

# European Investment Bank and France Stratégie Workshop, 11 March 2016, Paris 'Fact Finding on Investment and the Investment Gap in France and in Europe'

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The EIB co-organised a workshop on investment together with France Stratégie in Paris on 11 March 2016. The main objective was to identify investment gaps in France and Europe in the context of the operational implementation of the Investment Plan for Europe.

The workshop comprised four sessions – the first session discussed recent EIB and EIF activities supported by EFSI; the second panel focused on the implications of EFSI for investment in France; the third dealt with investment data and national accounts produced by statistical agencies; and the last session discussed recent trends in business investment in Europe.

## *Key messages*

- The crisis led to a significant slowdown in investment across the developed world. But there are also some EU specific and Euro Area specific factors that need to be addressed. Weak investment, above and beyond cyclical factors, has been a primary reason for the weakness of the recovery of the EU economy. Besides having a negative impact on current GDP, the low level of investment activity also negatively impacts the long-term growth potential.
- The objective of the Juncker Plan is to compensate for a part of the investment gaps in Europe. Clearly the EUR 315bn of additional investments that were announced when the Plan was launched are not sufficient to address all investment gaps. They will also need to be accompanied by structural reforms. But EFSI can have a positive impact on the investment climate in Europe and can address significant market failures, for instance in the sectors of renewable energy or energy efficiency.
- EFSI activities have a very broad scope with no specific geographical or sectorial focus. Through EFSI more than 200 projects (EIB and EIF) have already been approved in 23 EU countries, amounting to EUR 77bn, which corresponds to 25% of EUR 315bn.
- The first operations that were approved reflect the use of more innovative financial products, the focus on smaller and more risky projects, the support to the internationalisation of SMEs and the increased cooperation with national promotional banks.
- In particular, projects that would not have been financed otherwise (or not at this scale) are particularly relevant so that EFSI can have an impact on the real economy. Against this background, EFSI is an instrument that will continue to evolve to address both country-specific cyclical and structural issues.
- The pan-european presence of the EIB group can encourage more cross-border co-investments and develop better investment platforms to attract more foreign investors. It can also be an opportunity to show that innovative financing schemes that work well in one EU member state can be developed in other EU member states.
- The exchange of good practices across Europe will be reinforced by the Juncker Plan. In addition, the recent decision by the European Commission to combine EIB finance with ESIF (EU Structural and Investment Funds) highlights the needs to rely on different public support schemes at the EU, national and local levels.

**Through EFSI, the first pillar of the Juncker Plan, it is expected that €EUR 315bn will be mobilised over three years for investment in strategic projects and access to finance.** The second pillar consists of advisory and technical assistance for projects implementation to make finance reach the real economy. The third pillar, structural reforms and better regulations, aiming to improve the investment environment in Europe, is of the competence of the European Commission and EU member states.

**EFSI is a EUR 21bn guarantee, with EUR 16bn provided by the European Commission and EUR 5bn by the EIB, and is used to back investments in higher-risk projects than those usually supported by the EIB.** The expected leverage effect is 15, where  $15 \times 21\text{bn} = \text{EUR } 315\text{bn}$ . EFSI regulation has entered into force in July 2015, which has allowed the EIB to start delivering rapidly, while the governance structure has been put in place in the second semester of 2015. The EIB is now fully operational and is increasing the pace of project approval under EFSI.

**EFSI implies a real change of scale for the EIB for the financing of risky projects.** The model of EIB lending, which used to be characterised by large projects with low risk, will now consist of many more smaller projects with higher risk. While earlier, 'risky' projects amounted to EUR 4bn to 5bn per year, they will now correspond to EUR 20bn per year.

**Through EFSI more than 200 projects (EIB and EIF) have already been approved in 23 EU countries as of March 2016, amounting to EUR 77bn, which corresponds to 25% of the EUR 315bn announced when the Juncker Plan was launched.** The acceleration of the Juncker Plan is very interesting for the investment environment in Europe, in particular for risky investments where there are large gaps in the market.

**Examples of eligible projects in France that had been recently approved** include a small company involved in recycling titanium. There are no companies engaged in this strategic activity in Europe. This project is fully in line with the aims of EFSI: the company is located in a transition region (Auvergne), the investment is considered risky and it is cofinanced with BPIFrance. It also illustrates well the **strategy to cooperate with national promotional banks, which is crucial for the success of the implementation of the Juncker Plan.**

The EIB also supports an agriculture cooperative in Normandy that will export milk to China, a project well aligned with the **EIB aim to foster the internationalisation of small European companies.** The third project mentioned was a participation in a fund focusing on small infrastructure investments, which illustrates the **EIB focus on smaller infrastructure projects through different financial instruments.** Large institutional investors and insurance companies have full dedicated teams working on infrastructure investments. But smaller institutional investors do not always have the technical capacity or the resources. The EIB is thus supporting this market by expanding and diversifying investment opportunities for smaller investors.

There are also older or larger projects supported by EFSI in France. For instance, **the EIB is addressing a significant market failure by supporting third financing companies to carry out energy efficiency renovations on private homes on a large scale.** While energy efficiency renovation for public buildings is well advanced in France, it was more difficult to get it started for private buildings – an issue faced by many European countries as the banking sector is almost completely absent from this important sector at the moment. At least three factors explain the difficulty to finance energy efficiency renovation of private property: lower energy costs, the lack of capacity of commercial banks to finance small projects at this level of granularity, and the fact that homeowners are not willing to start energy efficiency works. Importantly, many European countries are interested in this new scheme supported by the EIB. And the EIB intends to **show that the scheme works in one country, so that a similar product can be developed in other EU countries.** Against this background, projects that would not have been financed otherwise (or not at this scale) are particularly relevant so that EFSI can have an impact on the real economy.

**In some cases, the EIB could take a participation above 50% and finance existing projects, not only new projects.** For instance, the EIB is giving a guarantee to a German Landesbank that reached the regulatory limit (set by its governance) for its portfolio of renewable energy lending. The EIB will put on its balance sheet the existing projects so that this German bank can finance the new projects it has in its pipeline.

**The cooperation with national promotional banks (BPIfrance and CDC) is a key element of success for the EFSI strategy on an aggregate basis as well as for individual projects.** The long-term cooperation with the EIB allows them to take on projects that they could not have financed on their own, while their extensive local network allows the EIB to develop smaller and more structured products, which will demonstrate EIB additionality and value added thanks to the Juncker plan. **The EIB is also developing its own local and operational presence in member states to better address market demand.**

**The EIF is also central to the Juncker plan as it finances projects at a much smaller scale for small and innovative businesses that operate at the frontier of financial and technological risk.** These companies often compete on global markets and this implies that the EIF will have to rethink its financial engineering. Like the EIB, the EIF has also recently expanded the size of its staff and EFSI has clear implications for the EIF as the EIB will focus on smaller projects. The EIF will have to develop more innovative financial products, test them and adapt them to local conditions – as some products for small companies may work well in some EU countries but not in others. It will also continue to develop new ideas – for instance, supporting *non-innovative* SMEs to improve energy efficiency or IT modernisation.

**The EIF collaborates not only with national institutions, but increasingly with regional or even municipal entities.** This raises the important questions of subsidiarity and added value of the EIF. But in the context of capital markets that are very fragmented in Europe (small business investors often have a strong national focus), **the pan-european presence of the EIF is a clear advantage, also to encourage more cross-border co-investments and develop better investment platforms.**

**The heterogeneity in investment needs across EU member states is very large. For instance, Greece needs much more investment than Luxembourg to relaunch the economy after the crisis.** The types of activities and sectors supported by EFSI have been discussed in EFSI regulations. And indeed, the first projects supported EFSI do focus on innovation, renewable energy, energy efficient and SMEs. However, the EIB selects projects based on their economic and financial quality. There is no pre-determined concentration on particular sectors or countries. **The EIB is present in all EU member states. After Spain and Italy, the third biggest recipient of Juncker Plan funding in 2015 was France.**

**For Greece, the EIB has set up a special Investment Team for Greece that will be based in Athens –** something new for the EIB, an institution usually very centralised. This will lead to a strengthened permanent EIB Group presence in Greece. The Investment Team for Greece will make a difference by ensuring that the EIB Group contributes through financial and technical experience as well as new operations – in particular to deliver projects for SMEs in a difficult environment.

**The objective of the Juncker Plan is to compensate for a part of the investment gaps in Europe in the aftermath of the crisis. Clearly the EUR 315bn are not sufficient to address all investment gaps but it can have a positive impact on the investment climate.** EFSI will need to be accompanied by structural reforms. Tensions between quantitative objectives at the expense of investment quality may sometimes arise. But it is often difficult to compare the quality of investment projects across different EIB products (e.g. compare a guarantee for a small agriculture cooperative with a large risk-sharing facility with CDC). There is also difference between the organisational structure of the EIB, with engineers and economists who focus on specific sectors, and the approach of the European Commission who focus on individual countries. The market failures are different across European countries but not necessarily across sectors. For instance, it is important to relaunch investment in the sector of renewable energy.

**A paper on the impact of labour regulation on capital intensity and labour quality (i.e. the share of skilled workers) was presented.** Against the background of labour market deregulation in recent years in Europe, the authors find that employment protection legislation (EPL) has a positive impact on capital intensity (capital as a share of GDP) and a negative impact on capital quality (e.g. ICT capital as a share of GDP or R&D share in investment). EPL also has a positive impact on employment quality (the share of skilled workers), which means that it can be a disadvantage for less skilled workers. EPL implies a substitution between labour and capital. This suggests that structural reforms could lead to a decrease in investment and a decrease in labour quality but an increase in ICT capital.

France appears as one of the most protective countries in terms of EPL, together with Italy, Portugal and Spain, but Germany and Netherlands (and the last two countries have substantially lower unemployment rates) also rank quite high in this index. This means that **EPL is not the unique determinant of the employment situation in Europe.** There is a negative correlation between EPL and the employment rate and a negative correlation between EPL and vulnerability (in particular for the youth). But the heterogeneity of labour quality may increase with EPL. In addition, when there is a contraction in employment, the share of skilled employment increases as they are usually better protected.

**When it comes to capital quality, it is important to make a distinction between ICT capital (which has a strong import component) and R&D investment,** which relies much more on skilled worker and where the impact of regulation is expected to be stronger. Countries with lower EPL also tend to be less generous for R&D support. There may be a trade-off between economic efficiency and worker protection. Clearly EPL is not always beneficial to the investment climate. In particular, **EPL regulation uncertainty can be detrimental to workers and firms.**

**A participant explained that there is no national selection of projects in the framework of the Juncker Plan.** In October 2014, before the plan was launched, EU member states had been asked to prepare a list of projects that could be implemented rapidly. France gave the example of 37 projects. The Juncker Plan is extremely open and the choice was made not to follow the list. The projects should correspond to EU objectives and need to start within 3 years after approval. CGI has a role of coordinator in France in the sense that it will inform promoters on how the Juncker Plan works and can support them. Based on the 300 projects that have been discussed with the CGI, there are at least 3 stylised facts to be mentioned.

- 1. Through the Juncker Plan, there is a real movement towards smaller infrastructure projects, on the back of a decentralisation of energy production capacity.** Small energy projects (e.g. windfarms or photovoltaics parks) struggle to find finance. The EIB has approved 12 French projects over the last 9 months and 6 of them are in the energy sector. But none are large energy projects.
- 2. France remains a country with large infrastructure projects and EFSI has contributed to unlock 3 large projects,** including a motorway around Strasbourg that had raised environmental issues between the European Commission and France. The EIB proposed a risk sharing facility that solved the economic problem (the initial beneficiary of the concession attributed by the French government withdrew from the project because of the high level of risk), which then allowed to solve the environmental regulation issue. Another large infrastructure project where significant market failures are addressed through EFSI is the “Plan France Très Haut Débit”. The private sector finances fiber optic cable installation in areas where this is profitable but public support is needed in more remote areas, where French departments become the promoters. Some departments are willing to finance broadband but others have passed on the responsibilities to regions. So far, two regions have attributed concession contracts so that it will be implemented by the private sector.

- 3. EFSI allows the EIB to finance smaller projects with more risk.** For instance, to better help innovative start-ups to scale up their operations once they stop receiving public support but are not strong enough to survive by themselves (a so called “Death Valley” in the lifecycle of innovative firms). France is not the country that suffered the most during the crisis but if the Plan Juncker supports more mature start-ups, this would allow for the development of more small-scale industrial projects.

**The EUR 8bn contribution of CDC was mentioned, accompanying those of other national promotional banks (e.g. Cassa Depositi e Prestiti, KfW, BGK), that will allow to focus on smaller projects (often promoted by local municipalities).** For instance, two third of recent PPP projects were worth less than EUR 30m. There is a need to “industrialise” the process for starting joint CDC-EIB infrastructure projects and the local presence of CDC can add value, in particular to allow for more granular projects. The joint CDC-EIB presence on PPPs can create important leverage effects as it gives credibility to the projects.

**The discussion stressed the needs for corporate R&D financing but also for financing process innovation,** where the need for guarantees is stronger. EIB and Bpifrance cofinancing reached EUR 300m in 2015, with the aims to finance more cross-border operations, attract foreign investors (not only national) and financing new industry projects with equity.

**It is clear that EFSI will not benefit all European countries equally, or even within countries, at the regional or local level.** For instance, France has strong expertise and public support in project preparation (e.g. through CDC and CGI), which is not found in all other European countries. In France, even when the project promoters are private operators, public authorities were at the source in 1 out of 2 projects. The lack of expertise of more recent national promotional banks will also be addressed through the European Investment Advisory Hub (EIAH). The exchange of good practices across Europe will be reinforced by the Juncker Plan and will help promoters bring their projects forward. One aim is to also support more cross-border projects, illustrated by the example of gas and electrical infrastructure interconnections between France and the Iberian Peninsula. Against this background, the recent decision by the European Commission to combine EIB finance with ESIF (EU Structural and Investment Funds) highlights the needs to rely on different public support schemes at the EU, national and local levels.

*Third session - Investment: what do national account statistics have to say?*

**The third session focused on how to understand investment dynamics using data from national accounts.** The standard measure of investment is Gross Fixed Capital Formation (GFCF), which is then scaled up by GDP to recover a measure of investment intensity. ESA 2010 set new standards for national accounts that broadened the concept of investment data to better cover R&D investment. Data on investment can be disaggregated by sector (corporations, government, household), by industry (NACE aggregation) or by type (asset breakdown). The data sources vary across countries: for instance, only half of the member states are using balance sheets data. Investment and can be based on real sources but often estimation is needed (e.g. for R&D, intangible investment, agriculture). **In terms of composition of investment, NFCs (non-financial corporations) represent almost 57% of investment in the EU28;** households represent 26% (but it is often difficult for statisticians to distinguish between households and small businesses); general government 15% and the remaining 2% are covered by financial corporations. The increasing use of micro data will help to better understand investment dynamics in Europe.

**A distinction was underlined between GFCF and the notion of investment used in economics. Investment represents expenditure (e.g. second-hand machinery purchasing) whereas GFCF represents (gross) changes in the capital stock.** In France, GFCF amounted to 21.7% of GDP in 2014 and public administration to 3.7% of GDP. For French households, dwellings represent the largest share of investment (almost 90%). For the general government, non-residential buildings represent more than 60% of the total, while notably

intellectual property rights amount to 25%. For NFCs, non-residential buildings, machinery and equipment and intellectual property rights each represent around 30% of the total, while dwellings amount to less than 10%. In particular, despite the crisis in both the EU and the Euro Area, investment in intellectual property rights has been increasing steadily in recent years.

**During the crisis, the decrease in GFCF was more modest in France and Germany than in the UK or the US. But the recovery is slower than in France than in these three other countries.** The fall in France was mainly due to the decrease in households' investment. There are also some changes in the structure of investment for NFCs, with a lower share going to machinery and equipment, which implies that the capital stock in France is aging. In addition, since 2000, there is less investment in modernisation and rationalisation of production equipment and in product innovation – which are conducive to productivity growth – and that most equipment investment is related to the renewal of existing capacity. **The relatively low number of robots in use in manufacturing production is a frequently mentioned indicator of a broader phenomenon as it is lower in France than in Germany or Italy.** More generally, R&D investment is also lower in France than in Germany.

#### *Fourth session - Fact finding on investment needs and the investment gap in Europe*

**The crisis led to a significant slowdown in investment across the developed world.** But there are also some EU specific and Euro Area specific factors. Weak investment, above and beyond cyclical factors, has been a primary reason for the weakness of the recovery. Besides having a negative impact on current GDP, the low level of investment activity also negatively impacts the long-term growth potential of the EU economy.

**Gross capital formation in the EU is well below the pre-crisis trend (1995Q1 – 2006Q2). The shortfall reached EUR 150bn in 2015Q3 for the EU of which about 110 billion is the shortfall associated with the Euro Area.** In terms of GDP, investment is 2 percentage points below the pre-crisis average for the EU, and 2.2 percentage points below the pre-crisis average for the Euro Area. A breakdown of the Euro Area into the Core (DE, FR, NL and AT), where France does not fare bad compared to other large countries, and the Periphery (IT, ES, PT and IE) reveals stark divergence in the development within the Euro Area. Gross fixed capital formation has increased rather early after the initial financial crisis in the core, while it has continued to decrease in the periphery until 2014 and started to increase only slightly thereafter. Measured as a percentage of GDP, gross capital formation in the core was 0.9 percentage points below its pre-crisis average of 21.3% (1996Q1 – 2006Q2), while in the periphery it was 4.4 percentage points below its pre-crisis average of 22.6% in the third quarter of 2015. **Against this background, EFSI is an instrument that will continue to evolve to address both country-specific cyclical and structural issues.**

**A paper on the recent slump in investment across developed economies by disentangling the role of expected demand, uncertainty and the cost of capital, was presented.** Investment growth dropped from 4.5% before the crisis to 0.5% over 2008-2014. The authors of the paper find that expected demand played the largest role in explaining the slowdown in business investment growth. Uncertainty also seems to have a clear impact across the EU. In other words, about 80% of the fall in investment is due to expected demand, while 20% to uncertainty. Financial conditions seemed to have had weaker impact overall and are only relevant for few Euro Area countries. Their results also indicate that systematically over-optimistic GDP growth forecasts since 2008 have supported business investment to a large extent.

**A participant stressed that Euro Area total investment remains low relative to economic activity while business investment seems in line with the level of economic activity.** This holds across the largest Euro Area countries, except for Italy where the compounded effects of low firm profitability, weak balance sheets and tight financing conditions continue to weigh on business investment. In Spain, profits have remained relatively stable since 2010 as Spanish firms have retained earnings and made strong efforts to

deleverage, on the back of structural reforms in the labour market and the creation of bad banks with bad loans concentration. In Italy, structural reforms have dragged investment compared to Spain, which made it harder for Italian firms to keep profits. Despite convergence in lending rates, Italian firms have more difficulty in obtaining finance for their projects.

**The conclusions highlighted the benefits for the EIB to keep ongoing the open dialogue with local experts to better identify investment gaps across EU member states.** Against this background, the EIB will conduct an investment survey that will help better understand investment dynamics and the optimal financing structure for more investment across Europe.