

Extract from:
Eulalia Rubio, David Rinaldi, Thomas Pellerin-Carlin,
"Investment en Europe: Making the best of the Juncker Plan",
Studies & Reports No. 110, Jacques Delors Institute, March 2016.

EXECUTIVE SUMMARY

1. Investment in Europe: making the best of the Juncker Plan

By Eulalia Rubio

1.1. Investment in Europe: facts, trends and on-going debates

- Europe suffers from an investment gap estimated at around €200-300 billion per year. Sluggish growth is the most important driver but empirical studies point at four additional factors: a slow process of deleveraging by households and non-financial corporations, the fragility of banks translating into a lack of finance for certain market segments and countries, high levels of political and economic uncertainty and the impact of fiscal consolidation processes on public investment.
- Closing the EU investment gap is crucial to revive short-term growth but also to attain other EU long-term objectives. More investment in intangibles is essential to enhance Europe's medium-term productivity growth. Significant investment is also needed to accompany the shift towards a low-carbon economy: according to the European Commission, an increase of public and private investment of around €270 billion annually will be required over the next four decades to finance the backbone of efficient, low carbon energy and transport infrastructures.
- The crisis has triggered changes in the structure and composition of the EU financial system. These can be summarized in two: a progressive fragmentation of the euro area financial system and the growing reluctance of European banks to finance high-risk investment, due to the processes of deleveraging and the introduction of stricter capital and liquidity requirements.

- Investment in Europe has been also penalized by cuts in public spending. The fall in public investment was significant during the period 2010-2012. Since then, the levels of public investment have improved in the EU as a whole but not in the euro area, where public investment remains 12% below the level of 2007. Drops in public investment are particularly marked in Ireland, Spain, Greece, Portugal and Cyprus.
- Growing fiscal constraints have led to a paradigm shift as regards to the use of public resources to promote investment. Direct financing is leaving room to the use of 'financial instruments' aimed at catalysing private investment. While the use of these instruments reports major benefits, it also entails new risks and challenges, such as the risk of crowding out private financing or more administrative and technical complexity.

1.2. The EU Investment Plan: assessing risks and opportunities

- The Investment Plan for Europe is a comprehensive agenda to tackle the multidimensional problems affecting investment in Europe. Its main goal is to mobilize up to €315 billion of additional investment between 2015 and 2018 but the Plan has also other objectives, such as improving the quality of project preparation, increasing the efficiency of public investment or creating a more investment-friendly regulatory environment.
- It is too early to assess the functioning and impact of the Investment Plan for Europe. However, preliminary evidence as well as previous experiences with similar instruments point at **nine major implementation risks** that can threaten the success of the Investment Plan within the initial three-year period.
 1. Although the performance of EFSI is encouraging so far and the target of €315 billion of mobilized investment seems attainable, all seems to indicate that **the Plan will not be sufficient to close the EU investment gap**.
 2. Given the pressures to attain the €315 billion goal and the broad and flexible definition of 'additionality' included in the EFSI regulation,

there is a risk that EFSI ends up being used indiscriminately to expand all types of normal EIB and EIF operations.

3. There is also a concrete **risk of re-nationalisation**; in particular, of seeing the EFSI being used to back projects co-financed by a National Promotional Bank (NPBs) that would have been anyway financed by the NPB alone.
4. **EFSI is likely to benefit disproportionately some countries**, particularly those having sophisticated financial markets and previous experience in running EIB projects
5. While, so far, the number of low-carbon projects supported by EFSI is encouraging, **nothing guarantees that the Fund will provide a sustained support to low-carbon projects over the whole investment period.**
6. The **combination of EFSI with Cohesion and Structural Funds** offers interesting opportunities but **will be technically and administratively complex**. This might translate into very few tangible results at the end of the initial investment period (that is, mid-2018).
7. **Investment platforms present potential advantages but can also entail some risks**. If the EFSI guarantee is given directly to them, this will permit a more flexible deployment of funds but will also imply a loss of control over the selection of single projects (which will be done by the platform's governance body, and not the EFSI Investment Committee).
8. In the absence of clear 'carrots' or 'sticks' to induce reform **lack of progress in the third pillar of the Plan (fostering investment-friendly regulatory reforms) is a serious risk**
9. The **new European Project Portal (EIPP) will have a marginal impact on investment** unless accompanied of mechanisms to standardize information and help potential investors assess the risks and economic returns of the projects.

1.3. Making the best of the Investment Plan: ten policy recommendations

Grounded on the previous analysis, this study formulates **ten concrete proposals for action** to be implemented within the initial investment period:

- **Recommendation 1: Ensure that the budget of the European Investment Advisory Hub (EIAH) is commensurate to the needs.** We propose in particular to increase the contribution of the EU budget to EIAH from €30 million/year to at least €40 million/year.
- **Recommendation 2: Establish a stable network of national EIAH offices covering the whole Union.** The EIAH plans to build a network of national offices but the approach is rather voluntarist and based on the establishment of different cooperation agreements. We propose a stable and homogeneous network, with a national EIAH office in each EU member state acting as both the national point of entry for EIAH's potential beneficiaries and as provider of EIAH services. The creation of this network should be complemented with reinforced support to countries having less technical capacity to structure projects. In particular, we suggest the creation of a programme to encourage the exchange of staff between NPBs involved in the provision of EIAH services.
- **Recommendation 3: Ensure consistency with Europe's low carbon goals.** We propose in particular to: give to the removal of fossil fuel subsidies high priority in the 'third pillar' agenda; devote an important part of EIAH resources to support the structuring of low-carbon projects and mainstream climate and energy efficiency considerations into the appraisal of EFSI projects.
- **Recommendation 4: Define geographical indicators at both aggregate and sectoral level.** The EFSI steering board should make use of its capacity to define indicative geographical diversification and concentration targets, and take the appropriate actions to reach these targets at the end of the investment period.
- **Recommendation 5: Exploit synergies between the EIB and NPB in the co-financing of EFSI projects.** To facilitate cooperation, we

propose delegating the monitoring of the EFSI projects co-financed by a NPB to the national bank. We also suggest granting the EFSI guarantee to NPBS only for financing trans-national investment projects or projects located outside the Bank's national territory.

- **Recommendation 6: Provide further guidance for the combination of ESI-EFSI funds.** The European Commission has recently published a note providing some guidance but it does not seem sufficient. Further guidance and technical support (through the Fi-Compass, inserted into the EIAH) should be offered to ESI authorities to combine both instruments - and in particular, to structure 'layered funds' with ESI and EFSI contributions.
- **Recommendation 7: Clarify the conditions of eligibility for investment platforms.** Only those platforms presenting some minimum standards in regards to their governance should be eligible to receive the EFSI guarantee
- **Recommendation 8: Complement the European Investment Project Portal (EIPP) with mechanisms for standardization.** Examples of standardization measures are the establishment of a database of standardized credit information on SMEs or, in the field of energy efficiency, the development of on-line tools to measure and compare the energy efficiency performance of corporate and buildings.
- **Recommendation 9: Promote the creation of transparent and well-designed national and regional public project infrastructure pipelines.** We propose in particular imposing as a rule the systematic involvement of NPBs in the partnership bodies supporting the definition of national and regional ESIF programs and defining some minimum standards of transparency and eligibility criteria in the procedures for selection of ESIF projects.
- **Recommendation 10: Set up complementary measures to boost public investment.** We propose broadening the scope of the 'investment clause' within the Stability and Growth Pact, establishing a common

public investment vehicle for the euro area and diversifying the purchase of assets in the context of the ECB quantitative easing program.

1.4. Looking ahead: discussing possible long-term scenarios

- If EFSI is successful within the initial investment period, public authorities might decide maintaining the scheme for a renewed period. If this happens, it would be highly desirable that Member States reconsider the possibility to put money into EFSI's capital.
- In the long term, EFSI will probably favour the intensification and expansion of cooperation initiatives between EIB and NPB. However, it is very unlikely that it leads to the creation of a hierarchically-based system of public investment banks in Europe, structured around the EIB as the central node.
- EFSI could also become the seed of a future euro area stabilization capacity, as foreseen by the Five Presidents' Report, but this would require important changes in its size, functioning and governance. This option would be more feasible if the goal is to create a fiscal mechanism to boost the euro area aggregate demand than if the fiscal capacity is understood as a cross-country shock absorbing mechanism.

2. Developing digital infrastructure in Europe: can the Juncker Plan play a role?

By David Rinaldi

2.1. Why prioritize digital infrastructure

- Digital infrastructure *empowers* citizens and businesses by offering all the services, opportunities and information which are available through the Internet. The European Commission has recognized that the availability of high-speed networks in Europe is a prerequisite for the digital economy to flourish and an essential part of the overall strategy for achieving job creation and economic growth.
- The ability of our economies to remain competitive globally, to grow and to promote job creation depends on how Europe will manage its digital

transformation. Besides providing a short-term boost to the economy, investments in NGA infrastructure creates the groundwork for long-term improved growth and productivity gains. It is estimated that broadband networks contributed to as much as 20% of total productivity growth in Europe and have the potential to add 0.5-1.5% to the GDP of the Union.

- As investment in infrastructure has lengthy payback periods and very low financial returns in certain scarcely populated areas, direct public intervention by means of financial instruments is advisable. Research highlights that the cumulative economic gains from universal high-speed broadband deployment are 32% above the total EU investment cost.

2.2. Digital infrastructure: where do we stand?

- Full coverage of basic broadband, i.e. the first of the three Digital Agenda targets for broadband was met. Nevertheless, Europe still lags behind other industrialized economies in the deployment and adoption of NGA networks. The actual take-up of broadband remains rather limited, particularly for fast and ultra-fast connections.
- There is a divide in terms of digital infrastructure deployment between member states, and even a more worrisome **divide within member states**, between urban and rural areas.
- The demand for connectivity has risen and will rise even faster in the near future. There are at least three crucial factors which will drive up the need for high-performance digital infrastructure in the near future: 1) the **advent of the IoT** will see an increase of connected devices and apps (about 8.5 billion connected devices by 2019); 2) **an increase in the number of users** (about 100 million new users by 2019), and 3) the **changing nature of usage**, with video traffic and Cloud-based services which will become more and more prominent. Broadband infrastructure needs to keep pace with these growing demands for broadband internet access.
- The regulatory framework in Europe is largely responsible for under-investment in NGA networks. The lack of a Single Market for Telecoms,

the absence of a common framework for spectrum allocation, the service-based competition approach and general regulatory uncertainty are the main obstacles to mobilizing private investment for broadband infrastructure.

2.3. Investment needs and gaps

- The investment gap is sizable. Data for the 2007-2013 period shows that level of capital expenditure (CAPEX) in wireless infrastructure grew by over 70% in the U.S., while it declined in Europe. The studies we surveyed point out that the estimated investment need to achieve the Digital Agenda targets and deploy world-class 4G technology is likely to be in the order of € 200 billion.
- About € 22 billion of public funds (mostly ESIF and NPBs) and about € 85 billion of private investment have already been allotted to digital infrastructure development. That results in an investment gap of roughly € 95 billion.
- ESIF planned financing for 2014-2020 and the limited CEF funds for transnational broadband projects do not appear adequate to help catching up with more connected countries or to address the rural divide.

2.5. How can the Juncker Plan be of help?

- Up to December 2015, out of the 42 projects approved by the EIB in the Infrastructure and Innovation Window of the EFSI guarantee, only three consist of digital infrastructure roll-out. Two in France and one in Italy. According to the data available, the average leverage effect is in the order of x11.2.
- Preliminary evidence suggests that EFSI-backed projects in digital infrastructure are additional in the sense that, like any other EIB operation, they intervene in areas and sectors where the level of investment is actually sub-optimal. However, these first three projects do not meet the additionality clause *stricto sensu* as, so far, the EU guarantee was employed by the EIB not differently than other normal operations. Telecom Italia as

well as regional and national French authorities have a track record of similar activities financed by the EIB.

- There is a concrete risk that the EU guarantee ends up benefiting disproportionately those countries which have experience in running EIB projects, which would leave certain countries behind.
- Additionality can still be detected and achieved thanks to: 1) the improved leverage on private investment, which can allow the financing of a higher number of projects, and 2) additionality in technology, in the sense that, thanks to the support of the EFSI, infrastructure projects are more likely to take place with more costly, ‘future-proof’ technologies.
- The case study puts forward five recommendations:

- 1. Delivering on the third pillar.** As the first barrier preventing private investment in NGA technologies is linked to the unfavourable, fractionalized and uncertain regulatory framework, achieving a Single Market for Telecoms and a reform of radio spectrum allocations are the two crucial aspects where political consensus should be found pressingly.
- 2. Coupling CEF and EFSI for transnational projects.** Since there is a relative liberty in the type of instrument to be used to allocate the € 170 million available for broadband deployment in the CEF framework, it is essential to create an interplay between CEF debt instruments and EFSI financing in order to amplify the otherwise limited contribution of CEF to the deployment of transnational projects in core infrastructure.
- 3. Creating ad hoc Investment Platforms for projects in rural areas.** Special efforts, driven by national public authorities in cooperation with EU institutions, should be put in place in order to facilitate private investment where it is absent; investment platforms can serve this purpose and bring together public sector institutions, firms and investors to work together for a specific geographic area. We recommend two models for Investment Platforms that help channelling financial resources for NGA technologies in rural areas: the French *syndicat mixte* model and the energy efficiency fund model.

4. Combining digital with energy transition. As the physical roll-out of broadband infrastructure is the primary cause of the high cost for network development, it is appropriate to coordinate work in public infrastructure to reduce the cost of networks' physical deployment. Particular synergies should be explored between the modernization of infrastructure for electricity distribution and the roll-out of fibre networks.

5. A closer focus on financing for digital infrastructure from the side of the European Commission, which could be achieved by including a session on investment data on the Digital Agenda Scoreboard, by improving Cohesion Data with more precise information on ICT projects, and by creating a Digital Infrastructure Financing Group to bring together the expertise of both the private and public sector and investigate the way to improve on the financing of digital infrastructure in less-covered countries and disadvantaged regions.

3. How can the Juncker Plan unlock energy efficiency investment in the short and long term? *By Thomas Pellerin-Carlin*

3.1. Why prioritize energy efficiency

- Energy efficiency investments aim at delivering an energy service, such as heating, but in a more efficient manner that leads to less energy consumption. As such, energy efficiency development is critical to help the EU achieve its objective to deliver sustainable, secure and affordable energy for all. It makes the energy system **more sustainable** as it reduces the consumption of coal, oil and gas, thus reducing both local air pollution and the global pollution of greenhouse gases that lead to climate change. The energy system becomes also **more secure** as it allows the EU to rely less on imports of coal, oil, gas and uranium from foreign countries, particularly from Russia. Last and not least, as less energy is needed, **the energy bill paid by the consumer diminishes** accordingly, ensuring that energy services remain or even become affordable for all households and businesses.

- The EU has three energy targets. Two focus on the reduction of greenhouse gas emissions and the rise of renewable energies, and are legally-binding at the EU and/or national level. This is not the case for **the third EU energy target that is a purely indicative target for energy efficiency**. It is therefore critical for the EU to propose incentives, such as EFSI's support, to public and private actors as to enhance the chances of the EU energy efficiency target being effectively reached.
- **Energy efficiency investments are virtually always profitable, but their payback times vary drastically**, from a few months to a couple of decades. This payback time is significantly influenced by the evolution of the end-user price for energy that is itself driven mainly by a mix of global prices and policy decisions.

3.2. Energy efficiency investment: where do we stand?

- The European Commission estimates that energy efficiency investments of over 100 billion euros a year are needed to allow the EU to reach its energy efficiency target. **The investment gap is currently estimated to be in between 38 and 54 billion euros/year.**
- Many EU public financing tools already exist. The practical choices on whether and how to use such tools mostly lies in Member States. **The current situation is a lack of correlation between where EU money on energy efficiency is actually spent, and where energy efficiency is most needed.**
- The regulatory framework in Europe is largely responsible for under-investment in energy efficiency. First and foremost, the EU energy efficiency legislation is poorly enforced in virtually all EU Member States. This creates useless uncertainties slowing-down energy efficiency investments in Europe. Second, both the EU and many Member States continue to subsidise fossil fuels, thus spending public money in a way that is detrimental to energy efficiency investments.

3.4. How can the Juncker Plan be of help?

- The Juncker Plan can be used to test innovative ways of financing and/or performing energy efficiency. It can experiment the roll-out of new financing methods, such as on-bill repayment and on-tax finance. It may also ensure that energy consumption data is accessible by everyone, and most notably by energy efficiency providers. This can only help in diminishing the vast pool of profitable energy efficiency projects that exists but remains untapped because of lack of access to relevant information.
- The Juncker Plan cannot solve the energy efficiency investment gap on its own, but it can be of help, **in particular in Central-Eastern Europe**. Focusing EFSI on boosting energy efficiency in those countries is critical as it allows investment where the needs are the greatest, as they inherited very inefficient energy systems from the Soviet regimes. It is also critical as those countries are the ones most exposed to energy security concerns: esp. a disruption of gas supply from Russia.
- Profitable **energy efficiency projects do not exist in a vacuum, they are created** at the junction of an energy efficiency beneficiary, an energy efficiency provider, and an adequate financing method. **The Juncker Plan can therefore help in creating more and better energy efficiency projects in Europe.** In concrete terms, it is critical to ensure that the budget of the European Investment Advisory Hub (EIAH) is commensurate to the needs, and that it is for instance used to hire specific members of staff with a specific knowledge of energy efficiency and a good understanding of the energy efficiency situation in specific EU Member States, most notably in Central and Eastern Europe.