is at** about 1.5 % of GDP, **the lowest level since the Euro's introduction**. Hence, the Eurozone's capital stock (related to GDP) is still growing on a net basis, but at an extremely slow pace.

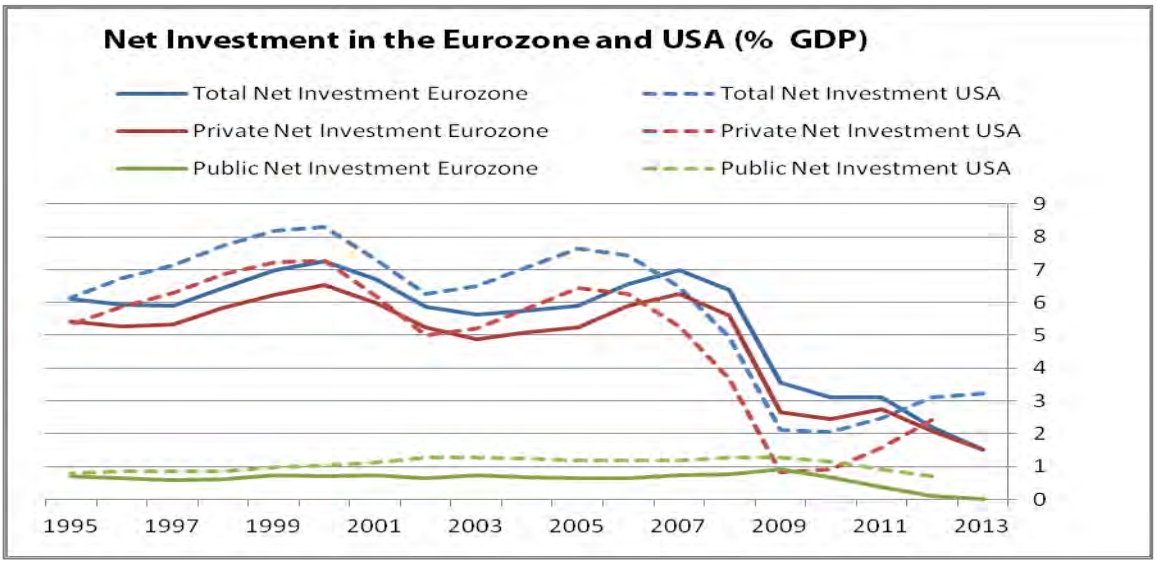

Figure 3: Net Investment over time, Eurozone and USA
(Source: Ameco)

US net investment shows a similar pattern as the Eurozone's. In the US, net private investment fell even more dramatically as it did in the Eurozone (up to today). However, **in contrast to the Eurozone, US private net investment has significantly risen since 2010.**

2.1.2 Special Focus on Infrastructure Investment

Insights on infrastructure investment are of special interest, given the focus of the Commission's efforts on infrastructure investment. Given definition and sector problems (see box), direct statistical data is not available due to the fact that infrastructure is not separately classified in national account statistics. As an imperfect proxy, we look at data on public investment, arguing that many infrastructure projects are publicly financed.

Figure 3 demonstrates a **downturn** in US net public investment, similar to the one in the **Eurozone**. However, US public investment is net clearly positive.

Infrastructure: Unclear Definition

In general, infrastructure is perceived as all long living facilities needed for the functioning of a society. Following this definition, investments in transport and communication systems, water and power lines as well as in schools and court buildings are investments in infrastructure. However, salaries for teachers or judges, are typically not included in statistical data on capital formation, which makes it hard to assess the *true* investments made in education or administration. Also, a sizable part of "classical infrastructure" such as telecommunication networks and power lines in Europe are in private property. As a result, focussing on statistical data on public investment does not give a perfect picture of real infrastructure investment.

Within the Eurozone, the history on **net public investment is very diverse** (Figure 4: Average Net Investment, split up in public and

private investment) with Germany showing very low net public investment and Ireland, Greece, Portugal and Spain showing the opposite.

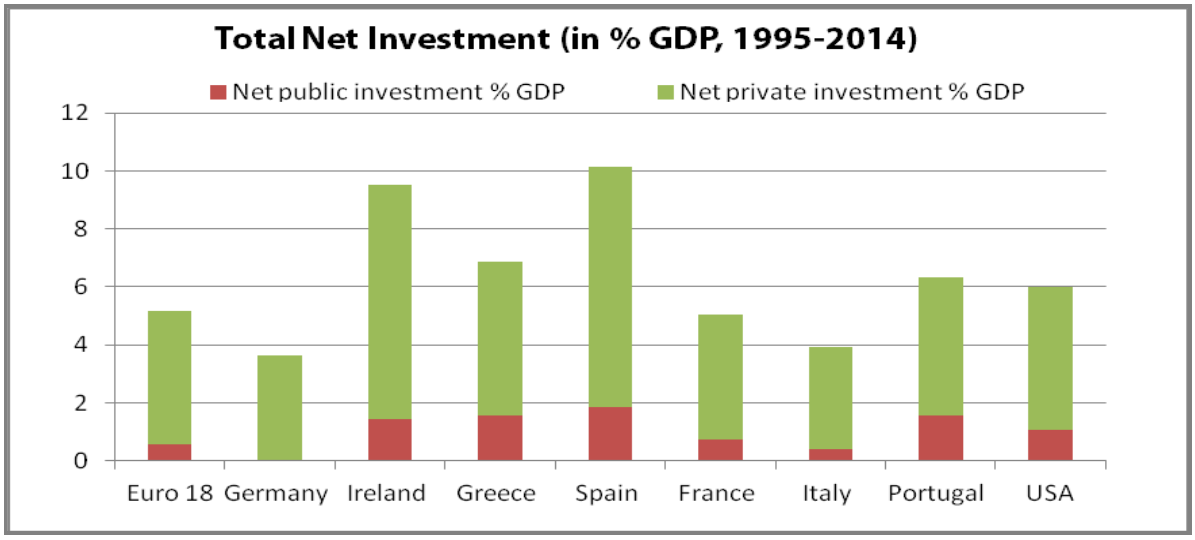

Figure 4: Average Net Investment, split up in public and private investment
(Source: Ameco)

2.2 No Easy Answers

Voices are numerous that low and falling figures on both private and public investment demonstrate a European "investment gap" and that counter-measures are necessary (see EU-Commission, IMF or Bruegel). Given historically low interest rates, higher debt-financed public investment in infrastructure is seen by some as a "no brainer".[7]

For three reasons elaborated upon below, we do not agree with the hypothesis of a European wide investment gap, which would make swift political reaction necessary.

2.2.1 Comparisons over Time and between Countries are Problematic

Undoubtedly, **private investment** in the Eurozone is sluggish with large deprecations on the existing capital stock causing very low net private investment.

However, we believe there is good reason to believe that the current level of investment should – at least in some countries – be seen as a correction of past inefficiencies. In fact, past investment bubbles in Spain or Ireland have been corrected, pulling Eurozone-wide private investment figures downwards altogether (Figure 5).

Those asking for strong investment incentives in post-bubble countries (Spain, Ireland) risk to focus on an incorrect benchmark. In those countries, past excesses in private investment caused a high level of indebtedness of private sector participants. For this reason, forcing private investment upwards in those countries might be difficult to finance from within those countries. Germany's net private investment is stable following a short dip in the financial crisis and is approximately on the same level since 2002. Hence, **at least for Germany, the diagnosis of a private investment gap seems premature.** Italy seems to be another story; with net private

[7] See Bruegel at: http://www.bruegel.org/nc/blog/detail/article/1457-infrastructure-investment-is-a-no-brainer/

investment falling since 2007 and negative since 2012.

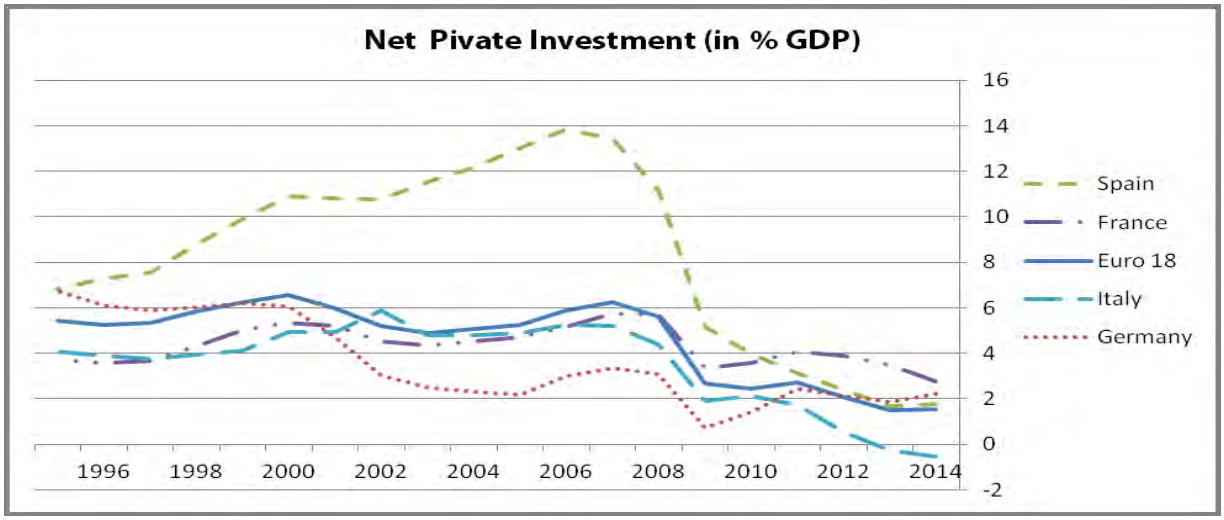

Figure 5: Net Private Investment over time, selected Member States
(Source: Ameco)

Focus on German Investment

In Germany the gross fixed capital formation amounted to € 554,045 Billion in 2013, which accounts for 19.7 % of GDP. 89 % of these investments were made by the private sector, corresponding to 11 % made by the public sector. In the long run, the overall German investment ratios show a downward trend. Only the reconstruction phase following World War II caused high investment ratios. This reconstruction phase ended in the 1960s to the 1980s, which is reflected in a decrease in investment ratios. The German reunification again triggered high investments, so that the investment rate rose to 23 % but decreased again during the 1990s. Since 2000 the German investment ratio remains below the average investment ratios of the Eurozone. This discrepancy can be explained by the introduction of the Euro and the subsequent capital exports by Germany to other countries of the Eurozone. These factors induced favourable investment conditions and led to a housing bubble in those countries of the Eurozone. This relative weakness of investment in Germany was removed by an improvement of investment conditions in Germany, by structural reforms and by consolidation policies. Focusing on private investments in equipment in relation to GDP shows that Germany is on the same level as the USA and is above average of the Eurozone.

Net public investment is homogenously low amongst Member States **and mirrors the current lack of capacities in public budgets.** In Spain, similar to net private investment, net public investment shows a sharp decline starting from very a high level of investment. Spain, Italy but also Germany show net negative public investment, hence pulling the Eurozone to an overall net public investment close to zero. At least for Germany, budget constraints do not explain the low level of net public investment.

Unless infrastructure investment is increasingly financed by private actors instead of by public investment, these low levels of net public investment are likely to have a negative effect on the future quality of infrastructure.

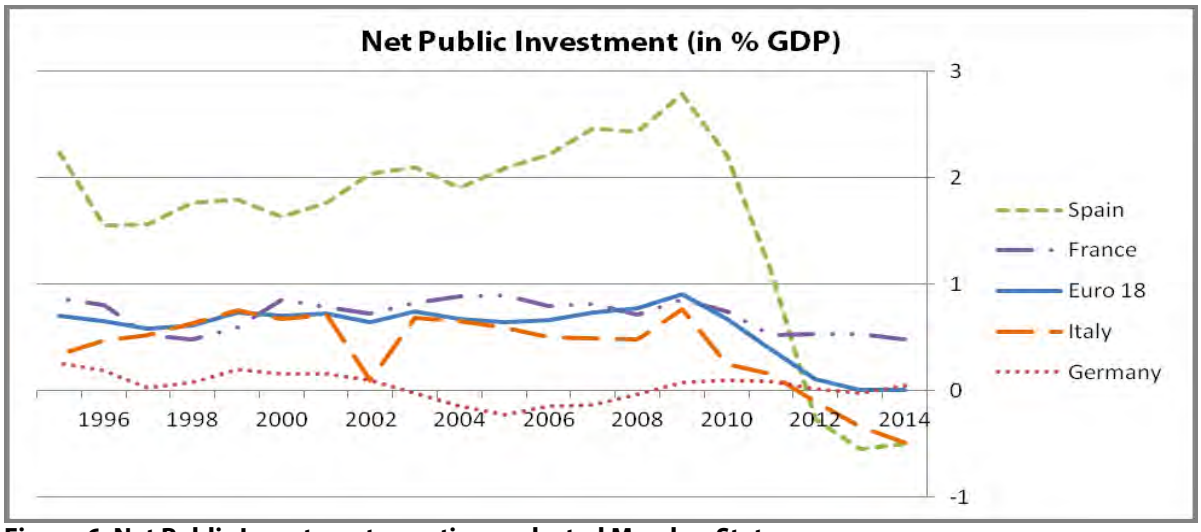

Figure 6: Net Public Investment over time, selected Member States
(Source: Ameco)

Fact 1: (1) Net private investment cannot said to be low in all Member States of the Eurozone. Moreover, in a number of Member States the fall of private investment should be seen as a downward correction from unrealistically high levels of investment. These went hand in hand with an increasing level of indebtedness, which now needs correction. (2) Falling public net investment mirrors public budget constraints after very high levels of public spending in some countries. Given the important role of public investment especially for infrastructure, this low level of investment might negatively affect the quality of infrastructure, at least in those countries which have not seen substantial investment in the recent past.

2.2.2 Lack of Knowledge about the Current Situation

Claiming that current investment is too low and that additional investment is necessary **makes sense only when having a reasonable view on the current status of the capital stock.** However, the **lack of adequate data does not allow us to have this view**.

The concept of depreciations allows us to look at net investment instead of gross investment. However, net investment data is very imprecise, as depreciations are applied on a general basis.

For example, depreciations do not take into account whether a road has been build on a useful spot or whether it is underused from the start on. Many of the investments in countries like Spain, which experienced an investment boom in past years are arguably not economically useful. This "dead" state of parts of the capital stock is however not reflected in net investment figures, which might hence be overly optimistic.

Neither can general depreciations take into account technological change. "Old-fashioned" copper phone lines, installed somewhere in the 1970s have been fully written down and where assumed to be close to useless for broadband data transport. However, new technologies such as VDSL-Vectoring suddenly allow broadband communication on these lines with minor additional investment only, making this assumed worthless infrastructure highly valuable again.

Looking at net investment data only would wrongly make one conclude that an investment gap were present or that the infrastructure of that Member State were fully out of date compared to that of a Member State with newly build fiber networks.

However, ignoring depreciations altogether and focussing on gross investment figures – as many do – is also not convincing, giving the long life span of (infrastructure) investments. Doing so is especially problematic in a European Union where Member States' infrastructure has been build at very different periods of time.

Fact 2: We know very little about the current state of Member States' capital stock and infrastructure. Typically used investment data does not allow us to diagnose upfront the need for investment.

2.2.3 The More, the Better? The Fairy Tale of the "Optimal Investment Rate"

Even if we were to have exact information on the current state of the capital stock, we are faced with the following problem: we simply do not know what level of capital stock is "optimal" and how many – let be, *which* – investments are economic beneficial. There is a huge amount of factors and interdependencies between the maturity of an economy and the investment rate, causing there to be no general calculation for an "optimal" investment ratio.[8]

Since EU-Member States differ in terms of economic maturity and in terms of industrialisation, there is no optimal investment rate at EU-level that meets the individual need for investments in every single Member State. Furthermore, the calculation of an optimal investment rate for even one economy is impossible given the impossibility to pre-define abstract criteria which optimise the functioning of a complex open economy. **Those claiming to know exactly *how much* should be invested *where*, pretend to be in possession of knowledge which is simply not available.**

Hence, we refute the concept of an "investment gap" as it starts from the wrong assumption of an all-knowing institution. In reality, every single investor makes its individual decision on the expected profitability of investments. That decision might prove right or wrong, but we will know so only ex-post.

Fact 3: The starting point of the Commission's Investment Plan (see below) is the assumption of an "investment gap" in Europe. However, there is no such thing as an "optimal investment ratio". Given many unknown factors and interdependencies and due to large differences between Member States in terms of economic maturity and structure, calculating "investment gaps" is pretending to be in possession of knowledge which is simply not available.

[8] Polster (1971), Zum Problem der optimalen Investitionsquote, Osteuropa-Institut München, Reihe: Wirtschaft und Gesellschaft; Duncker & Humblot Berlin

3 The Commission's Answer: An Investment Plan for Europe

In his mission letter to Jyrki Katainen, the Vice President of the EU Commission in charge for Jobs, Growth, Investment and Competitiveness, Jean-Claude Juncker ordered the swift elaboration of an investment plan, which should mobilise € 300 billion of **public and private investment** in the real economy.[9] Juncker and Katainen finally presented a € 315 billion investment plan to boost growth and create jobs within the next three years (2015–2017) on 26th November 2014.[10]

The investment plan is based on three pillars:

- The mobilisation of € 315 billion additional investments in a European Fund (EFSI),
- An investment advisory service located at the European Investment Bank (EIB) to ensure that the investment triggered by the Fund meet the needs of the real economy,
- Measures to provide greater regulatory predictability and remove barriers to investment.

3.1 The First Pillar: European Fund for Strategic Investments (EFSI)

In January 2015, the Commission will formally propose the establishment of a new Fund ("European Fund for Strategic Investments", EFSI). The European Parliament and the Council should vote on this in a fast-track-procedure, in order for EFSI to be in force by June 2015. Although the exact financing, functioning and role of EFSI will be known only once legislative procedures are completed, the Commission's Communication[11] offers the following picture.

The Commission presents EFSI as a fund vehicle equipped with a capital stock of € 21 billion. This capital stock come in the form of:

- **€ 8 billion in cash**, originating from the EU-Budget[12]
- **€ 8 billion as guarantee** backed by the EU-Budget
- **€ 5 billion as EIB-contribution** of an **unclear nature**.

Backed by the capital endowment of € 21 billion of the EFSI, the EIB will raise € 63 billion from private investors by issuing bonds on the capital market. Any capital-raising by the EIB would profit from the EIB's AAA-Rating, enabling a cheap mobilisation of capital.

Subsequently, EFSI aims to use these € 63 billion to co-finance projects together with private money from other investors. This co-financing by EFSI may take the form of credits, guarantees and direct equity. In doing so, EFSI would carry first loss tranches from any projects it participates in, hence decreasing financial risks to private project investors.

The Commission expects a **leverage factor of 15**. Each Euro of initial EFSI-capital would raise 3 Euro of private capital on the capital markets and private investors would join on the project level by a factor of 5. All in all, this would cause total investment of € 315 billion.

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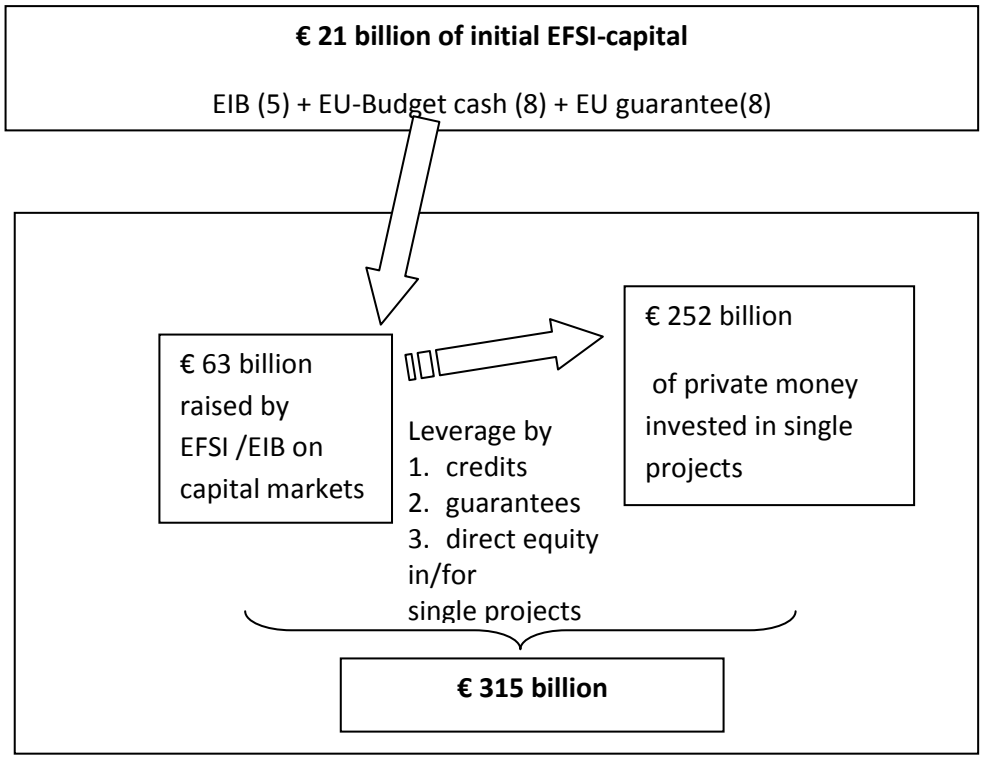
[9] http://ec.europa.eu/about/juncker-commission/docs/katainen_en.pdf
[10] http://ec.europa.eu/priorities/jobs-growth-investment/plan/docs/an-investment-plan-for-europe_com_2014_903_en.pdf
[11] COM(2014) 903, Communication from the Commission on „An Investment Plan for Europe", 26.11.2014
[12] These € 8 billion are set together out of means from the Connecting Europe Facility (€ 3,3 billion), the Horizon 2020 Program (€ 2,7 Billion) and € 2 billion of unused reserves within the EU Budget.



Member states can financially contribute to the initial EFSI-capital on a voluntary basis, either directly or indirectly through National Promotional Banks (NPB). The Commission has announced to "take a favourable position towards such contributions" in the context of the assessment of public finances under the Stability and Growth Pact.[13] Private investors can join at the level of the Fund or participate directly at project level.[14]

EFSI will be set up within the existing structures of the European Investment Bank (EIB) Group, the difference to existing EIB-instruments being a significant higher risk than with traditional EIB activities.

Due to EFSI being established at the EIB, its management body will ensure that the investment guidelines are adhered and that public support does not exclude or crowd out private investment. All projects (co-)financed by the EFSI will have to meet certain criteria to be eligible for support. The Commission will formulate a set of core principles.

In general, the Commission wants to ensure that infrastructure projects investments supported under EFSI address unmet needs (e.g. not duplicate existing infrastructure), crowd in private financing to the maximum extent possible and avoid crowding out privately financed projects. The projects supported by EFSI should generally be open to all users, including competing operators, on fair, reasonable and appropriate conditions as to avoid the creation of entry barriers to entry.[15]

[13] COM(2014)903, p. 7
[14] http://ec.europa.eu/priorities/jobs-growth-investment/plan/docs/investment-plan-qa_en.pdf P.8
[15] COM(2014) 903, P. 7

The newly established EFSI will support strategic investments in

- Infrastructure, notably broadband and energy networks, transport infrastructure
- Education, research and innovation
- Renewable energy and energy efficiency
- Risk finance for SME and mid-cap companies across Europe

EFSI will use instruments such as

- Loans, guarantees, direct equity
- Additional guarantees for high-quality securisation of SME loans
- Investments in private fund structures such as European Long-Term Investment Funds (ELTIF) set up by private investors and/or by National Promotional Banks.

3.2 The Second Pillar: Project Pipeline and Investment Advice

The second pillar of the investment plan is to ensure that the additional funding meets the needs of the real economy. Therefore the Commission wants to introduce a "fundamentally new approach to the identification and preparation of investments projects across Europe, by improving the way in which private investors and public authorities approach and access information on investment projects".[16]

Following a request by the Council at the informal Ecofin Council of September 13th 2014, **the Commission set up a "Task Force" to identify viable investments** of European significance. Under participation of Commission, Member States and EIB, this Investment Task Force carried out a first screening exercise of potentially viable projects. The criteria for the selection of the projects are set out in its report, e.g. the EU value added of the project, the economic viability and a reasonable time horizon for starting the project.[17] **The Member States were asked to provide a list of potential investments projects. The national lists are to be discussed at the meeting of the European Council on 18th December 2014.**

The Commission now calls upon the European Council to endorse to set up a pipeline of projects at EU-level and strengthen technical assistance in form of an investment advisory "Hub" at the EIB, to start in June 2015.[18] In this Hub, investment advisory services and expertise from the Commission, the EIB, the National Promotional Banks and the managing authorities of the European Structural and Investment Funds will be available in an integrated way. The Hub will give support with regards to

- technical assistance for project structuring,
- the use of innovative financial instruments,
- the use of public-private partnership solutions.

[16] COM(2014) 903, p. 11
[17] http://ec.europa.eu/priorities/jobs-growth-investment/plan/docs/special-task-force-report-on-investment-in-the-eu_en.pdf
[18] COM(2014) 903, P. 11

Furthermore, the Commission shows affection for the elaboration of a **system of "European certification for viable projects** that fulfil certain criteria"[19] providing a clear "credibility label" for European investment projects.

3.3 The Third Pillar: Improving the Investment Environment

The Commission wants to **create regulatory predictability and** to **remove barriers to investment.** Therefore it underlines the importance of a simpler, better and more predictable regulation in the EU, which is already one of the main priorities of its mandate. Furthermore it wants to create a Capital Markets Union to reduce the cost of funding for small and medium sized enterprises. As measures to achieve this goal in the short term, the Commission wants among others to review high quality securisation markets and present criteria for simple, transparent and consistent securisation.

The Commission also wants to reinforce the level-playing field and eliminate barriers in investments in the single market by fostering a **European Energy Union** and ensuring the full implementation of the Third Energy Package. Furthermore it is eager to conduct structural reforms in transport infrastructure and systems, notably those with a cross-border dimension. The Commission also emphasises the necessity to develop a "truly" connected Digital Single Market, including swift legislation in the areas of data protection, telecoms regulation and by modernising copyright as well as consumer rules for online and digital purchases.[20] Between the lines the issue of net neutrality is raised by the Commission: "The **Digital Single Market** should be open to new business models while ensuring that essential public objectives are met and consumers should be given unhindered access to online content and services across Europe without discrimination based on their nationality or their place of residence". [21]

4 Five Recommendations for the Investment Plan for Europe

Currently, the Commission's ideas for the investment plan for Europe are still vague on a number of issues. Further substantiation is expected following the official proposal for an EU-regulation establishing EFSI by mid-January 2015.

With the following recommendations, we point to some key issues which deserve consideration in the months to come when Council and Parliament are to discuss the EFSI-regulation.

Even though we claim that there is no "optimal level of investment" and although we call upon policy makers to be very restrained in pushing for a certain level of investment or even stimulating investment in certain branches or lead markets, it is common sense that overall, **investment is useful as** it may increase the future growth potential of the European economy. Given very high levels of indebtedness (both private and public) in many European countries, **growth seems to be a most promising means in order to regain a sustainable level of indebtedness.**

In that sense, the Commission's initiative deserves fundamental support. However, the following points should be taken into account.

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[19] COM(2014) 903, P. 12
[20] COM(2014) 903, P. 15
[21] COM(2014) 903, P. 15

4.1 Pillar 1: Minimisation of Risks for Member States' Budgets is Important (Recommendation 1 and 2)

We applaud the Commission's decision to avoid increasing public debt in order to finance the EFSI. This is not self-evident, given the circulating idea of using ESM money for financing public investment. Public funds are – and will remain for some time – scarce in quite some Member States and there is no alternative to a consolidation of public budgets, especially in Eurozone countries.

Hence, the financial architecture of the Commission's plan (leveraging little public money in order to mobilise larger amounts of private funds) is probably the best it could achieve.

The Role of Private Investment in Infrastructure

Public investments in the EU show a downturn since the 1970s from about (gross) 5 % to around 2.5 % of GDP in the 2000s.[22] Over the last decade, infrastructure investments turned out to be in general pro-cyclical owing to strong fluctuations in private finance.[23] In the EU, research revealed that the government sector finances about one third of all infrastructure investment. Most of the remaining part is financed by the private sector and project finance. But private finance of infrastructure has fallen substantially during the recent crisis. Wagenvoort et al. (2010) conclude that considering the constraints to government finance and the need of fiscal consolidation, more finance for infrastructure will need to come from private sources.[24]

Whether the assumed leverage of a factor of 15 is realistic will depend on a number of factors which are still undecided upon today. However, in the context of defining the financial engineering details of EFSI, efforts should be made to minimise risks to public budgets.

EFSI's capital is confined to readily available means of € 13 billion only.[25] The remaining € 8 billion are mere **guarantees under the running EU-Budget**. When this money were **not earmarked** in the EU-Budget and the EFSI were to materialise losses in excess of € 13 billion, **chances are high that** the EU would need a supplementary budget, with the **Member States** having **to inject fresh capital in the EU-Budget**. Given the necessity (mentioned above) of consolidating public finances, this would be counterproductive.

Recommendation 1:	Policy makers should earmark € 8 billion in the EU-Budget to serve as EU-guarantee to the EFSI.

[22] Väälilä et al. (2005), Roads on a downhill? Trends in EU infrastructure investment, EIB Papers Vol. 10, Iss. 1, P. 19
[23] Wagenvoort et al. (2010); Infrastructure finance in Europe: Composition, evolution and crisis impact, EIB Papers Vol. 15 Iss. 1; P. 33
[24] Wagenvoort et al. (2010); Infrastructure finance in Europe: Composition, evolution and crisis impact, EIB Papers Vol. 15 Iss. 1; P. 34
[25] Consisting of € 8 bio. Leftovers from the EU-Budget and € 5 bio. from the EIB.

Being in possession of € 21 billion[26], the EFSI's plan to leverage these public resources with a factor of 15 is very ambitious and will be possible only – if at all – by taking a high amount of risk on the level of single investment projects.

Sticking to the aim of mobilising over € 300 billion of private investment will make it necessary to either

- speak out far reaching EFSI guarantees to private investors and/or to
- give cheap EFSI-credit to private investors and/or to
- invest directly in projects in a risky equity manner with EFSI-money.

With every like decision, risks to EFSI's (or EIB's) bond subscribers grow. Rather than growing bond spreads, we expect this to translate into the EFSI's (or EIB's) share holders, i.e. Member States having to absorb any remaining losses with additional capital injections. The alternative of bondholders incurring losses on an AAA-rated EIB-bond seems unrealistic. Given this, there is an obvious need to avoid losses having to be financed by public budgets in order to safeguard public budget consolidation.

How exactly to reach this aim is not straightforward as at the same time, there is an objective need for EFSI to enter risks in order to avoid eating up the € 21 billion of EFSI capital[27]. This is so as EFSI will need profits (P) in order to counter its two main cost-factors:

- Costs (I) of taking up € 63 billion of private capital and
- Losses (L) which materialise on the project level, be it as loss guarantees are called upon by private investors or as EFSI's equity investments fail.

Starting $P < I + L$, the € 21 billion[28] of EFSI capital will be written down. Avoiding an increase in capital costs will make it necessary for Member States to inject new EFSI capital.

Summarising, **there is an obvious trade-off between reaching the highest possible commitment of private investors and minimising risk to public budgets.** Policy makers should however make sure that EFSI can never incur losses in excess of € 21 billion Euro.[29] Assuming that the EIB will tap capital markets and that its AAA-Rating will be safeguarded at all times, **large losses incurred by EFSI would have to be borne by Member States and not by the EIB's creditors.** The upper ceiling for any EFSI loss will depend on the exact use especially of EFSI guarantees. In adverse scenarios, EFSI loss may well exceed € 21 billion[30] by a multiple amount, causing high costs to Member States.

[26] In the remainder of this paper, we assume that recommendation 1 has been put into practice and that EFSI in effect is in possession of € 21 billion. Upon not following recommendation 1, we consider EFSI to have € 13 billion of capital only.
[27] Respectively € 13 billion if recommendation 1 is not accepted.
[28] See Footnote 27
[29] Alternatively, of € 13 billion if recommendation 1 has not been accepted.
[30] Alternatively, € 13 billion.

Given that we see no easy way to ensure that EFSI losses will never exceed € 21 billion[31], we suggest the EIB to issue bonds with a contract clause entailing that creditors will be serviced only as long as EFSI losses do not exceed € 21 billion[32]. This will most surely increase costs of borrowing and hence decrease the leverage effect. It would however also limit risks to public budgets without questioning the EIB AAA Rating.

Recommendation 2:	Policy makers should attempt to limit potential losses of the EFSI to max. € 21 billion[33] by paying special attention to the use of EFSI guarantees. However, there is only one way to avoid EFSI losses affecting Member States' budgets in all cases: The EIB should issue bonds with a contract clause entailing that creditors will be serviced only as long as EFSI losses do not exceed € 21 billion.

4.2 Pillar 2: Good Investing is even more Important (Recommendation 3 and 4)

Although we fundamentally support efforts easing investment, it is essential that such investments are economically efficient. Everything else would be a waste of very scarce public resources, further increasing public debt without the necessary value added.

At the moment, we see a serious danger of EFSI's decisions upon whether or not to support investments not being purely objective, but being blurred by political arguments. This causes inefficiencies and may even cause losses for EFSI which go at the expense of tax-payers. We see two main reasons for this:

1. To our understanding – and this would be in line with current practice under state aid rules – a project which is publicly supported by EFSI only, will not be formally subject to state aid rules. Nevertheless, the Commission has announced a set of "core principles" which a project will have to meet to be eligible for support under EFSI. If however – in addition to EFSI-support – a project receives national financial support, this will be assessed under a "simplified and accelerated state aid assessment".
2. With the Investment Task Force and with Member States having proposed a number of investment projects, which they claim deserve EFSI-support, a political competition for EFSI resources has begun. Inevitably, policy makers will be under pressure to reach a "fair" distribution of EFSI-means amongst Member States. This is inefficient as it departs from allocation money to the most promising projects.

It is **politically unrealistic to expect EFSI to make investment decision on an objective level**. Nevertheless, we suggest applying **European state aid** rules in full, **both to investment projects where only EFSI support is given as to projects with additional national support.** In order to reach this for the first group of projects, a self-commitment of the EU-Commission to do so would be sufficient.[34]

[31] Alternatively, € 13 billion.
[32] Alternatively, € 13 billion.
[33] Alternatively, to max. € 13 billion, if recommendation 1 has not been accepted.
[34] We have seen similar ideas in EU-Regulation, e.g. when banks are aided with financial means, originating from non-national money (e.g. from bank restructuring funds).

Applying – as the Commission plans to do – European state aid law in a different intensity to both sorts of projects creates an incentive to all Member States to attempt to have as many projects as possible profit from EFSI support only. This is **counterproductive**, as it either discourages Member States from investing or **risks to lower the standard of the "simplified and accelerated state aid assessment".**

Recommendation 3:	The EU-Commission should self-commit itself to fully apply EU-state aid law both to investment projects which profit from EFSI support only and to projects profiting from additional national financial support.

Many market participants partly explain low levels of investment with **information asymmetries**. Especially infrastructure investment demands a high amount of very precise information, often on a local level. Identifying projects as well as gathering and processing information demands a high amount of costly research. The investment teams in charge of this activity seem not to be active to the necessary extent. At least in part, this can be explained by the hitherto dominant role of banks in this kind of investments. This role seems to be under change and other investors are not (yet) in possession of the necessary know-how.

The Commission's idea to strengthen technical assistance by installing an **investment advisory "Hub" at the EIB is well meant and does pinpoint a bottleneck in investment.** At best, it might cause investors to investigate projects which weren't on their radar so far. Given competition for the best investments and given high financial risks however, investors will and should not trust too heavily on the EFSI Hub.

In any case, a "credibility label" for European investment projects should not be tied too close to any EFSI financing as this risk to undermine the exact credibility of the label, given high political pressure upon the selection of investment projects. The "credibility label" for European investment projects risks becoming non-credible when the label is a precondition for EFSI-financing.

Recommendation 4:	An investment advisory hub at the EIB might add to investors' efforts in identifying useful investment projects. Given high political pressure, the "credibility label" for European investment projects risks becoming non-credible when the label is a precondition for EFSI-financing.

4.3 Pillar 3: Legal Certainty is most Important (Recommendation 5)

Uncertainty is inherent to long-term investment. Besides uncertainty on consumer patterns – which cannot and/or should not be removed by political action, there often is a high level of regulatory uncertainty. The latter however, can be removed by policy makers to a certain extent.

Creating a simpler, better and more predictable regulation in the EU – both of European and of national regulation – is the cheapest and most effective way to remove barriers to investment. Political and regulatory risks are the main impediments to infrastructure investment, which tends to run over long periods of time.

In all areas on which the Commission focuses (Energy, Telecommunications and Transport) there is considerable regulatory uncertainty, both on European and on national level. This ranges from uncertainty on electricity feed-in tariffs over uncertainty on net-neutrality rules up to the lack of clarity on the legal feasibility to introduce road toll systems.

Admittedly, removing legal uncertainty on these long terms is easier said than done. Understandably, no policy maker is willing to commit to strict rules which should be valid for many decades to come. However, any change towards more legal certainty will decrease costs for fostering investment.

Recommendation 5:	It is indispensable to increase legal certainty in European and Member States' regulation. This is a cheap and very effective way of removing barriers to investment

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