Italian Presidency
of the Council
of the European Union
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Promoting investment

On-going initiatives and the role of Ecofin

(Informal Ecofin – Breakfast meeting, Milan, 13 September 2014)

1. Promoting investment as a driver for growth and jobs

Economic performance in the EU has been disappointing in recent years. Recent economic data show that the recovery is very weak. Unemployment increased dramatically and remains stubbornly high in many Member States.

Both private and public investment has fallen significantly. Insufficient aggregate demand and low capacity utilisation during the crisis together with the overall macroeconomic uncertainty have been drawing back new investment. On the supply side, enhanced regulation on financial institutions, for instance higher capital requirements for banks, has held back private investment in the short run. Real sector structural impediments to growth have also acted as a drag for private investment. In the euro area, moreover, limited access to credit due to financial fragmentation has been weighing heavily on firms' investment decisions, especially for SMEs. Meanwhile, public investment has plunged as a result of Member States' efforts on fiscal consolidation.

Stimulating private and public investment to promote growth and jobs must be at the top of the European economic policy agenda. The need for an ambitious "Investment Package" was in fact stressed by President Juncker in his inauguration speech at the European Parliament and a number of initiatives to encourage investment are underway, both at national and European level. Yet much more must be done to promote investment so as to foster economic activity and job creation in the short run and to attain higher potential growth in the medium to long term.

2. On-going initiatives

This section presents a non-exhaustive overview of current initiatives to promote investment. These are of a very different nature and span a wide spectrum of channels through which they intend to affect investment. For ease of exposition, they are presented in a "thematic" fashion, focusing on Europe. Another list of on-going initiatives, classified according to promoting actors and fora, is presented in the Annex.

2.1 Structural reforms and investment

Favourable business environment (in terms of infrastructure, corporate tax system and regulation, and more generally, other features such as access to services and judicial system) is crucial for attracting investment. Structural reforms are expected to yield a better business environment both directly (*e.g.* reducing start-up and operational costs) as well as indirectly (*e.g.* through more flexible labour market), albeit with a lag. It is therefore important to stay focused and maintain the reform momentum, in order to achieve these long-term benefits on potential growth, also through higher investment.

Over the past years, a series of programmes have been launched both at national and European levels to improve corporate regulation by reducing administrative burdens and simplifying administrative procedures. Examples of such initiatives at the EU level include the Small Business Act, encompassing policy actions supporting SMEs and entrepreneurs, and the Commission study on “Business Dynamics”, measuring the impact of the legal provisions and administrative procedures on start-ups, business transfers and bankruptcy, with particular attention to SMEs.

The relationship between structural reforms and investment, recalled in this section, is briefly explored in a short companion note.

2.2 Finance for growth

EU economies have traditionally been heavily dependent on bank intermediation for financing investment. However, in light of deleveraging efforts by banks after the crisis, together with a sluggish economic recovery, bank lending to non-financial corporates has continued to fall in the past six years. Following major advances in the regulatory reform agenda to prevent future crises, current priorities should increasingly focus on actions to facilitate the financing of the economy. Two major issues have already been identified by a number of official documents at European level and deserve a thorough consideration: (i) the need for long-term financing, and (ii) the development of a more balanced financial system through the availability of alternative sources of finance. As will be discussed more in depth in the dedicated session of the Informal on the broader initiative “Finance for Growth”, measures to this effect include:

i. **Revitalising the market for simple, transparent and robust securitisations** – under the Commission’s initiative, a preferential treatment for “qualifying” securitisations has been and will be introduced, such as under the Solvency II framework, while a number of international initiatives are also underway, for instance by the BCBS, IOSCO and the G20;
ii. **Deepening market-based financing channels** – especially for SMEs (*e.g.* via increased use of equity financing, project bonds, mini-bonds). Some Member States have made efforts to facilitate the debt financing of infrastructure and SMEs’ access to capital markets;
iii. **Promoting the diversification of the EU financial system through the establishment of a “Capital Markets Union”** – access to capital markets and non-bank financial intermediaries needs to be enhanced in the EU in particular for SMEs. Inter alia, this will require improving investors’ access to business, credit and financial information on EU SMEs, for instance through greater harmonization of such data along with the creation of a dedicated European platform.

In the meantime, the resources of Member States to Public Private Partnerships (PPPs) diminished significantly during the crisis. The European Commission will undertake in 2014 a Union-wide evaluation to encourage the EU authorities to enhance private sector involvement, especially in infrastructure projects. The Commission together with the European Investment Bank (EIB) will also assess ways to share best practices of PPPs (in the course of 2014).

2.3 Promotion through EU budget

A number of EU initiatives to promote investment have already been put into practice and are underway, such as: (a) infrastructure financing through the Connecting Europe Facility

(CEF); (b) improving access to debt financing for companies and public institutions undertaking research, development and innovation (RDI) projects through the Risk Sharing Finance Facility (RSFF); (c) the forthcoming Horizon2020 programme for the financing of investment in research and innovation by SMEs and mid-caps; and (d) the Competitiveness of Enterprises and Small and Medium-sized Enterprises (COSME) programme for the financing of investment by SMEs.

Enhancing quality investment, however, requires significant financial resources, additional to those already committed under the EU budget. Further efforts in structural reforms can enhance project capability. A significant effort to better align Cohesion policy to EU 2020 targets was made in the current programming cycle, together with an explicit support to improve project design and implementation through more effective governance. These policy lines should be pursued further, with much more determination, in finding ways to refocus the EU budget towards investment, for instance, at the mid-term review of the Multiannual Financial Framework (MFF) 2014-2020, scheduled for 2016, and/or within the context of the on-going projects financed by the EU budget.

2.4 Reinforced cooperation between EIB and National Promotional Bank (NPBs)

Cooperation among National Promotional Banks (NPBs) and with the European Investment Bank (EIB) has been strengthening over time.

In the past few years, joint work between the EIB and NPBs has expanded to cover a wide spectrum of activities, including intermediated lending to finance private investment by SMEs, the financing of public infrastructure operations (including the project bond initiative), and/or the joint participation in equity funds.

In this context, the experience of the Marguerite Fund (the 2020 European Fund for Energy, Climate Change and Infrastructure)[1] to deploy capital-intensive infrastructure investment operations, provides a good example of how enhanced cooperation can be fruitfully exploited and lead to significant operational results.

The experience of the Marguerite Fund and the Project Bond Initiative have proven that pooling resources, sharing expertise and knowledge among NPBs as well as with the EIB can exploit synergies and complementarities and add to their respective funding capacity.

In this regard, the partnership between the EIB and NPBs can be enhanced and placed on more solid institutional basis, with a view of setting up a common “Platform for Investment” – a European version of the Long-term Investors Club – and providing additional financial capacity to EU-wide operations in priority areas.

3. The role of Ecofin

Investment policies stand at a strategic intersection where synergies between different policy tools, including structural, fiscal, monetary and financial policies, come into play. The credibility of reforms and confidence over economic prospects, which would benefit from coordinated public actions, are key ingredients to make policies work effectively. Moreover, investment is often cross-border and thus generates international spill-overs.

All these reasons add to its key role as the engine of growth and make investment an area of key policy interest to EU Finance Ministers. Indeed, Ministers at their breakfast meeting in July recognised the importance of reviving investment, especially in the private sector, to promote growth in the EU. However, the brief discussion also pointed to some apparent

[1] Established under the impulse of Italy’s Presidency of the EU in 2003 and with the backing of major European long-term financial institutions (including the EIB) together with the Commission.

misallocation of financial resources in the EU, given that in some sectors and regions financing seems sufficiently available but viable project proposals are scarce, whereas in other areas many viable projects do not find adequate financing, especially when the project time horizon extends to the long term.

This partially reflects diverging economic and financial conditions and market fragmentation. Besides, institutional bottlenecks such as cumbersome authorisation procedures, poor investment governance, and inadequate institutional capacity may also be holding back the appropriate design and implementation of public and private investment projects. However, the conundrum of available financing without suitable project proposals in some areas and, in contrast, the inadequacy of funds for available projects in others also suggests that there is a need for better management and coordination of investment projects across the Union, particularly in an environment where the recovery falters and domestic demand remains generally weak.

Current economic conditions make it urgent to address any possible mismatch between resources and projects. In addition to structural measures improving business environment and technical support to project design at the national level, initiatives at EU level should be explored to target resources to flagship areas where projects and resources are inadequate. Their bankability has been hampered by low risk-adjusted rates of return, which, in turn, are determined by a long time horizon, persistently low confidence in future economic perspectives, a mis-evaluation of the social returns and other relevant circumstances. These are all investment-depressing market failures that have macroeconomic relevance during periods of insufficient aggregate demand.

Against this background, the Ecofin Council provides the most suitable institutional setting to discuss, elaborate and adopt policy actions of European interest to address the existing market failures leading to insufficient investment. The Council can act to support investment in various ways. First, it can provide **general political support** to the initiatives of European interest. A united commitment is necessary for keeping the reform momentum and preventing unnecessary market volatility. Second, it can advocate and **support on-going proposals** that are under its direct control. A coordinating/guiding role, which cannot be performed by individual programme or project operators, could be provided by the Ecofin Council for better resource allocation and acceleration of certain projects.

Finally, it may as well **stimulate and promote new initiatives**, especially those targeted to fill financing gaps in priority areas. In this regard, the European Commission has already identified substantial investment gaps and financing requirements, in particular in four “flagship” areas, namely: **green economy**, **ICT-energy-transport networks**, **the digital single market**, and **social infrastructure** (in particular, hospitals, schools and universities). These sectors are considered to be the key elements for boosting potential output, competiveness, and social well-being in Europe. One way to fill financing gaps could be through the establishment of an ad-hoc fund which could leverage resources from a reinforced cooperation between the EIB and NPBs, with the possibility of strengthening available capital, if necessary.

Issues for discussion

- ***Do Ministers agree that the Ecofin Council should take an active role in promoting investment?***
- ***What initiatives could the Ecofin Council take to support investment?***
- ***Do Ministers agree that the EU budget should devote more resources to promote investment? Should the Ecofin Council act to this effect in the context of the mid-term review of the MFF?***

Annex
On-going initiatives for promoting investement
(listed by national and international institutions and fora)*

1. National authorities

- Informal position papers on finance for growth
  - **France** "*An Agenda for Growth and Change in Europe: French Contribution – 24 June 2014*" (main proposal: a comprehensive five-year investment policy, utilising EU and national public and private resources)
  - **UK** "'*Finance for Growth' – United Kingdom informal paper*" (main proposals: reviving securitisation, developing a pan-EU private placements (PP) market; review of the Prospectus Directive)
- National efforts and progress in structural reforms (for better business environment)
- Facilitating SMEs' access to capital markets

2. EU

- The Small Business Act (policies supporting SMEs and entrepreneurs: http://ec.europa.eu/enterprise/policies/sme/small-business-act/index_en.htm)
- The Commission study on "Business Dynamics" (measuring the impact of non-efficient transfer of business on job creation and start-ups: "*Business Dynamics: Start-ups, Business transfers and Bankruptcy*" European Commission (2011) http://ec.europa.eu/enterprise/policies/sme/business-environment/files/business_dynamics_final_report_en.pdf)
- Infrastructure financing through the Connecting Europe Facility (CEF) (http://ec.europa.eu/digital-agenda/en/connecting-europe-facility)
- Improving access to debt financing for RDI projects through the Risk Sharing Finance Facility (RSFF) (http://www.eib.org/products/rsff/)
- The Horizon 2020 programme (for the financing of investment in R&D by SMEs: http://ec.europa.eu/programmes/horizon2020/)
- The Competitiveness of Enterprises and Small and Medium-sized Enterprises (COSME) programme (for financing investment by SMEs: http://ec.europa.eu/enterprise/initiatives/cosme/index_en.htm)
- Joint discussion paper by the BoE and ECB ("*The case for a better functioning securitisation market in the European Union: A discussion paper*" Bank of England and European Central Bank (May 2014): https://www.ecb.europa.eu/pub/pdf/other/ecb-boe_case_better_functioning_securitisation_marketen.pdf)
- The Commission *Communication on Long-Term Financing of the European Economy, 27.3.2014, COM (2014) 168* (http://ec.europa.eu/internal_market/finances/docs/financing-growth/long-term/140327-communication_en.pdf)

- The Commission *Sixth report on economic, social and territorial cohesion*, *“Investment for jobs and growth. Promoting development and good governance in EU regions and cities”, July 2014* (http://ec.europa.eu/regional_policy/sources/docoffic/official/reports/cohesion6/6cr_en.pdf)

3. G20

- Establishing growth and job creation as a priority issue in the agenda (together with a numerical target of raising the GDP by additional 2% over the next five years on average in the G20 https://www.g20.org/official_resources/communique_meeting_g20_finance_ministers_and_central_bank_governors_sydney_22_23)
- Working Group on Infrastructure and Investment (incl. “Practices for Prudent Securitisation”(http://en.g20russia.ru/news/20130906/782782178.html)
- Study Group on Financing for Investment (https://www.g20.org/sites/default/files/g20_resources/library/G20_Workplan_on_Financing_for_Investment._Study_Groups_Findings_and_Ways_Forward_1.pdf)
- The G20/OECD High-Level Principles on Long-Term Investment Financing by Institutional Investors (http://www.oecd.org/finance/private-pensions/G20-OECD-Principles-LTI-Financing.pdf)

4. Others (international Standard Setting Bodies, independent research institutes)

- The CEPII proposal for the creation of the “Eurosystem of Investment Banks (ESIB)” (Valla, N., Brand, T. and Doisy, S. (2014) “ *A New Architecture for Public Investment in Europe*” CEPII Policy Brief No.4 July 2014, http://www.cepii.fr/CEPII/fr/publications/pb/abstract.asp?NoDoc=7030)
- The BCBS revision of the Basel III securitisation framework (http://www.bis.org/publ/bcbs269.pdf)

*This list, as well as the one in the main body of the paper, is for convenience only and has no pretence to be exhaustive.