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Special analysis

Investment package – an activation impulse for Europe?

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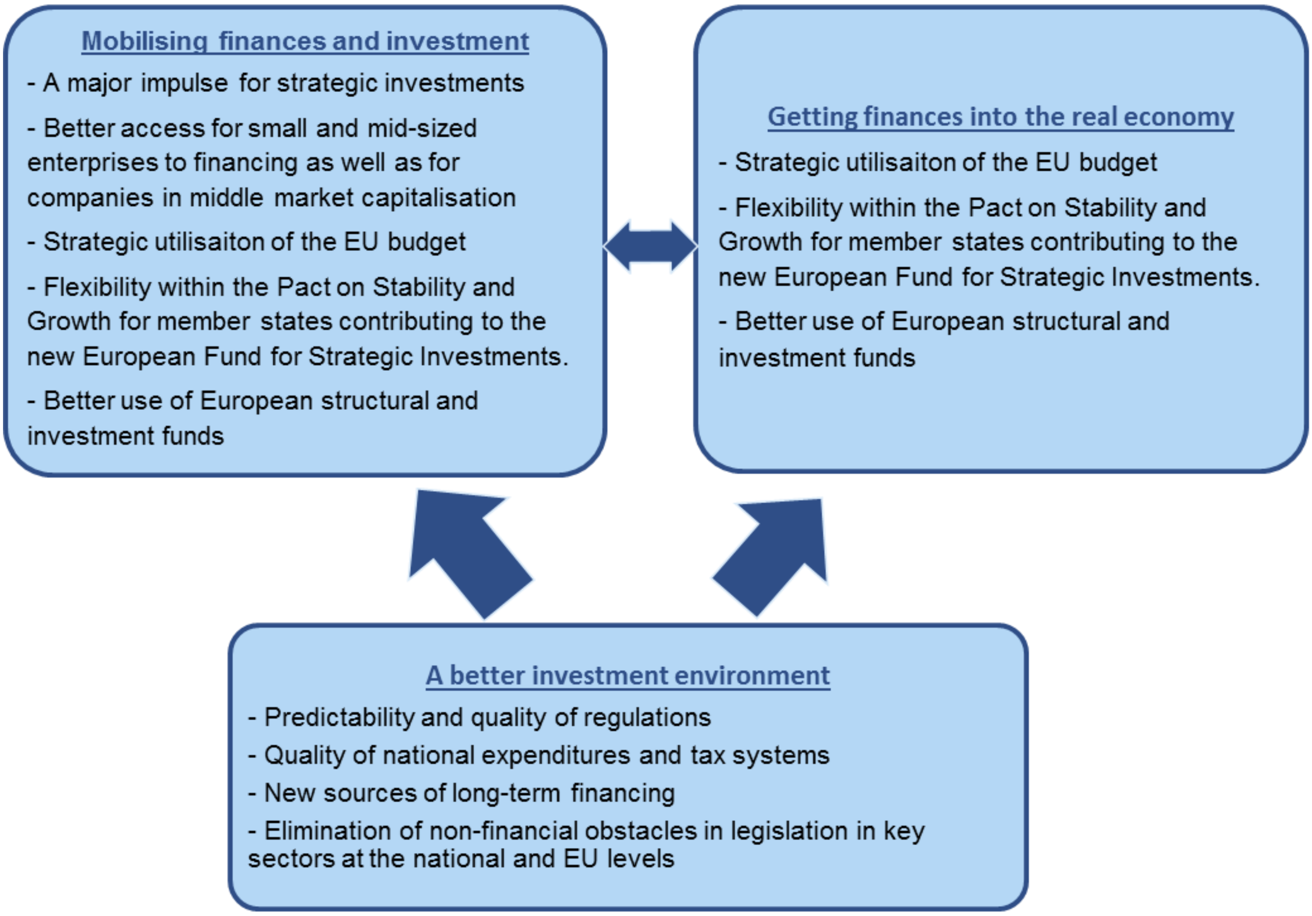
Introduction

In view of the recent economic crisis and provable reduction of investments in recent years in practically all EU member states, an effort to **jump-start and revive** the "stalled" engine of European investments is more than understandable. However, this investment plan is also intended to **increase investors' confidence and return finances to the real economy**, where they should not only help jump-start revival, but create new jobs as well.

The investment plan for Europe will be a package of measures, which over the next three years (2015-2017) will unblock investments from the public and private sector and release them to the real economy in the amount of at least **EUR 315 billion**.

Investment plan for Europe



European Fund for Strategic Investments (EFSI)

A very important part of the proposed investment plan is the establishment of a new European Fund for Strategic Investments, due to the option of **identifying riskier projects** and involving them in activities that are a subject of greater strategic interest, which, therefore, are more difficult to structure. The European Fund for Strategic Investment will provide **additional sources of financing** and will be focused on **projects with high social and economic value** beyond the scope of the projects currently being financed by the European Investment Bank or existing EU programmes.

The **administrator and organiser** of this specialised fund will be the **European Investment Bank (EIB)**, and it will be co-financed by the EIB and the European Commission. The fund will finance strategic projects in the entire EU in the areas of infrastructure, such as broadband access, energy and transport, education, research and innovation, energy from renewable resources and energy efficiency. Part of the new financing will be reserved for **support for investments of small and mid-sized enterprises** (those with fewer than 250 employees) and enterprises with middle market capitalisation (those with 250 to 3,000 employees, through the European Investment Fund (EIF), a body within the EIB group specialised in this type of financing.

The new fund, which will be focused on strategic investments, should be **attractive for private investors**, since they take on more complex and risker parts of transactions. This should help investors overcome capital shortcomings by acquiring larger amounts of direct capital investments and additional guarantees for high quality securing small and mid-sized enterprises' lines of credit. This is an effective way to jump-start the economy and create jobs, including jobs for young people, among whom there is a high unemployment level in many member states.

The topic of the investment package and the EFSI was also discussed by the **European Council** at its summit held on 18 December 2014. It emphasises in its conclusions that the European Fund for Strategic Investments would be an addition to the scope of ongoing EU programmes and to the EIB's traditional activities. In relation to this, it is necessary to support the full use of all existing and allocated EU resources. The Commission will cooperate closely with the affected member states during a search for a solution for the purpose of maximum use of obligations defined in the multi-year financial framework for 2007-2013 and acknowledges that it is desirable in the years to come to implement long-term projects using the flexibility of existing rules.

The European Fund for Strategic Investment will provide the European Investment Bank group (EIB and EIF) a **partial guarantee against risk** (protection from initial losses). This guarantee against risk will enable the European Investment Bank to offer products that will absorb more risk than traditional products.

This will make it possible to invest in projects with higher added value, but also higher risks, which at this time cannot receive financing. Part of the fund's risk capacity can also be used together with national banks providing support.

It has been stated above that thanks to the new investment package, investments should be activated amounting to at least EUR 315 billion, which could then help jump-start further growth and improve the situation on the job market as well.

The fund itself will have EUR 21 billion at its disposal, of which EUR 16 billion will be a created guarantee within the EU budget, and the European Investment Bank will provide an additional EUR 5 billion.

The EU guarantee will be 50% supported (EUR 8 billion) from already existing resources (3.3 billion from the Connecting Europe Facility, 2.7 billion from the Horizon framework programme for research and development, 2 billion from budget reserves).

EFSI	Risk capacity	Multiplier (average)	Investment into the real economy
Long-term investments	16 bn		EUR 240 bn
SME and enterprises with middle market capital	5 bn	x 15	EUR 75 bn
Total	**21 bn**		**EUR 315 bn**

Source: European Commission

So the basis of the fund will be EUR 21 billion, which, as the European Commission points out, could mobilise EUR 315 billion. The **multiplication effect** of the fund should be at least **1:15**. This multiplication effect is a cautious estimate based on prior experience from EU and EIB programmes. For a comparison, the increase in the European Investment Bank's capital in 2013 had an estimated multiplication effect of 1:18.

Just like within the existing facility for loan guarantees for small and mid-sized enterprises within the **COSME** programme, each EUR 1 billion in financing results in an average of at least EUR 20 billion in capital available for small and mid-sized enterprises, which corresponds to the multiplication effect 1:20.

The estimate of the effect 1:15 of the European Fund for Strategic Investments is the result of the initial risk capacity of the fund and is on average **calculated as follows**: for each single initial euro for fund protection, 3 euros of financing could be provided for a specific project in the form of subordinated debt. Since for the particular project this creates a security reserve, it is possible to predict that private investors will invest in priority tranches of the particular project. It is apparent from the experience of the EIB and the European Commission that 1 euro of subordinated debt catalyses 5 euros in total investment: 1 euro in the subordinated debt plus 4 euros more in priority debt. This means that 1 euro of fund protection generates 15 euros of private investments in the real economy, which otherwise would not occur.

Member states, either directly or through their national banks providing support or similar institutions, will have the opportunity to contribute to the fund in the form of capital. It is important to point out that in the context of assessing public finances within the Stability and Growth Pact, the Commission adopts a favouring position towards such capital contributions. **Private investors** can also get involved at the level of the fund. The aim is to mobilise additional investments, which when maintaining the current situation would not occur. In connection with this, the role of the new fund and other policies is to mobilise public resources and jump-start private investments and co-financing without creating new debt, and therefore, as stated above, capital contributions to the fund will also be viewed positively.

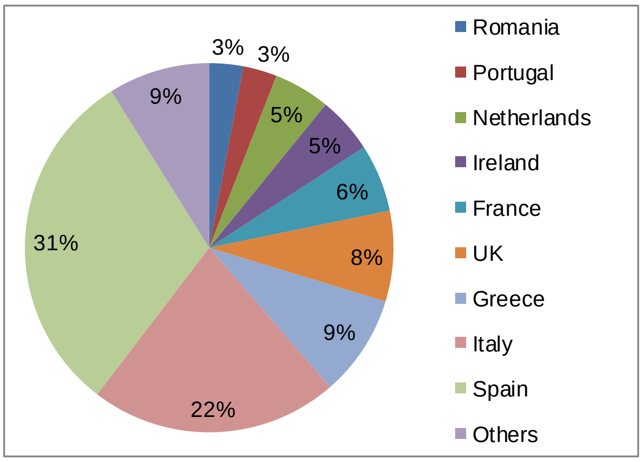
The trend of high indebtedness of certain member states and mainly the decline in investments since the economic crisis needs to be reversed. After all, **since 2007 investments have fallen by more than EUR 400 billion**.

The largest part of the **decline in investments** in the EU from 2007 to 2013 can be attributed to **Spain** (31%), **Italy** (22%), **Greece** (95), **the UK** (8%) and **France** (6%), which makes up ¾ of the total decline as a result of the sizes of their economies and the extent of the decline in investments or a combination of both factors.

Low confidence among investor also greatly contributes to the low level of investments. This investment uncertainty stems from low expectations about demand for goods and services, splintering of financial markets and a lack of the capacity to tolerate the risks that are necessary for the catalysing of investments. Another problem is the insufficient economic recovery and the resulting uncertainty regarding further development.

The situation is not helped either by the high and in some cases even further **rising level of indebtedness** and the related credit risk in member states that have been hit by the crisis the hardest. So the investment package should help investors gain access to financing that would otherwise be difficult to get, particularly for riskier projects with long-term financing. The ability of the system to bear risk is reduced by the limited fiscal maneuvering space and limitation of bank financing. In connection with this, the best way to use public money is to strengthen the capability of bearing risk in the interest of restarting private investments.

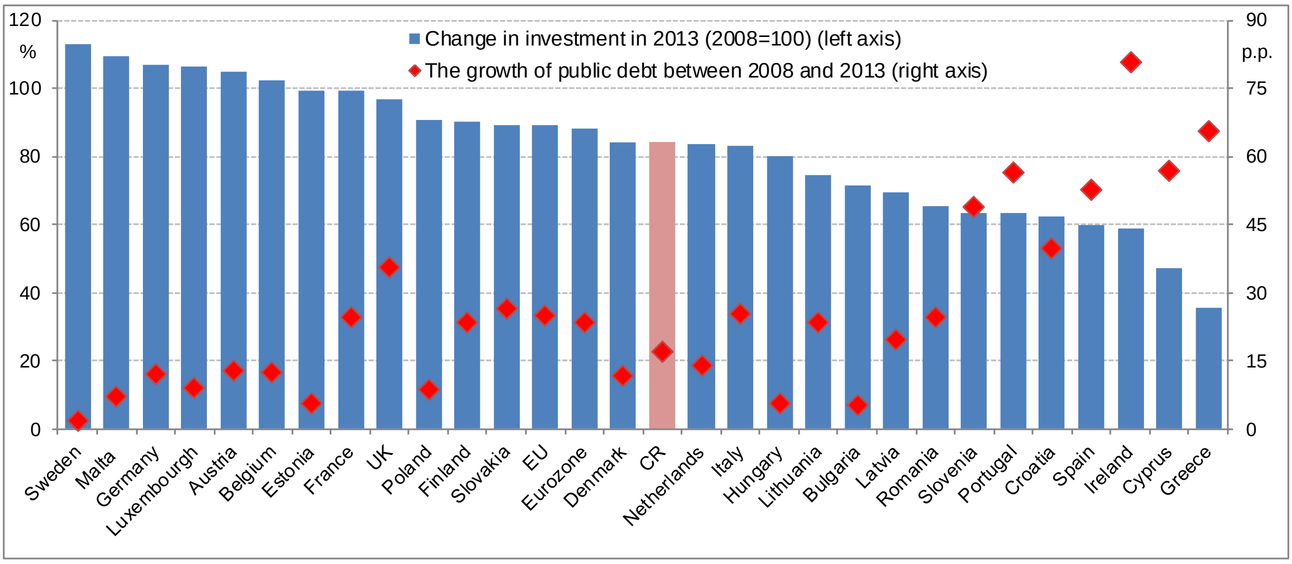
Part of the decline in investments in the EU from 2007 to 2013



Source: European Commission

That, in a situation when there has been a decline in investments and high debt levels in certain EU states, is more than problematic, as the following graph shows. Compared to 2008, in 2013 only 5 states had higher investment levels. The worst off is **Greece**, which compared to the situation in 2008 is achieving just under **40% of the needed level of investments.** It is worth pointing out that states that have managed to maintain their investment levels are among the member states where public debt in proportion to GDP has risen the least since 2008. **Ireland, Greece, Cyprus, Portugal** and **Spain** can "boast" of **an increase in public debt** by more than 50%. However, **Greece** is also among **the most indebted member states** (174% of GDP in 2013).

Change in investments and growth of public debt-to-GDP



Source: European Commission - AMECO

It will not be easy to find a universal and comprehensive solution to improve the situation. The resources that are available in the EU will need to be mobilised and activated to support investments. The Commission prefers an approach based on three pillars: structural reform, so that Europe can set off on a new growth path; fiscal responsibility, so that public finances become healthier and financial stability is ensured; and investments for jump-starting and sustaining growth.

However, where should those resources be directed? **A list of sustainable projects** has been created in connection with technical assistance, which directs resources to where they are needed. Member states already now provide a work group established by the Commission and the EIB in September 2014 with **lists of projects selected based on three main criteria:**

- Projects with added value of the EU to support the EU's objectives), economic sustainability and value – projects with high socioeconomic returns are preferred.
- Projects, which can be commenced at the latest within three years, meaning that capital expenditures can be expected during 2015-2017.
- Besides that, the projects specified in the list should have the potential to receive more sources of financing. They should also have a reasonable size and expandability (depending on the sector or sub-sector). The Commission and the EIB will also launch an extensive technical assistance programme, the aim of which is to identify projects and assist them, so that they are more attractive for private investors.

The Commission and the European Investment Bank (EIB) have set up **a work group**, so that together with member states they can address potential obstacles to investment and evaluate projects for which it will be possible to release finances. The EIB group will ensure that the list of the European Fund for Strategic Investments is **transparent and regularly updated**. Member states, including local bodies and national banks providing support, EU bodies and private investors will be able to contribute to the list by submitting or financing projects.

This means that each project in the list will or should be financed as part of the plan, but thanks to the list it will be visible which investments financing can be released for, and the criteria used to select projects will be transparent.

Providing support for preparing and implementing projects is an important part of the plan. As part of the new approach, the **opinions** of experts from the Commission, the European Investment Bank, national banks providing support and the management bodies of European structural and investment funds **will be made public** in a comprehensive manner.

The support particularly includes:

- technical support during project structuring;
- use of innovative financial instruments;
- use of output from partnerships between the public and private sector.

The **Centre for Investment Advice** will concentrate all investment-related advisory services together, and all questions related to technical support will be directed to a single user-friendly portal with **three target groups**: project submitters, investors and management bodies from the public sector. The intention is to boost and speed up investment through comprehensive and quickly provided advice with the following objectives:

- to prepare and process quality projects and investments;
- to increase the effectiveness of use and the potential of European structural and investment funds (ESIF), the Connecting Europe Facility (CEF), Horizon 2020 and other EU funds, particularly through more intensive and more transparent use of financial instruments corresponding to the needs of the market;
- to improve access to other public and private sources of financing.

This dynamic list currently contains approximately **2,000 projects** at the EU level, a third of which are related to **transport**, and just under a third of the projects are focused on issues related to **strengthening the Energy Union**, a fifth of the projects are related to **knowledge, innovation and the digital economy**, 15% are related to building **social infrastructure**, and one tenth are related to **resources and the environment.**

For the **Czech Republic**, just under **50 projects** have been submitted worth more than **CZK 300 billion**, for purposes such as road construction, reconstruction of residential property, natural gas pipeline construction, natural gas storage, water reservoirs, etc.

Another important step besides creating the European Fund for Strategic Investment and a list of projects is **improvement of the investment environment**. The regulation framework at the EU and national levels must be clear, predictable and stable. The European Commission will have to focus on amendment and/or elimination of specific legislation, regulatory obstacles and other hindrances that are putting the brakes in investment.

Conclusion

The investment package should be a major step in the positive shift in the trend of investments towards growth, which should also have an effect on **increasing the EU's GDP** and **creating more than a million jobs.** Putting investment activities in motion will be very important especially in the member states most impacted by the crisis. But what will this bring for the **Czech Republic**? The impact of the investment package on our country will be rather indirect. Since we have a problem drawing money from cohesion funds and there is plenty of liquidity in our economy, the main benefit of Juncker's package will be economic revival in the other states.

The Czech Republic is a small open economy dependent on export and **an increase in investments in other states could increase the number of orders for Czech companies.** The investment package is practically at the beginning of its journey.

There will still be a lot of discussions held about the European Fund for Strategic Investments. In January of 2015, the European Commission will present the legal framework for the European Fund for Strategic Investments, and if those responsible for enacting EU regulations reach an agreement by June, then **the new investments could be activated as soon as mid 2015.**