5. EU governance and the European Fund for Strategic Investment

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5.1 Introduction

A priority for the new European Commission that entered into power in November 2014 is to promote investment. For that purpose the Commission launched the so-called Juncker investment plan. Through a combination of financial injections and guarantees the Commission tries to initiate investments worth € 315 billion over the period 2015-2017. Key elements of this plan are the creation of a European Fund for Strategic Investments (EFSI), the crucial role of the European Investment Bank (EIB) and cooperation with other government levels and private partners.
The Juncker investment plan is welcomed as a game changer in some corners, because it is supposed to allow the EIB to support financially more risky projects with the EU budget as a risk buffer.
The success of the plan is determined by the expected multiplier effect (leverage effect) of the initial € 21 billion that the EU is planning to make disposable. This effect is estimated at 15:1 meaning that each € spent by the EU should entail € 15 euro spending by other partners from other government partners and the private sector.
Such collaboration is of course not novel. Multi-level governance is a theoretical concept, which was developed in the analysis of the operation of the European structural funds (Stephenson 2013). Over the period 2007-2013 the concept was broadened to include, besides several layers of government, financial intermediaries and private investors as they now also played a role in the EU cohesion policy (Dabrowski 2014). The operation of the structural funds can be placed in the framework of the European Administrative Space, defined as an informal entity based on a legal and administrative framework (Cioclea 2012).
The Juncker investment plan features some innovative governance aspects that merit a closer look:

- *The new role of the European Investment Bank:* Robinson (2009) states that the role of the European Investment Bank has been insufficiently analysed from governance viewpoint: 'consideration of the EIB should prompt a re-invigoration of multi-level governance theory' (Robinson 2009, 652) and 'it is clear that our understanding of multi-level governance can only be enhanced by an appreciation of the role of the EIB' (Robinson 2009, 665). It is exactly this same EIB, which has to act as the motor of the Juncker investment plan.
- *The introduction of 'national promotional banks' and 'investment platforms'*: Member states can make direct contributions to EFSI or indirectly through 'national promotional banks' or 'investment platforms'. Although these need not to be new institutions, their involvement adds a possible additional layer to the governance system.

The issue that emerges is whether these features signify a new step in the evolution of the multi-level type of governance and as such marks an improvement in the operation of the European Administrative Space. The analysis of these elements should allow assessing whether the EFSI governance structure constitutes an improvement in the way public investment is financed within the EU. First of all however it is to be assessed what case the EU and governments at other levels have to intervene in investment. The research questions can therefor be formulated as

- Is there a need for governments to intervene in investments?
- Does EFSI constitute an improvement regarding this government intervention?

The paper is organized as follows. In the next section the case for government intervention in investment is analysed. The following sections expand on the two allegedly innovative elements in the Juncker investment plan.

5.2 The need for government to intervene in investment

We will analyze the role of the Juncker Plan for the EU governance in the classical framework for government intervention in the economy as set by Musgrave & Musgrave (1989). Government has three functions in the economy: allocation, stabilization and redistribution. In the case of allocation government intervention is needed when markets show failures as is the case when they offer insufficient amounts of collective goods, entail external effects in production and/or consumption, suffer from asymmetrical information or exhibit distortional

forms of behavior. In its stabilization function government has to counter the business cycle. Redistribution is warranted when the market leads to an income and wealth distribution that is not socially acceptable. In a multi-level governance setting this intervention is by definition not restricted to one level of government. In the context of this paper the relevant governing levels are the EU level, the level of the member states and their sub-regional government levels. The next question is then whether any of the reasons for intervention as suggested by Musgrave & Musgrave on any of these governing levels is warranted for in the case of investment.
Starting point is investment in the private sector and its role in economic growth. It is a well-established fact that investment, as a way of postponing consumption, actually increases future consumption and in this sense motivates private economic actors into investing part of their income instead of consuming it. As a result there will be economic growth that raises the standard of living of the actors. The economic decisions made by these actors will be coordinated by the markets, e.g. the capital markets will connect actors with excess savings with actors needing financial means in order to invest. Experience teaches however that markets can fail in generating the right investment, that market investments can be insufficient and that they can be unevenly spread in geographical terms. These problems with private investment necessitate the intervention of governments at different levels. In table 1 these two dimensions are brought together in a matrix. We will now briefly discuss each of the entries in the matrix.

Table 1: Investment policy at different policy levels

	Subnational levels	***National level***	***EU***
Allocation	Regional & local budgets Development banks	National budgets Guarantees Development banks	Structural funds EIB
Stabilization	SGP	SGP	EIB EFSM, EFSF, ESM
Distribution	Structural funds EIB	National taxes National social security	Structural funds EIB

Regarding the allocation line in the matrix, the Commission (2014) points at market failures being

> *'the result of (i) asymmetric information, (ii) externalities and (iii) market power (weak competition). They affect both the demand and supply of investment. Typical examples include (i) credit rationing and high return requirements due to banks' high transaction costs for identifying viable investment projects (e.g. in the SME sector), (ii) underinvestment in areas such as research & development, infrastructure, education and environmental projects, where the benefits of investments can accrue also to competitors and (iii) under-supply of financial services resulting from market concentration due to mergers, exits of competitors or other impediments to effective competition. A specific externality in the EU context lies in the enhanced market integration fostered by cross-border projects.'*

It will be clear that the characteristics of non-rivalry and non-excludability existent in many provisions warrant government intervention in the allocation domain. Investment in areas ranging from railways, roads, waterways, energy networks, telecommunication, airports to research and development has to be undertaken by governments because private investors decide insufficiently or not to enter in these ventures because they cannot recoup the considerable upfront fixed costs or are unable to internalize the external benefits, although the benefits for society exceed the costs. Regarding the government level that should take care of these market failures, the decentralization theorem developed by Oates (1975) states that societal preferences regarding these provisions should prevail. Since preferences are more homogenous in smaller communities, lower levels of government should be the first to intervene. The more there are spill over effects, tax competition effects and scale effects in provision and financing of public provisions, the higher the optimal level of intervention will be. In the first entry we find public investment at subnational levels. Through the budgets of regional and local governments an important part of public investment is financed: local streets, the public domain, investment in garbage collection, etc. are typical for these lower levels. Because of scale effects leading to natural monopolies, investment in railways, highways, energy and telecommunications are typically organized at a higher level of government. The question as to whether the EU has a task in correcting market failures in investment can be answered positively. As Griffith-Jones & Tyson (2012) state, at the EU-level 'one of the most critical market failures was in financing large scale infrastructure projects.' Early on the EU took up this task, both through the

creation of the European Investment Bank and through the structural funds: 'as well as the EIB as an institution providing loans, the European mechanisms created to support the integration process included both grants through the Structural Funds and guarantees to catalyse lending by the private sector' (Griffith-Jones & Tyson 2012).
Also in the first line features another kind of market failure, i.e. asymmetric information in the case of lending to SME's. Banks are very reluctant to lend to SME's because it is very costly to do the necessary research in order to define the real creditworthiness of SME's and the viability of their investment projects. It is not clear on which government level the correction of this market failure is best organized. Reality shows that governments on all three levels are active in this area, usually through dedicated public-owned financial institutions.
Concerning the second line in table 1, stabilization is, according to conventional wisdom, best taken up at a level as high as possible, because of macro-economical import leakages. Subnational levels are not well equipped to stabilize their economies by using their investment budgets. National governments would be better up to this task but are refrained by the provisions of the Stability and Growth Pact (SGP). At the EU level the EU budget would look like an obvious instrument to stimulate the economy, but its small size (appr. 1 % of EU GDP) and the requirement of equilibrium prohibit it playing a significant role. The EIB stepped in when the euro crisis hit by engaging in a clearly and crucial countercyclical role. Also by establishing at first temporary and later on permanent rescue mechanisms like the European Financial Stabilisation Mechanism (EFSM), the European Financial Stability Facility (EFSF) and the European Stability Mechanism (ESM), the EU took up in an alternative way a task of stabilizing the European economy.
Regarding redistribution the lower levels of government are not usually seen as a good platform. The usual instruments of taxation and social security do not lend themselves to be organized on a small scale. Unwanted migration would duly punish jurisdictions, which would try to differentiate on those aspects. However, when investment is involved the picture is different because it is mainly about regional redistribution and less about vertical or horizontal income redistribution. The latter are mainly taken care of by national governments through their progressive taxation and social security systems. The former seems to be in the EU the ultimate playground for the use of EU instruments like the structural funds and the EIB in close cooperation with subnational governments, hence the emergence of the concepts of multi-level governance (Stephenson 2013) and European Administrative Space (Trondal & Peters 2013).
So it is without question that governments, the EU level included, have a role to play in investment. At the EU level this role has been taken up since several decades by the creation of the EIB and by the structural funds. The next question then is whether, in the presence of this EU investment policy, an extra effort is needed as signalled by the creation of the EFSI.

5.3 Insufficient investment and the need for EFSI

The establishment of EFSI has an impact on most of the entries in table 1. Is there a need for EFSI, on top of the already functioning policies? According to some observers there is no doubt, because, since the euro crisis, investment levels in the EU have failed to reach the pre crisis levels. Barbiero (2014) argues that 'it is clear that the EU fiscal framework was unable to foster public investment as a counter-cyclical fiscal stabilisation tool during the deepest crisis since the second world war in EU those countries with fiscal space, in contrast to other advanced economies'. Griffith-Jones & Tyson (2012) state that 'the EIBs level of additional financing was dwarfed by the scale of retraction in private market capital flows'. Buti (2014) finds that the drop of investment in the eurozone countries since 2007 is unmistakably clear. In figure 1 the ratio of total investment to GDP in the EU28 also shows the same trends.

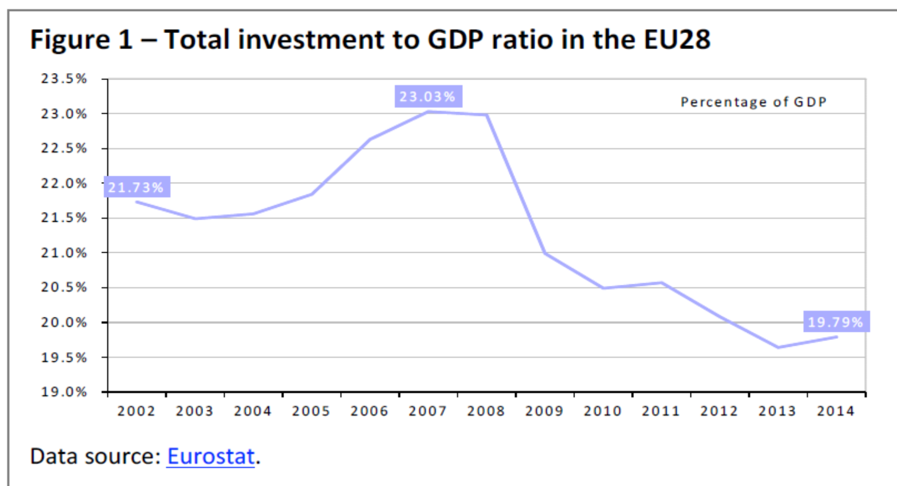


Figure 1 – Total investment to GDP ratio in the EU28

Data source: Eurostat.

Source: EPRS (2015)

The IMF (2014) finds that 'the stock of public capital (a proxy for infrastructure capital) as a share of output has declined significantly over the past three decades'.

The idea that investment is lacking in the EU is not supported universally however. Gros (2014) takes a dissonant view in stating that 'superficially, higher investment seems always desirable. But the argument that Europe needs more investment now because its investment rate is currently lower than before the crisis is wrong on two accounts.' In the first place Gros (2014) argues that it is natural that during an economic boom, as the EU was experiencing before the crisis, investment is higher than is needed, putting the investment that takes place in the ensuing recession in the wrong light. Moreover an argument can be made stating that much of the high investment was in the wrong places, creating bubbles (e.g. in the housing sector) and was not much helping growth in the long run. The second reason involves the demographic phenomenon of a falling working-age population growth in Europe. This means that less investment in terms of GDP is needed to maintain the capital output ratio constant.

The IMF (2014) adds another critical note to the debate by observing that public investment is beneficial only in certain situations. 'Increased public investment raises output, both in the short term because of demand effects and in the long term as a result of supply effects. These effects vary with a number of mediating factors, including (1) the degree of economic slack and monetary accommodation, (2) the efficiency of public investment, and (3) how public investment is financed.' Increased public investment only helps in countries with a high efficiency of investment. The IMF classifies only France, Germany and Spain as 'high efficiency', while 'Italy, Greece and Slovakia are low efficiency and should thus not be asked to increase spending'.

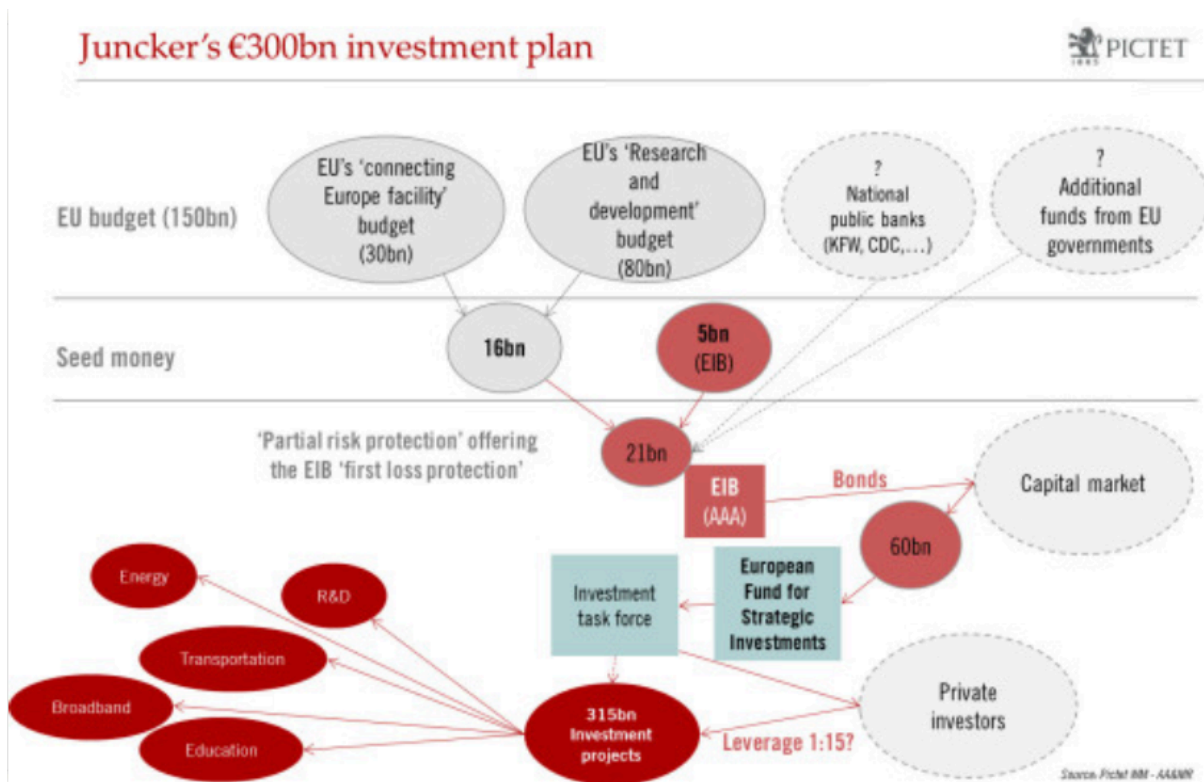
That leads Myant (2015) to observe that the Juncker plan will increase the level of investment but that 'this is likely to be greatest in those countries that need EU help the least and smallest in those that need it the most.' This observation also puts in doubt the role of the EU-level as there is no obvious argument for such a programme to be run from that level. The effect envisaged by EFSI could also be achieved by projects run separately in individual countries as only a limited part of the projects are of a cross-border nature. The Juncker plan does not have a mission to allocate investments in the countries that need it most, as there will be no country- or sector-specific quotas (European Commission 2015).

Thus, in this context, it is not at all clear whether the EFSI can have a value added in relation to the existing EU investment policies. In the next section we will focus on the characteristics of EFSI that can help decide about this question.

5.4 The features of the Juncker Plan

EFSI was launched jointly by the EIB Group and the European Commission to help overcome the alleged investment gap in the European Union. It is supposed to mobilise private financing for strategic investments, i.e. investment in 'transport, energy and digital infrastructure; education and training, health, research and development, information and communications technology and innovation; expansion of renewable energy and resource efficiency; environmental, urban and social projects; as well as support for smaller businesses and midcap companies.' (EIB 2015, 1) The EFSI constitutes the most important pillar of the three pillar approach in the Juncker plan. Besides EFSI, in a second pillar, the Juncker plan wants to create an improved investment environment, which mainly consist of further removing barriers to trade within the EU single market. The third pillar targets at improving how finance reaches the real economy by installing an Investment Project Portal and a Europan Investment Advisory Hub (EIAH). According to Marty (2015) 'the technical assistance organized by the EIB (and in part financed by the European Union's budget) (…) will appreciably be developed to help promoters to structure and finance their projects better. The platform notably aims to support the introduction and increased use of complex financial packages.'

Figure 2: The structure of the Juncker plan



Source: Durante (2014)

The EFSI wants to unlock EUR 315 billion of investment over the period 2015-2017. Figure 2 sketches how this has to be done. Crucial is the multiplier effect of 15, transforming an initial amount of 21 bn € into an investment amount of 315 bn €. The starting sum of 21 bn partially comes from the EU budget. From a sum of 16 bn €, 8 bn has to be reshuffled from the existing 2015 to 2020 budgets (2.7 bn from redirecting H2020 funds, 3.3 bn from Connecting Europe funds and 2 bn from existing margins in the EU budget). The origin of the remaining 8 bn € is not clear. The 16 bn € should work as a guarantee fund from the EU to the EIB offering a specific cover to the investments financed by the EIB Group in case there are any losses. The EIB itself also should invest 5 bn € from its own resources. Backed by this 21 bn € the EIB should be able to generate three times this amount (60.8 bn €) in investment through AAA-rated bonds on the capital markets. This amount is then expected to further generate the 315 bn € in investment, divided over an infrastructure and innovation window and a Small and Medium Sized Enterprises (SME) window. The first window runs over the EIB, while the second one runs over the European Investment Fund (EIF), which is a part of the EIB Group targeted on the financing of SME's. It is expected that the EIB will provide EFSI financing of appr. 49 bn € and the EIF around 12 bn €, hopefully leading to long-term investments of appr. 240 bn € in the first window and of appr. 75 bn € in the second one. Projects financed by EFSI need to go through the standard EIB due diligence as well as through an assessment by the EFSI Investment Committee to decide whether they are eligible for backing under the EU guarantee.
A crucial factor is the multiplier of 15. According to the Commission this is a prudent average, 'based on historical experience from EU programmes and the EIB' (Commission, factsheet). The EU guarantee is portfolio-based (covering hundreds of projects), which means that the multiplier can only be exactly measured at the end of the investment period and only on a portfolio basis, not project by project. Standards & Poor (2015) expects 'this 15x multiplier to be achieved by a combination of leverage and an element of crowding-in (incentivizing co-investment) from other funding sources. The EIB could deliver new loans, supported by a first-loss piece guarantee from the EU. These loans would then crowd in other investors to achieve the overall investment target. EIB projects typically attract about 3x as much private investment as it finances through its loans for projects. However, the EIB believes it could significantly increase this multiplier by financing higher-risk (and higher-yielding) projects or being more junior in the structure of the project financing, as these projects will benefit from the first-loss piece guarantee from the EU.' Claeys (2014) agrees and finds that 'the EIB often leverages itself by a factor of 6 before attracting enough private investors to cofund its projects to increase investment by a factor of 3 leading to an overall multiplier of 18'. This optimism is not shared by all observers however. Medarov (2015) find that 'the projected multiplier effect was called "overly optimistic" by some

financial experts.' Société Générale finds a leverage ratio of 15 to 1 'overly optimistic'. (https://www.societegenerale.com/en/content/look-headlines-0)". Veugelers (2014) adds 'there is much scepticism if this 1:15 multiplier is realistic, particularly as private funding needs to be 'additional' – it should not crowd out already planned investments'.
The issue of possible crowding out brings up another crucial factor in EFSI, namely the additionality. Regulation (EU) 2015/1017 defines this concept in article 5 as 'support by the EFSI of operations which address market failures or sub-optimal investment situations and which could not have been carried out in the period during which the EU guarantee can be used, or not to the same extent, by the EIB, the EIF or under existing Union financial instruments without EFSI support'. This means that the supported projects will typically have a higher risk profile than the normal EIB projects.

After approximately one year of operation (end of September 2016) the EIB reports that 40 % of the total 315 bn € has been allocated, spread over the 324 transactions that were approved (http://www.eib.org/efsi/).

5.5 The new role of the EIB

It should be clear that the EFSI is not a proper fund or legal entity and that it does not trade independently. It is enshrined in the EIB and its dedicated governance should ensure that it remains focused on its objective of increasing the volume of higher risk projects supported. As such it is only a label for new EIB assets. 'This label will be awarded by the newly created "EFSI investment committee" to some projects that the EIB previously did not want to fund because it considered them too risky, and that will now benefit from the EU guarantee' (Claeys 2015). The idea is that the EFSI would lead to a major change in the way the EIB functions. The EIB would take on more risk by funding high-risk/high-return projects that, without the EFSI, would not be able to secure finance. In doing so the EIB would take in a less dominant position by agreeing to finance a smaller share of each project to avoid crowding out private investors. In addition, the EIB would be junior to its co-financiers in order to reduce the risks taken by private investors.
The EFSI thus puts the EIB into the drivers seat by attributing to it a crucial position in raising and allocating the capital for the extra investment in the Juncker plan. The EIB is the obvious candidate because it has the most experience. Since this experience is mostly in supporting relatively small numbers of projects, 'it would need to take on a larger role' (Myant 2015). Also according to Darvas (2012), the EIB 'seems to be the best institution to carry out such an investment programme.'
In taking on this new task the EIB does not enjoy complete autonomy however. The EFSI activities cannot be entirely mixed with the normal EIB-activities since that would not lead to the wanted additionality. The governance of the EFSI is covered by article 7 of Regulation (EU) 2015/1017. This article states that the EFSI will be governed by the Steering Board, the Investment Committee and the Managing Director. The Steering Board comprises four members, appointed for three years, three by the Commission and one by the EIB. The Managing Director is responsible for the day-to-day management of the EFSI and is assisted by a Deputy Managing Director. The Investment Committee has as its responsibility to examine potential projects and to approve the support of the EU guarantee for EIB operations. The Committee is composed of eight independent experts selected through an open and transparent procedure. The experts are appointed for three years.

What do these innovations mean for multi-level governance theory? According to Robinson (2009), in many cases the EIB remains absent in multi-level governance analyses, although 'the EIB places a considerable premium on expertise and knowledge, requiring certain institutional structures of partnership between government and non-government actors to be in place before the loan bidding process'. It seems logical to assume that the introduction of the Juncker plan will enforce these institutional structures. Crucial here is the interplay between the EIB, the Commission and actors from subnational government levels and from the private sector. Already in the period 2007-2013 the EIB and the Commission cooperated in several programmes (JASPERS, JESSICA, JEREMI, etc.), looking for a leverage effect of jointly financing projects through structural funds spending and EIB loans (Robinson 2009). These programmes are explicitly mentioned in Regulation (EU) 2015/1017) as expecting to feed the EIAH with good practices. Through the Juncker plan, according to Marty (2015), the 'dialogue between the Commission and the EIB, the promoters, investors and other institutional players is provided for on European, national and regional levels to facilitate developments and to raise awareness on the new financing methods.' This will promote synergies between national programmes and those undertaken on the EU level. Marty (2015) even looks beyond the Juncker plan and foresees the possibility of converting the Structural Funds into these new EFSI instruments. This fits into the view of Valla (2014) that 'over time, Structural Funds have become sadly famous for lacking a strategic vision. Their allocation is perceived as opaque and sub-optimal.'

5.6 The introduction of 'national promotional banks' and 'investment platforms'

From a multi-level governance and European Administrative Space perspective an even more important development is the prominent role attributed to national promotional banks and investment platforms in the operation of the EFSI. They are expected to play a role 'in identifying viable projects, developing and, where appropriate, bundling projects, and attracting potential investors' (Regulation (EU) 2015/1017, recital 34).
The same regulation defines 'national promotional banks or institutions' as 'legal entities carrying out financial activities on a professional basis which are given a mandate by a Member State or a Member State's entity at central, regional or local level, to carry out development or promotional activities'.
Main examples of national promotional banks are Germany's KfW, France's Caisse des Dépôts and Bpifrance, Spain's Instituto de Crédito Oficial and Italy's Cassa dei Depositi e Prestiti. According to Valla (2014) they can be game changers 'if they choose to put the unavoidable upfront cash that the Fund needs to effectively work'.
Promotional banks are better known as development banks or as development financial institutions (DFIs) and have been around for a long time. Most of them have been established in the period 1946-1989 on national, subnational and supranational level and were seen as less useful in the next period. Since the financial and euro crisis however development banks have become more active and new ones have been set up (Wruuck, 2015). At the European level the EIB, also a development bank, has stepped up activity. The establishment of the EFSI also involves an important role for national development banks.
Wruuck (2015) points at the new elements in the present EFSI context: 'what is different this time is i) the creation of a joint facility to promote investment in which national DFIs can take part and ii) that the discussion about DFIs role and their potential for European economies is not only regionally focused. Rather, DFIs are considered as part of the economic policy toolkit to address problems on a national as well as on a European scale.' In that sense promotional banks are becoming more and more integrated in the EU multi-level governance system and become a part of the European Administrative Space. This does not come without its problems however. The European system of promotional banks is very heterogeneous as are the types of cooperation and coordination between them. For that matter proposals have been raised (Valla a.o. 2014) to create a 'Eurosystem of Investment Banks' (ESIB)

By 'investment platforms' Regulation (EU) 2015/1017 means 'special purpose vehicles, managed accounts, contract-based co-financing or risk-sharing arrangements or arrangements established by any other means by which entities channel a financial contribution in order to finance a number of investment projects'. They include:
(a) 'national or sub-national platforms that group together several investment projects on the territory of a given Member State;
(b) multi-country or regional platforms that group together partners from several Member States or third countries interested in projects in a given geographic area;
(c) thematic platforms that group together investment projects in a given sector.'
Further guidance concerning investment platforms is given by the European Commission (2015): 'Investment platforms are in essence co-investment arrangements structured with a view to catalysing investments in a set of projects (as opposed to individual projects). Investment platforms are a means to aggregate investment projects, reduce transaction and information costs and provide for more efficient risk allocation between various investors.'
Contrary to the promotional banks investment platforms do not have a long pedigree. The Commission (2015) itself offers examples of a few recent multilateral investment platforms. 'Marguerite', the 2020 European Fund for Energy, Climate Change and Infrastructure was launched in December 2009 by a number of leading public financial institutions such as the EIB, KfW, the Caisse des Dépôts and the Cassa Deposito e Prestiti. It invests mainly in European infrastructural brownfield and greenfield projects in the transport, energy and mature renewable sectors. A similar initiative is the European Energy Efficiency Fund (EEEF) involving the European Commission, the EIB, the Cassa Deposito e Prestiti and the Deutsche Bank. With the presence of a private bank the EEEF takes on the form of a supranational public-private partnership (PPP). A third initiative, the European Fund for South East Asia, is also is a PPP. They are not regular PPP however. The distinguishing factor between a regular PPP and an investment platform is that the latter invests in a portfolio of projects while the former engages in individual projects. There is a similarity with what the OECD calls 'co-investment platforms', whereby pension funds and sovereign wealth funds pool their resources to invest jointly in infrastructure projects. They do so in order to benefit from a number of advantages: 'better alignment of interest with other pension funds, like-minded investment horizon, lower fees, better control of the characteristics of the investment, larger commitments, local knowledge, and a spreading of risk' (OECD 2014).

5.7 Conclusions

In this paper the Juncker plan developed by the Commission in order to step up investment in the European Union is analysed from the viewpoints of effectiveness, its impact on multilevel governance and its contribution to the European administrative Space.
Although a good economic case can be made for intervention in investment at the EU level, it is clear that the extra instruments created by the Juncker plan can only have added value if it does not act as a substitute for existing financing sources but leads to extra investment. Although it is still early to have a clear view on that issue, the suspicion is there is not much additionality present.
The central institution in the Juncker plan, the EFSI, is placed under the umbrella of the EIB, but is managed by a separate and independent governance structure. As the spider in the centre of the web the EFSI has to count on actors at various governance levels. At the EU level there is a close similarity between the objectives of the Juncker plan and the European structural funds that are managed by the Commission under the EU budget. The EFSI can contribute to a better coordination between both instruments. At the national and subnational levels the EFSI has a role to play in coordinating investment projects and policies with promotional banks and private investors. As such it adds to the elaboration of the European administrative Space.
Summing up, while it is still early to draw definite conclusions, the Juncker plan seems to have triggered a renewed kind of multi-level governance with a larger role for the EIB.

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