Bundesverband der
Deutschen Industrie e.V.

INDUSTRIAL POLICY DOSSIER

Juncker's investment plan for Europe.

Opportunities for German companies

July 2015

- **The European Fund for Strategic Investments (EFSI), a key component of Juncker's investment plan, was adopted in June 2015. It is expected to mobilise 315 billion euros for the real economy.** The EFSI will provide funding for not just long-term infrastructure investments but also SME and mid-cap projects, thus opening up opportunities for German companies in need of fresh capital. A European investment portal and a hub for investment advice will be established to give guidance and support.

- **The objective of the package is to increase competitiveness and stimulate growth.** Investments in Europe have been declining for the last two decades, and the growth potential on the continent has increased at a slower pace than the one of our trading partners. The investment backlog has been caused by a lack of liquidity, but also by other non-financial barriers.

- **The investment plan will be supported by measures to improve the investment environment.** The Capital Markets Union is geared towards improving access to venture capital and creating uniform conditions in Europe. Structural reforms will be an important step to enhance the investment climate.

- **In a first phase, the fund will run four years.** The EU will provide a capital guarantee of 16 billion euros and the European Investment Bank (EIB) 5 billion euros. By leveraging up and the participation of other investors, the fund aims to mobilise 315 billion euros in investments and create up to 1.3 million new jobs.

Content

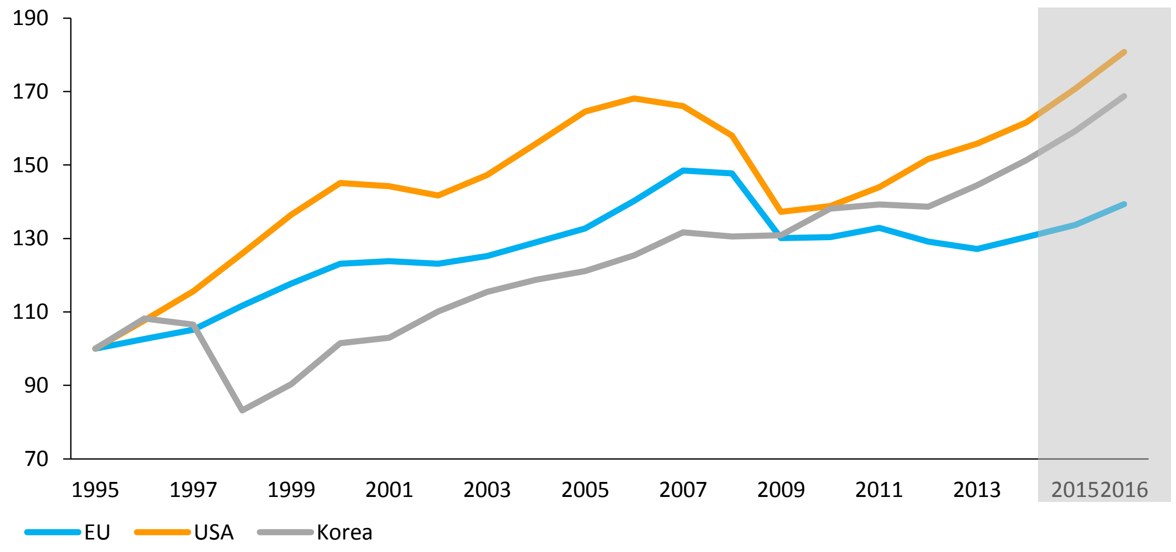
The economic status quo in the European Union

Compared to the US, the European economy has experienced less growth and a slower recovery since the crisis hit in 2008. Estimates put real GDP growth in the EU at 1.8 percent for 2015 and at 2.1 percent for 2016. The corresponding values for the US are 2.5 and 3 percent (European Commission, 2015a; IMF, 2015). Unemployment rates also differ, with those in the EU expected to be 9.6 percent this year and 9.2 percent next year. Forecasts for the US look significantly better, with the figures standing at 5.4 and 5.0 percent.

Acute investment backlog is slowing growth in Europe

Speaking in 1974, former German Chancellor Helmut Schmidt said that "the profits of today are the investments of tomorrow and the jobs of the day after tomorrow". Since the 1990s, however, EU investments have only been growing slowly. After hitting a high in 2007, they have stagnated at a low level, while other comparable countries have seen their investments pick up. The situation with research and development (R&D) spending is even more severe, with the EU lagging far behind international benchmarks. China's R&D intensity already caught up with the EU's in 2012.

Development of gross fixed capital formation



Source: AMECO, 1995 = 100, constant 2000 prices, estimates for 2015 and 2016

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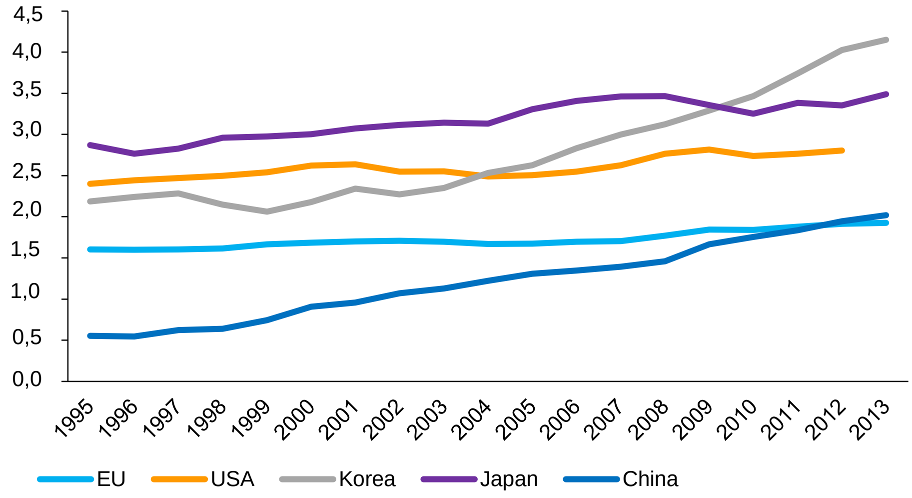
Development of R&D quota



Source: OECD 2015

The EU's investment level is currently 15 percent lower than its peak in 2007. This development covers both private and public investments, and has several causes.

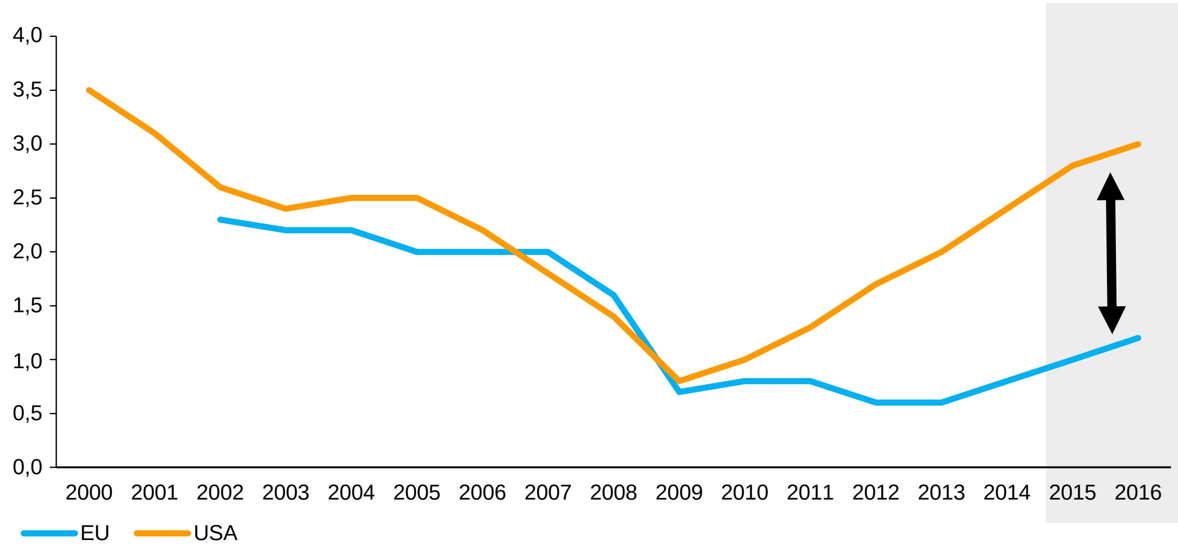
Barriers to investment

Lack of investor confidence	Uncertainty and volatility scare off investors.
Stretched public budgets	State investments have dropped significantly since 2009.
Credit crunch in crisis-hit countries	Despite low interest rates, companies are not getting loans because of their risk profiles and general uncertainty.
Obstructive financial market regulations	Compliance and risk regulations make corporate financing uninteresting or impossible for investors.
Lack of venture capital	Start-ups and young companies have particular difficulties acquiring capital.

Source: BDI

Production plants are outdated, infrastructure expansion is stagnating, and the digitalisation of the economy is making sluggish progress – all of which is causing a loss of competitiveness and growth potential. This has been especially clear since 2009. In the US, investment activity rose quickly after the crisis, thus developing production capacity for the future. Growth potential in the EU, however, plateaued at a low level of about 1 percent. A modest increase is expected in 2015 and 2016 at the earliest.

Potential for growth



Source: EIB 2015c, estimates for 2015 and 2016

European competitiveness is at risk

Inadequate levels of investment over the past two decades have caused many European companies to become less competitive. This is a particular problem for the high-tech industry, which is suffering badly from the stagnation in R&D activities. At just over 2 percent, R&D intensity is currently well short of the Europe 2020 target of 3 percent. Japan and South Korea have already exceeded 3 percent, and are gradually increasing their competitiveness. A similar picture exists with patent applications, where the EU is again lagging behind. Europe is in danger of losing its ability to keep up in the global innovation race.

The European Investment Bank estimates that the following annual sums are needed to fill the investment gaps in selected areas.

Annual investment required in the EU	
Area	**Investment volumes needed (in billion euros)**
Research & Development	130
Energy grids	100
Transport networks	50
Digitalisation of the economy	55
Educational facilities	10
Environment, water, climate	90

Source: EIB 2015a

Lack of risk-bearing capacity and insufficient equity capital

The markets are currently unable to finance investments for several reasons. First, many financial intermediaries lack risk-bearing capacity. Banks are often undercapitalised, which means that projects with a high risk profile are not very attractive. Innovation projects in particular are falling by the wayside. Second, the long-term nature of public infrastructure projects often makes them uninteresting to investors. With cross-border infrastructure – such as transport, energy and data networks – the situation is complicated by the fact that member states only have limited options for cooperation. Budgetary and administrative hurdles obstruct public-private partnerships.

Structural reforms are urgently needed

The OECD (2015) also recommends a wide range of measures to revive investment activity. Stimulation via a relaxed monetary policy is already happening in the Euro area and has provided the necessary liquidity as a basis for investment growth. However, additional instruments are needed to ensure that the stimulus continues to provide a boost. From a fiscal policy perspective, the OECD proposes a budget-neutral reallocation of public spending towards investments. As the investment multiplier is higher than the one of consumption spending, this instrument will have a doubly positive effect. In addition to improving long-term supply factors, it will also stimulate the economy in the short term. Promoting public-private partnerships for infrastructure projects is also an effective tool. To reduce insecurity, the OECD suggests bringing public budgets back to a balanced position. In addition, structural reforms must be introduced to respond to demographic changes and the higher anticipated costs for pensions, healthcare and nursing services. Simplifying access to the capital market and taking measures to stabilise the financial market are also – and rightly so – on the OECD's list of recommendations.

The Juncker plan: just one piece of the puzzle

The European Commission correctly identified these problems, and in November 2014 presented an instrument – its investment plan – to remove barriers to investment. In addition to providing liquidity, the measure suggests accompanying tools whose use will largely determine the success of the plan. A key question will be whether the planned Capital Markets Union can create the necessary stimuli for investments. Some member states also still have to do their homework and introduce reforms to make structures more conducive for investment.

Sustainably reviving investment activities requires the combined efforts of numerous instruments and actors. It is especially important that the member states do not ease up on their reform efforts. The current situation, with its low interest rates, a weak euro and cheap oil, offers the ideal conditions for boosting the economy with investments. If the EU misses this window of opportunity, it risks remaining stuck in its current state of low investment and GDP stagnation.

Juncker's investment plan in detail

The plan was first presented on 26 November 2014, and the regulation establishing the European Fund for Strategic Investments (EFSI) was approved by the European Parliament and by the Council in June 2015. The EFSI, which is the heart of the investment plan, can now become operational. The European Commission will add a few points of detail as delegated act, but the main elements are already fixed.

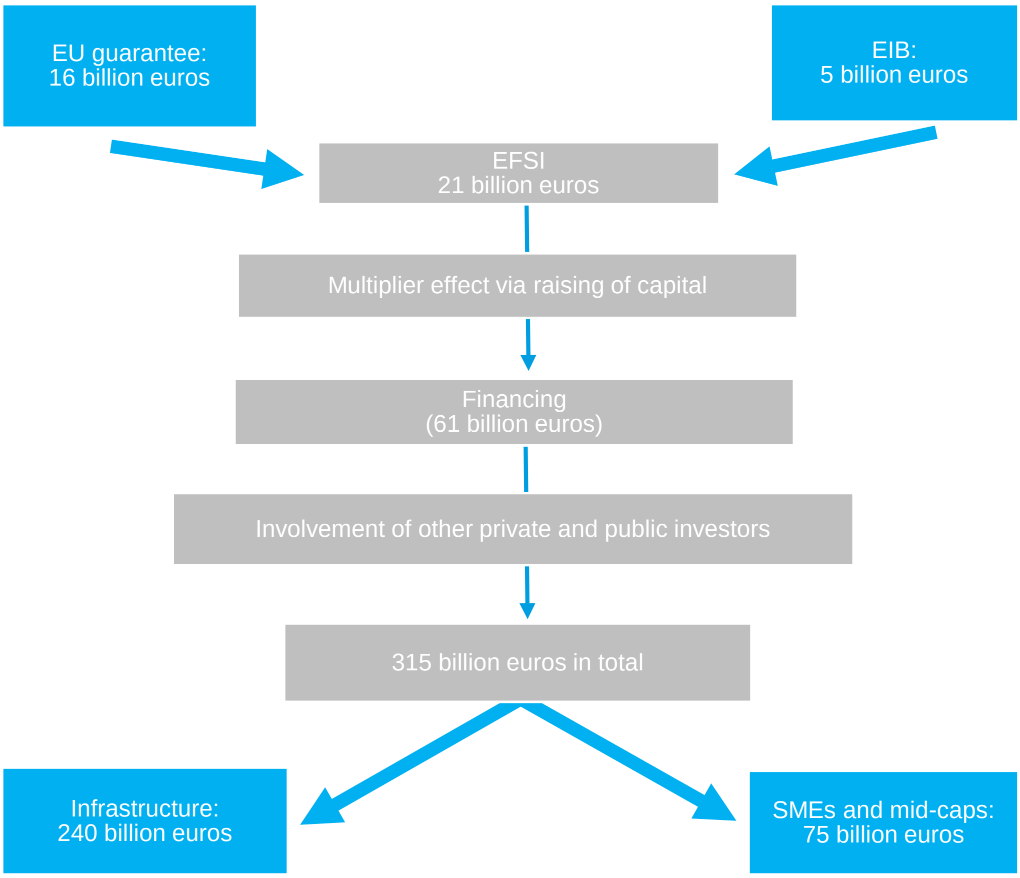
The Juncker plan at a glance
The European Fund for Strategic Investments (EFSI) is set to mobilise 315 billion euros.
The EFSI will be financed with 21 billion euros (5 billion euros from the EIB and 16 billion euros from the EU).
The 1:15 leverage ratio will come from the additional capital raised by the EIB and from the participation of private investors.
240 billion euros will go to larger investment projects, and 75 billion euros to SMEs and mid-caps with up to 3,000 employees.
The fund will be run by a steering board, a managing director and an investment committee. The committee will be responsible for approving the support of the EU guarantee to the EIB for certain investment projects. The EIB will handle the processing.
Financing for investments by SMEs and mid-caps will primarily come from the European Investment Fund (EIF).
To support the implementation of investment projects, two other instruments will be set up independently of the EFIS: an investment portal (EIPP) that will present projects to interested investors, and a hub for investment advice (EIAH) that will serve as the central point of contact for technical support and advisory services.
The EFSI is to be accompanied by a package of measures designed to remove barriers to investment. The Capital Markets Union and structural reforms should improve the overall investment climate.
Source: BDI

Capital endowment via the European Union and the European Investment Bank

The EU is providing the EFSI with a 16 billion euros guarantee via 8 billion euros of its own funds. Of that, 2.2 billion euros will come from reallocating funds from the Horizon 2020 programme, and a further 2.8 billion euros from the CEF (Connecting Europe Facility) transport programme. The remaining 3 billion euros will come from the EU's so-called budget margin.

The EIB is making a further 5 billion euros of its own capital available. The EFSI is therefore endowed with 21 billion euros in total. With this as its basis, the EIB will acquire additional funds on the capital market and is planning to back roughly 61 billion euros in financing. This corresponds to a leverage ratio of approximately 1:3. The EIB has a AAA rating and achieved a similar ratio with its last capital increase. On average, the EIB intends to co-finance EFSI projects at 20 percent (a ratio of 1:5), which means that 315 billion euros could be invested. The multiplier ratio of EFSI basic funding to the investment sum thus amounts to 15. Of the total, 240 billion euros are earmarked for larger projects (such as long-term infrastructure projects) and 75 billion euros for SMEs and mid-cap companies.

The EFSI financing structure



Source: BDI

Achieving the planned multiplier effect of 1:15 will depend heavily on how well the accompanying measures in the Juncker plan improve the overall investment climate. The EIB has achieved ratios of between 1:18 and 1:20 with past capital increases. However, its portfolio so far has involved less risk than the EFSI projects do. To achieve the average co-financing of 20 percent the EIB will have to offer investors a suitable level of risk assumption.

A wide range of investment projects is possible

The EFSI funds are available for almost all infrastructure and innovation investments. There are also no rules on minimum or maximum investment sums. The funding criteria are deliberately broad in scope and will allow financing projects across all economic sectors and countries. However, the steering board has been tasked with preventing risk concentration and thus with proposing upper limits per sector and country. These limits will be published.

In particular, the regulation sets out five financing criteria.

Financing criteria for EFSI projects	
Technical feasibility	The technologies necessary for realising the investment must be in place.
Economic viability	Projects must stand up to a profitability analysis in line with the EIB's standards.
Compatibility with EU principles	The project must promote inclusive growth, employment and social cohesion.
Mobilisation of private capital	As a rule, investments should lead to co-financing from the private sector.
Additionality	Without EFSI financing, the project would either not be financed or would not be financed to the same degree.

Source: BDI

The additionality criterion says that investments can only receive financing if they would not receive support from existing EU instruments – in particular those of the EIB. EFSI projects will thus mostly have a higher risk profile than the activities usually financed by the EIB.

The EIB will ultimately make a portfolio decision by implementing EFSI. Selecting higher-risk projects will increase the overall volatility of its balance sheet. A suitable level of diversification can reduce concentration risks in specific sectors and countries. If the EIB spreads its involvement across a variety of member states and industries, it should be able to keep its risk in check. However, macro risks such as global shocks (rising oil prices, rapid changes in exchange rates, etc.) are a threat and could endanger the 21 billion euros capital basis of the EFSI.

Diverse financing instruments create more flexibility

The EFSI provides for numerous possible forms of financing. Explicitly, the EFSI regulation lists EIB loans, guarantees, counter-guarantees, capital market instruments, and any other form of funding or credit enhancement instrument, equity or quasi-equity participations. It also allows for co-financing through national promotional banks, investment platforms and funds.

A key component of the financing process will be "first-loss" guarantees and other risk-bearing instruments. This is designed to compensate for the higher risk involved compared to conventional EIB projects and mobilise private-sector financing. The EFSI reduces the risk of investment projects and enables the subordination of a part or all of the capital. Investments that are unattractive on an ex-ante basis can thus be made more interesting for investors with lower risk-bearing capacity. Whether the targeted multiplier effect of 1 to 15 will be achieved will ultimately depend on aigning the financing tools to the risk tolerance of investors.

Governance through a steering board and processing by the EIB

The EFSI will be run by a steering board comprised of four members. Three of these will be appointed by the European Commission and one by the EIB. Decisions will be made by consensus and one member will serve as the Chairperson. The Steering Board will determine the strategic orientation of the EFSI and appoint the Managing Director and the Deputy Managing Director as well as the members of the Investment Committee, composed of the Managing Director and eight independent market experts. The committee will use investment guidelines to select appropriate investment projects to finance with the provision of a guarantee for EIB investments. The financing will then be processed operationally using the established structures of the EIB.

The European Parliament will have extensive rights to information and monitoring functions related to the governance of the EFSI. In the last rounds of negotiation, the European Parliament secured consultation rights and veto rights in the appointment of management officials. The management is also required to submit six-monthly and annual reports on its operations. The first drafts of the EFSI Regulation had included awarding further seats in the steering board to countries that make contributions to the initial 21 billion euros in capital. This paragraph was then omitted from the final text of the regulation in the interests of maintaining independence.

Nine member states have already stated that they would make a financial contribution to the investment plan through their national promotional banks. Germany announced that it would contribute up to 8 billion euros in the form of instruments such as global loans to other promotional banks and venture capital, or in the form of financing for the project platforms. Spain, France, Italy, Luxembourg, Poland, Slovakia, Bulgaria and the United Kingdom are also contributing funds to co-finance investments. Alongside these public contributions, funds from the private sector in particular are needed to achieve the targeted fifteen-fold leverage.

Support provided by project platform and investment advisory hub

The European Commission and the EIB will set up the European Investment Project Portal (EIPP). It will be a publicly available database with relevant information on current and future projects in the EU. Project initiators seeking financing can use the portal to promote their projects to prospective investors by providing transparent and structured information about their projects. However, being included in the database does not guarantee to be financed by any EU funding.

The EFSI Regulation also provides for the establishment of an advisory platform, the European Investment Advisory Hub (EIAH). Building on existing advisory services, the EIAH will be a single point of contact for advisory support for investment project identification, preparation and development, and a single technical advisory hub for investment project financing within the EU. This will take place in cooperation with the national promotional banks and advisory agencies.

Capital Markets Union and structural reforms serve as supporting measures

A transparent, stable and simple regulatory framework is needed to unfold the planned investment to its full potential. Inconsistent European and national regulations are presently curbing the investment drive of investors. In its Green Paper on Building a Capital Markets Union, the EU addresses these investment barriers and proposes measures to support the deeper and increased integration of the European capital markets. In contrast to the US, companies in Europe are mainly financed by conventional bank loans. The Capital Markets Union is designed to increase the capital market orientation of companies in parallel to conventional financing channels. It is intended to harness additional financing potential.

Instruments and objectives of the Capital Markets Union

Securitisation markets for "high-quality" securitisation	Bring securitisation volume back to pre-crisis level.
Standardised credit information on SMEs	Attract more investors to SMEs and mid-cap financing through transparency and simplification.
Simplification of the Prospectus Directive	Reduce the administrative workload (the stated goal of the revision).
Uniform framework for private placement	Bring market volume back to Europe.
Harmonisation of company, tax and insolvency law	Facilitate cross-border operations.

Quelle: Europäische Kommission 2015b

The proposals for a Capital Markets Union are still under deliberation within the political process. The European Commission is reviewing it for consistency with regulations already in place.

Extensive structural reforms are needed in parallel to the EFSI and the Capital Markets Union. The European Semester and the coordination of macroeconomic developments are designed to create a stable fiscal environment. The further deepening of the internal market is currently being addressed in the areas of the Digital Agenda and the Energy Union. Numerous measures to reform the goods and services markets are still unfinished to complete the internal market. The European Parliament (2015) believes that a deeper integration will unlock enormous potential to increase the EU's GDP.

Opportunities for German business

Juncker's investment plan with its three strands (1. the EFSI; 2. supporting the implementation of investment projects through EIPP and EIAH; and 3. improving the investment environment through measures such as building a Capital Markets Union and carrying out structural reforms) can help close the investment gap in Europe. The investment plan and its supporting measures will combat the causes of the weak growth in Europe in a targeted manner. Yet the success of the entire scheme will depend on a number of other factors.

Small and large companies stand to benefit

The investment plan opens up considerable opportunities for the German mid-sized business sector (SMES and mid-cap companies with up to 3,000 employees). Even though the financing situation for industry in Germany is satisfactory on the whole, there are bottlenecks in some areas. Access to venture capital, in particular, could be improved. The German market has gaps particularly in venture capital financings above 20 million euros. The "first-loss" guarantees of the EFSI could help facilitate investment in this sector. The reactivation of the securitisation market also harbours opportunities for SME and mid-cap financing.

Larger German companies are set to benefit particularly from the long-term infrastructure projects, such as those in the ICT sector. In view of the strong export orientation of the German business sector, investments abroad will also generate orders and create added value in Germany. Innovation financing has considerable potentials as well. The EIB refers to projects such as the modernisation of production facilities and product development. In June 2015, the EIB already financed an innovative pulp mill in Finland with 275 million euros. This shows that innovation projects in particular also offer opportunities for large companies.

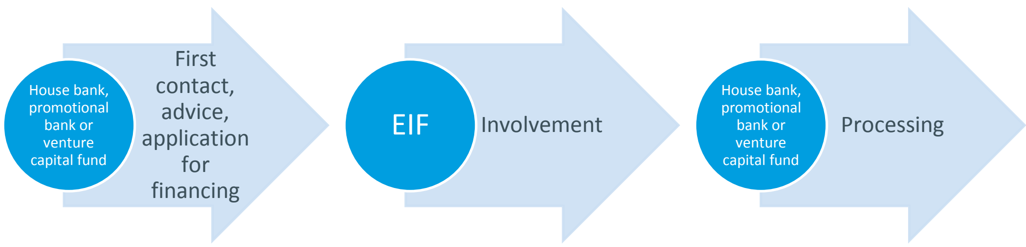
Procedure for companies: from project application to financing approval

Details on the evaluation, decision-making procedure and processing of guarantees still need to be worked out. The general procedure is based on clear processes. Large projects are processed via the EIB. It is also possible for a promotional bank to obtain a guarantee from the EIB for its financing.

Mid-sector financing starts with the house bank of the company, a promotional bank (such as the KfW in Germany) or a venture capital fund that has an agreement with the European Investment Fund (EIF). After the financing has been granted, it is processed in the same way as the EIF has processed SME and mid-cap projects thus far.

There are a wide range of financing instruments available including loans, guarantees, capital market instruments and equity participations.

Procedure for SME and mid-cap financing



Source: BDI

Procedure for large project financing

Source: BDI

A transparent, speedy and professional processing of the financing with a single point of contact (one-stop shop) will be crucial to the success of the investment plan.

Assessment of the Juncker investment plan

The package of measures contained in the investment plan has the potential to revive investment activity in Europe for the long term. Alongside the financial arm EFSI, the supporting measures of structural reforms as well as the Capital Markets Union will be needed to increase the investment appetite of investors. Focusing solely on the EFSI's liquidity provision and risk-bearing capacity will not close the investment gap.

Strengths and opportunities

One of the strengths of the innovation offensive is the considerable endowment of the EFSI with a financing potential of up to 315 billion euros. What is more, this investment volume will be achieved without placing a huge burden on the EU budget. Another positive aspect of Juncker's investment plan is that it enjoys broad political consensus and is supported by all major stakeholders. Its broad range of financing instruments will enable the flexible processing of a wide range of investment projects. The current low interest rates also provide a favourable environment for the investment plan. The chances are therefore very high of improving the overall investment environment, stimulating the economy in the short term and increasing growth potential in the long term.

Weaknesses and risks

There is still a lack of clarity regarding the supporting measures – the Capital Markets Union and the announced structural reforms. The extent of the leverage that can be attained is also uncertain, and it is impossible to estimate the actual investment volume in advance. The risk of misallocating funds cannot be ruled out. The ensuing cuts to Horizon 2020 and CEF - though lower than originally planned - still amount to 5 billion euros. The additional financing could also crowd out market financing. The EFSI instruments should rather work as a complementary channel to the present financing channels. When it comes to the processing of financing, it will be very important to avoid inflated bureaucracy and a politicisation of investment decisions.

Concluding remarks

A conclusive assessment of the investment plan will only be possible in the next few years. An evaluation of the first phase is scheduled to take place 18 months after the EFSI Regulation has entered into force. This report will provide insights into the procedural achievements of the plan (number of projects in the pipeline, leverage ratio, etc.). The translation of investment into growth, jobs and competitiveness is a long-term process and will only become apparent after the expiration of the EFSI. In the opinion of the BDI, it is of decisive importance to dismantle both the financial and the non-financial barriers to investment. Fiscal consolidation, structural reforms, and the transparent and non-bureaucratic integration of the capital markets are at least as important in achieving the stated objectives as providing liquidity through the EFSI. EFSI will not turn Luxembourg into Silicon Valley, but it is a start to addressing the financing problems on a wide scale, a task that is of critical importance to Europe’s future.

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