Juncker's investment plan indicates a recognition from the European Commission of the need for new economic policies. However, its scale is limited. To provide more investment over a longer time period there should be greater commitment of public resources, a stronger institutional structure and a bias towards investing in countries with less internal resources. Investment also depends on relaxing austerity policies and ending pressure for reforms to reduce employment protection, both of which are factors holding back internal demand.

**Policy recommendations**

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**Introduction**

Jean-Claude Juncker received approval for his long-awaited investment plan at the European Council meeting on 18 December 2014, with more details and clarifications on 13 January 2015 (European Council 2014; European Commission, 2015a). Forecasting at least €315 bn additional investment over the three years 2015-2017, it was given a central place in what he claimed would be a determined effort to spend five years saving Europe, albeit also assuming member states’ ‘commitment to intensifying structural reforms and to pursuing growth-friendly fiscal consolidation’ (European Council, 2014, p.1). The commitment to investment is a welcome addition to the European Commission’s thinking and suggests an implicit recognition that past policies have failed to revive the European economy. However, it still suffers from serious shortcomings that will significantly limit its positive effects.

In particular,

− the proposed funding mechanism offers considerably less than is needed, as demonstrated by the preliminary estimates of justifiable investment, referred to below,

− the proposed governance mechanisms mean that investment will be biased towards those countries that could afford it the most easily without the programme,

− a large part of the proposed accompanying measures are at best of little relevance and at worst will hamper the development of a serious investment plan.

− above all, the potentially most important accompanying measures are ruled out. The Juncker plan is conceived as running with continuing policies of austerity which are themselves a major reason for the continuing low levels of investment.

**Questions to be answered**

A proposal for a credible European investment plan needs to answer a number of questions. It needs to explain why investment is necessary and where it should be directed, why it has not been happening already, how it will be financed, what governance structures will be created, what other measures might be needed to make it effective and why such a programme should be led from the European level.

**The catastrophic decline in investment**

The first of these receives the most convincing answer. A so-called Special Task Force, with representatives of member states, the Commission and the European Investment Bank (EIB), argued in its final report in December 2014 (Special Task Force, 2014) that investment had fallen 15% below its pre-crisis peak and that this was the major cause of continued economic stagnation. Juncker’s plan would cover about one third of that annual gap or, as will be indicated below, about one quarter of the total investment justified by governments under the plan’s chosen priorities. It would be a start.
However, the past decline, and hence need for revival, is unevenly spread across Europe. Decline has been particularly severe in a number of countries that have been hit hardest by the crisis. Figure 1 shows the declines in gross fixed capital formation as a percentage of GDP in a sample of countries. Only in Germany had the figure increased, while in some others reductions were enormous.

This, and the extent of continuing divergences in economic levels across the EU, point to a powerful case for raising the level of investment. It is needed to overcome the wide divergences in economic and social levels across EU member states, as exacerbated by effects of the crisis. It is also needed both to provide an immediate stimulus to demand and because of the long-term need in all countries for infrastructure, facilities for education, training and research, innovation and new technologies, energy transformation, urban renewal and social services. These include typical public sector activities and the public sector should be expected to be involved in, if not lead, much of the investment. Indeed, it is governments that have been asked to come forward with proposals. Member states were immediately able to identify 2000 projects awaiting implementation with a cost of €1300 bn, of which €500 bn could come in the next three years (Special Task Force, p.10).

Why has investment not happened?

To explain why this investment has not been forthcoming, the Special Task Force pointed to ‘a wide array of barriers and bottlenecks’ (p.5) and advocate a similarly wide array of policies, including reducing regulation, completing the single market and continuing with ‘structural reform’. This last term has frequently been used to mean policies to reduce employment protection, the scope of collective bargaining and ultimately wages, but there is no basis in the Task Force’s analysis for expecting such measures to contribute to higher investment. These thoughts rather echo preoccupations present in past European Commission policies and general demands repeated by the business lobby (eg Business Europe 2014).

In fact, the key constraints on investment are recognised at various points in the Task Force report, differing somewhat between the private and public sectors. The issue for private investment has been ‘low demand growth’ (Special Task Force 2014, p.8), leading to expectations of continued low demand in the future. This is not a matter of a lack of confidence in the general, but a lack of confidence reflecting an accurate perception of reality. Demand is low and there is therefore every reason to hold back on investment. The same point is confirmed by the European Commission’s Business Surveys (http://ec.europa.eu/economy_finance/db_indicators/). A comparative study showed that in 2013 more than half of manufacturing businesses noted some constraints on production and over 40%, in other words almost all of those identifying any constraint, reported ‘insufficient demand’ as a limiting factor. More than one response was possible and demand was followed some way behind by financial constraints and a shortage of labour (7% and 4%) (European Commission 2013, pp.8-9). Bank lending is constrained, with particularly poor conditions in countries in the greatest difficulty, by low demand and poor business prospects leading to doubts over the safety of lending (cf, ECB 2015). The way to boost business confidence is therefore to restore demand and a publicly-backed investment stimulus would make a significant contribution.

The barriers to public sector investment are inevitably slightly different and can be seen from examples provided by the Task
Force report of projects that are ready to be started. Of 46 they selected as illustrative, finance appears explicitly as the key barrier in all but three. For some the barrier was a lack of long-term finance, for some it was the effects of Eurozone budget rules and the cuts that have been imposed while for some it was the unattractiveness of the projects to private lenders. Remarkably, regulatory issues appear even in a secondary role very rarely, one of the few examples being a German offshore windfarm development with private involvement where the issue is uncertainty over future government support.

How can it be financed?

The financing question is to be solved by establishing a fund, the European Fund for Strategic Investment (EFSI), with a starting value of €21 bn, of which €5 bn will come from the EIB and the remainder will be a guarantee from the European Commission. This will then be used to guarantee credits from the private sector long-term investors to favoured projects reaching the value of €315, fifteen times the original commitment. It is hoped that the initial sum will be increased by contributions from member state governments.

This part of the plan suffers from the following weaknesses; the EU is committing only a small guarantee and relying on an exceptionally high leverage rate. This follows estimates of what has been achieved in the past from the most secure long-term investments, but it does not reflect the position in countries in the greatest difficulty. Investment will therefore either be strongly focused on countries in the least difficulty or fall well below the target level.

— there is no reason why member states should commit extra resources to the EFSI. They are expected to do so out of a general desire to help EU economic recovery without any promise of return, with no guarantee that their projects would be financed and without any direct ability to influence investment decisions. The initial funding of €21 bn is therefore unlikely to increase much, if at all.

— repayment will be especially difficult for countries constrained by Eurozone debt rules. The only solution for non-commercial projects is ‘an increased adoption of the user-pays principle’ (Special Task Force 2014, p.48), so that for example health investment would presumably be possible only if access is limited to those who can pay. The implication is that investment is likely to be biased towards projects offering quick financial returns and towards countries facing the least budget difficulties, with very little on offer to public sector projects elsewhere.

What other policies do they offer?

The emphasis in accompanying measures is on continuing with existing rules on budget deficits and public debt levels, with a very little flexibility in their interpretation. This makes financing public sector projects extremely difficult. It also raises questions over their usefulness: there is, for example, little point in building and equipping new schools and research facilities if there is no funding to run them once completed.

Two small concessions are made on Eurozone budget rules. One is that member states contributing to the EFSI will not be penalised as long as any resulting breach of the Stability and Growth Pact is small and temporary. The second is that some co-financing of projects may also be exempt, but again only temporarily, only in countries where GDP growth is negative or where the level is judged to be ‘well below its potential’ and only for projects which are deemed to have ‘direct long-term positive and verifiable budgetary effects’. This amounts to a very slight broadening of the interpretation of existing rules (European Commission 2015b, pp.7-9).

The continuing emphasis on ‘structural reforms’, when this is partly a euphemism for reducing employment protection and pay levels and for limiting the scope for collective bargaining, should also be judged counter-productive. Cutting wages has contributed in a number of countries to lower demand, without visible positive effects in raising exports. Cutting wages can also nullify the positive effects of investment in areas which need to attract and retain qualified employees.

How is it a European plan?

A final remarkable feature of the Juncker plan is that there is no obvious argument for such a programme to be run from the European level. There are some cross-border projects, but they are a small part of the total. For the most part, the same effect could be achieved from programmes run separately in individual countries. The crucial EU contribution should, as outlined below, be in opening access to finance for countries that are currently the most severely constrained. Under Juncker’s plan they will have no new access to finance beyond what could be available from their own budgets with, in a few cases, a very slight relaxation in budgetary rules. Thus the programme will
allow countries to circumvent those rules when they contribute to a fund without facing penalties while to use those resources directly to support projects of their own choice would not be allowed.

Thus a reasonable forecast is that the Juncker plan will lead to some increase in investment in EU 'core' countries. Much the same result could have been achieved by those same member state governments using their own resources directly to promote investment. It will have the least effect in Eurozone members that have experienced the greatest economic difficulties. As Figure 2 indicates, it is not enough when set against the past fall in investment and it is not even enough when set against the projects that have been identified by member states for the Special Task Force. A way needs to be found to develop a more ambitious project.

**Is there an alternative?**

An alternative is needed, as previously proposed by the ETUC (2013), that provides a serious basis for restoring sustained growth and for overcoming the divergences between EU member states. It needs to offer more investment over a longer time period, to counter the geographical bias that would follow from leaving decisions with financial markets and to give a clearer role to institutions at the European level.

The biggest contribution that the EU level can make is in opening access to finance. Many countries, and hence the EU taken as a whole, can borrow at historically very low rates of interest, little more than zero in real terms. A European institution with access to long-term credit could bring affordable investment to countries where it is needed.

The obvious candidate is the EIB which can borrow on financial markets. Increased lending would depend on increasing its share capital which, in the past, has always required proportionate contributions from all member states. Reluctance could be expected from many but, unlike investment in EFSI, they would be shareholders entitled to shares in future profits.

The EIB has shown some ability to direct investment to fund projects in countries in the greatest difficulty. Newly-committed investment to the four programme countries in 2013 (Greece, Ireland, Portugal and Cyprus), which accounted for 4.2% of EU GDP, was 5.3% of the total. However, the EIB has remained cautious, guarding its AAA rating, and could only lead a substantial investment programme if it took on a wider role, closer to the of a development bank. That would mean emphasising the wider development impact of projects that it selects.

It would also depend on cooperation with institutions at national levels. The Special Task Force report referred to the benefits of advising and sharing best practice and of countries developing their own coherent plans for future investment. Advice and information is to be made available. Success will also depend on the development of adequate institutional frameworks, including national investment banks, in individual countries. This needs to be addressed more vigorously as it too is an area of substantial inequality between EU member states.

However, success for an investment plan depends also on a relaxation of the rules that lie behind austerity, low demand and the prolonged stagnation in the EU. The limits set for the Eurozone are not related to any proven level at which debt is in danger of becoming unsustainable. Indeed, most EU members have passed the 60% debt quota and many of those below that...
level pay more to borrow than many above. Ease of borrowing depends on lenders’ perceptions of whether a country will be able to repay and that depends on perceptions of health and growth in an economy. Rules should be relaxed, at the minimum, to give clear support to the investment plan and economic recovery. Logically, that should include contributions into an investment fund or to a possible EIB capital increase, public co-funding of projects, repayment of debts and current costs of running projects once they are in operation.

It can be added that debt repayments on new loans for public investment projects should not prove a problem. An increase in investment leads immediately to higher GDP, and hence higher tax revenues. This effect is multiplied immediately by a further stimulus to private investment and in the longer term by increased national income once investment projects are completed. There is therefore minimal long-term danger to state budgets from financing an investment plan that leads to renewed economic growth.

The fundamental problem for the investment plan as currently proposed is that it is expected to emerge with a very limited public financial commitment, alongside continuation of other policies that serve to depress demand. It would all run so much better if austerity were replaced by a recognition that only by restoring growth in demand can overall growth be restored and debt levels reduced. That requires recognising that a successful investment plan cannot run alongside a policy framework that denies scope for public spending and public borrowing.

References


