The European Commission's investment plan: a critical appraisal and some alternatives

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The idea of a systematic plan to boost investment and hence to spur economic recovery across the European Union has been thrust into the centre of European policy-making by the new President of the European Commission Jean-Claude Juncker. The details of his proposal took shape fairly rapidly in the last months of 2014 and the first months of 2015 and met with a generally positive, if sometimes slightly sceptical, welcome. The proposal promised a boost to investment equivalent to 0.8% of EU GDP to run over a three-year period.

An EU-wide stimulus to boost growth was not a new idea. Measures to increase demand by running fiscal deficits were proposed by the European Commission and also the International Monetary Fund (IMF) in late 2008. However, that was a short-lived episode and was reversed with the strong emphasis on fiscal discipline and austerity especially from 2010. The idea of stimulating investment then made periodic appearances as a means to promote growth that could run alongside severe constraints on current spending. Thus in June 2012, the European Council agreed on its Compact for Growth and Jobs, intended as a means to boost growth, which contained a commitment to a €120 billion investment package.

However, the Eurozone continued to record negative growth in 2012 and 2013 and the Juncker plan is intended to help reverse that trend. It has clearly been developed in the face of political constraints, which rule out the general stimulus recommended in 2008-2009, that would require abandoning austerity and adopting greater flexibility in fiscal rules. The same political constraints also rule out increased capitalisation of the European Investment Bank (EIB), which would require contributions from all EU Member States. The result is an investment plan, which is likely to contribute to some increase in investment, but not enough to satisfy legitimate needs, and not enough to provide a substantial economic stimulus in the context of continuing policies of fiscal restraint.

Section 1 of the present chapter provides a background to the meaning of the term 'investment' and to its place in economic policy. The following sections then develop a critical assessment of the Juncker plan by setting it against different criteria, including its structure and justification (section 2), the proposed means of financing and the conditions of repayment (section 3), and the governance of the scheme and arguments for running it at the European level (section 4). Section 5 concludes by setting out some suggestions for alternative, arguably more promising, approaches to investment.

1. Defining 'investment'

A standard economic definition of investment is 'capital formation – the acquisition or creation of resources to be used in production' (Coen and Eisner 2008). It is frequently understood as the production of physical goods that can then create more goods in the future, although, as will be argued in the discussion of education and research, investment does not always need to lead to visible physical results. A common contrasting usage presents investment as putting funds into financial assets, with no direct relationship to any productive activity. For economic policy purposes the economic definition is the appropriate one. Investment can then play a role in an economy, both as a basis for long-term growth and to provide an immediate stimulus.

Basic textbook macroeconomics, starting from Keynesian theory, explains depression in terms of a level of aggregate demand below the level required to achieve full utilisation of a country's resources. This can be corrected by injecting demand into the economy, and increased investment is one way to achieve this, albeit neither the only nor the quickest way. For a rapid stimulus, the best method is to increase the purchasing power, and hence the consumption, of the lowest paid as they are the most likely to spend it quickly. Reducing taxes on company profits, or on the highest personal incomes, will have less effect as a smaller proportion of any increase is likely to be spent. In this respect the stimulus packages of 2008-2009 were relatively ineffective, often amounting to little more than reductions in business taxes which were continued even as cuts were made within the new austerity agenda (Watt 2009).

The most obvious reason for choosing to stimulate an economy specifically through investment is a desire to boost longer-term growth, with the short-term stimulus to demand as a welcome by-product. It has further justifications as the stimulus may be easier to finance from private sources and may also pay for itself from higher incomes in future years, assuming that the investment takes appropriate forms. In fact, a specific advantage of investment over other forms of stimulus is that it can attract private finance to boost the impact of public spending.

As indicated, investment is usually taken to mean physical products: buildings, machinery and the like. In national accounts, this comes under the heading of 'gross fixed capital formation', which includes investment in commercial businesses intended to enable production of goods and hence to bring financial returns in the future. It also includes investment in infrastructure, such as roads and public buildings, that may be publicly funded and that will not lead directly to financial returns, but could be expected to do so indirectly by increasing productivity across the economy (for example, by improving communications and access to a previously remote area). Fixed capital formation also includes private house building, which appears closer to private consumption in that it improves living standards but has no necessary implications for future production.

By way of contrast, an interpretation of investment as spending now that increases production in the future points to the case for including some activities that appear in private or public sector accounts as current expenditure, along with consumption, but which should bring long-term benefits. Research spending has been reinterpreted in national accounts from consumption to an addition to fixed capital, albeit with difficulties and simplifications in how it will be measured. Education has been reinterpreted in European Union and EIB thinking not as consumption but as investment in human capital, as it leads to higher productivity of people in the future (European Investment Bank 2006: 2-3). However, in national income accounts only investment in fixed assets that can be used for education appears as investment. Ongoing activities are classified as consumption.

The choice made between different possible interpretations of investment has implications for the criteria to be used in an investment plan. The EIB has recognised that assessing the viability of an investment project requires an assurance that facilities will be used, and that depends on availability of finance for future current spending (European Investment Bank 2011: 18-21). This implies that countries facing the most severe fiscal restraints will be less able to justify investment in education, irrespective of the benefits it might bring if adequately financed. Indeed, as will be argued, the conception of the Juncker plan as running alongside austerity leads to severe limitations on the kinds and locations of investment likely to be financed.

2. The Juncker investment plan

2.1 A plan for the 'last chance' European Commission

The importance of an increase in investment for economic recovery in the European Union is clearly recognised in Jean-Claude Juncker's proposal for a comprehensive investment package, approved at the European Council meeting on 18 December 2014; more details and clarifications surfaced in the following weeks (European Council 2014, European Commission 2015a). The European Commission President predicted at least €315 billion in additional investment over the three years of 2015-2017, giving this a central place in the 'last-chance' European Commission[1]. A caveat was that the investment plan came with accompanying requirements for Member States 'to intensifying structural reforms' and to pursue what was described as 'growth-friendly fiscal consolidation' (European Council 2014: 1). These requirements, it will be argued below, will weaken its effectiveness.

The justification and background to the Juncker plan are set out in various public and policy statements, above all in a substantial report produced by the so-called Special Task Force on Investment in the EU, set up in September 2014 with representation from the European

1. The President warned that voters were losing patience with EU bureaucracy and a failure to create prosperity. In his view it is therefore the 'last-chance Commission' (http://www.euractiv.com/video/juncker-will-be-last-chance-commission-309405).

Commission, the European Investment Bank (EIB) and Member State governments. Its final report (Special Task Force 2014), produced in December 2014, gave a justification for the plan and filled in details on possible ways forward. Significantly, the Task Force left no doubt of a perceived need for substantial investment. Member States were immediately encouraged to identify projects awaiting implementation and a list of 2000 projects was quickly prepared with a cost of €1300 billion, of which €500 billion could be committed in the next three years (Special Task Force 2014: 10).

The following sections examine the Juncker proposal against a set of questions that provide a basis for judging its likely outcomes and also for assessing possible alternatives. In particular, the proposal for an investment plan needs to explain why investment is necessary, where such investment should be directed, why such a scheme has not been implemented so far, how it will be financed, how credits will be repaid, which (new) institutions will be involved, what governance structures will be set up, what other measures might be needed to make it effective and, finally, why such a programme should be organised at the European level.

2.2 Why do we need investment?

A simple argument for special measures to increase investment is provided in the aforementioned Special Task Force's report. Investment had fallen 15% below its pre-crisis peak in the EU and this was said to be the major cause of continued economic stagnation. Two immediate reservations are, first, that the ultimate cause of low investment remains to be proven: it could be low overall demand or austerity policies, indicating that targeting investment might be the wrong starting point. Secondly, the Juncker plan would cover only about one quarter of the gap it identifies.

Moreover, there are substantial differences in the extent of the decline in investment between countries. Table 1 below compares investment as a percentage of GDP in 2014 with the period of the pre-crisis boom. While GDP had recovered, investment remained depressed, with particularly severe declines in Greece, Ireland, Cyprus, Romania, Spain and the Baltic Republics. Most of the decline was in private investment, but public fixed investment also fell by more than 50% in Ireland, Spain and Greece. Some other countries stood up rather well, with investment recording an increase in Germany. Using the criterion of the fall in investment from pre-crisis levels therefore provides a justification for an investment with a geographical bias towards those countries where investment has fallen the furthest.

Table 1 **Gross fixed capital formation as per cent of GDP in a sample of EU countries, 2004-2008 and 2014**

	2004-2008	2014
EU	22.0	19.3
Eurozone	22.5	19.5
Germany	19.7	20.0
Estonia	34.1	25.8
Ireland	27.3	16.4
Greece	23.6	11.6
Spain	30.0	18.9
France	22.5	21.6
Italy	21.3	16.8
Austria	23.2	22.1
Poland	20.4	19.5
Portugal	22.8	14.6
Romania	31.2	22.0
Sweden	23.1	23.1
United Kingdom	18.1	17.2

Source: Calculated from AMECO database
(http://ec.europa.eu/economy_finance/ameco/user/serie/ResultSerie.cfm).

It could be argued that these declines should not be interpreted entirely negatively, as the level of investment up to 2008 was partly directed into unproductive assets, notably private housing, and was based on high levels of credit that proved unsustainable (Gros 2014). This argument can justify ensuring that investment is well-directed in the future, but it is not a persuasive argument against an investment plan as such. The sustainable level of investment remains unclear after the crisis, which followed in large part from banking activities unrelated to real investment. There were significant construction booms in a few EU Member States, but the subsequent fall in investment affected almost all activities and sectors, in many cases with no obvious relationship to any conceivable past over-investment. Indeed, investment has been brought to extraordinarily low levels in a number of countries, leaving unemployed people and unused productive capacity that could contribute to a revival of well-directed investment activity. A final point is that, as indicated by the list of projects prepared by Member States (Special Task Force 2014), there are identifiable needs for new investment both in public sector activities and in the private sector.

However, a strong case for an investment plan does depend on more than just evidence of past decline. It needs to be demonstrated that it will bring positive results. Here the Juncker proposal is cautious, predicting an increase in investment but giving no details on its wider impact. It does give general indications of the aims and these broadly correspond to the priorities of *Agenda 2020* (European Commission 2010), covering transport and energy infrastructure, education, health, research, information and communication technologies, innovation, renewable energy, environmental infrastructure, urban renewal and social fields. The investment plan is also to provide financial support for smaller businesses.

In fact, the effects of the immediate stimulus are relatively easy to predict in terms of GDP and to a lesser extent employment. If nothing else changes in the economy except the level of investment, there will be an immediate and equal increase in GDP. That may be reduced if other economic activity is squeezed out, but this is unlikely in a period of high unemployment and low long-term interest rates. The increase in GDP would probably be greater than the initial increase in investment thanks to the Keynesian multiplier effect. This further increase is harder to predict, in terms of timing and extent, and depends on the nature of the investment. Labour-intensive activities with a high share of domestic inputs (housing construction and heat insulation are examples) should have the greatest impact on domestic employment, thereby stimulating further demand and economic activity.

Some multiplier effects are therefore likely, meaning an increase in GDP and employment greater than the initial investment. Longer term effects, after investment projects have been completed, may be considerably greater, but are very hard to estimate and even more dependent on the nature of the investment. Thus improved education is widely accepted to have contributed to past growth, but it is very difficult to separate its effects from that of other factors. Returns to education have been evaluated by its effects on personal incomes, which generally rise with the years spent in formal education, but that arguably ignores many further benefits of education to society. It also offers widely differing results between countries, reflecting partly different income levels and different degrees of inequality (OECD 2009). Moreover, as indicated above, investment in education is interpreted as investment in facilities and buildings and it is very difficult to separate out their contribution from that of current spending (European Investment Bank 2006: 20).

It should be added that the impact of investment in increasing GDP and employment will also depend on any geographical bias. Short-term multiplier effects should be greater where there are the most unemployed resources, meaning countries in the greatest difficulty. Conventions for measuring longer-term returns may lead to a bias towards higher-income countries where returns will often appear greater. On the other hand, investing in research or higher education facilities in lower-income countries could be judged very positively, bringing the potential for wider social benefits and development across economies. An aim of reducing divergences across the EU would therefore imply emphasising criteria that take account of the wider development potential following from investment projects.

2.3 Why is investment currently so low?

To explain why investment was not being undertaken without the investment plan, the Special Task Force (2014: 5) pointed to 'a wide array of barriers and bottlenecks'. That explanation seems to serve as justification for policy responses that go beyond the investment plan and encompass structural reforms and fiscal consolidation. In fact, there is nothing in the Special Task Force report to demonstrate that fiscal consolidation, essentially meaning keeping to the rules of the

Stability and Growth Pact, would lead to higher levels of investment. Nor is there much reason to see structural reforms making a positive contribution. This term has frequently been used to mean policies to reduce employment protection, the scope of collective bargaining and ultimately wages and there is no basis in the Task Force's analysis for expecting such measures to contribute to higher investment.

Indeed, the insistence on fiscal consolidation and structural reforms, and much of the accompanying emphasis on regulatory uncertainty and administrative burdens, do not follow from an analysis of what led to the fall in investment. They rather echo preoccupations present in past European Commission policies. There is some common ground here with the emphasis in the Business Europe contribution to the discussion on the investment plan which called for 'a step change in efforts to tackle the obstacles hampering private investment in Europe (Business Europe 2014: 3). Some obstacles they refer to could be genuine problems, but they are not new and therefore cannot be seen as the cause of the low level of investment after 2008. No argument is presented to show how they could be.

In fact, the key constraints on investment are recognised at various points in the Task Force report. The report differentiates between the private and public sectors. The issue for private investment has been 'low demand growth, low levels of capacity utilisation, heightened economic and policy uncertainty, and, in some countries, the bursting of construction/housing bubbles, corporate deleveraging and financing constraints (Special Task Force 2014: 8), leading to expectations of continued low demand in the future. There are frequent references to the issue of business confidence, as if it were an independent influence. However, any lack of confidence should be seen rather as following from an accurate perception of reality. Demand is low. Businesses are aware of this and therefore have every reason to hold back on investment. The importance of this factor in explaining low levels of business activity emerges clearly from the European Commission's Business Surveys and from the European Business Cycle Indicators (European Commission 2013a).

In the years up to 2008 60% of managers in manufacturing firms reported no barriers limiting production. This fell to 40% in 2009 and only partially recovered in the following years. The main barrier was identified as 'insufficient demand' and this perception never returned to its pre-crisis levels, remaining at around 40% of respondents (European Commission 2013a: 9). Finance was far less of a problem, growing in importance somewhat in 2009 and remaining relevant to 7-8% of businesses. It was a particularly severe constraint on businesses in Greece, Spain, Italy and Cyprus, with the numbers affected reaching almost 50% of businesses in some years (European Commission 2013a: 10). It was relatively short-lived and unimportant in Germany and France.

Bank lending has also failed to recover in full from the low point in 2008. Wide divergences between countries were revealed by a European Central Bank (ECB) survey for the six months up to March 2013, showing that 85% of SMEs seeking credits in Germany encountered no obstacles, while only 25% in Greece had the same good fortune (European Central Bank 2013). Interest rates charged also varied widely, with businesses in periphery countries paying about twice as much as those in Germany. It can be added that effects on economies as a whole were compounded by the greater importance of smaller businesses in the countries worst affected, while larger firms are more important in France and Germany. These large firms are the ones most able to finance investment, should they feel it justified by demand levels.

Research based on a survey of borrowers and lenders across the EU showed a number of factors contributing to the decline in lending to SMEs (Bain *et al.* 2013), including banks' need to be more cautious after the financial crisis, changes in the structure of banking that reduced competition between potential creditors and finally the disruption of long-established links between lenders and borrowers which made assessments of credit-worthiness more difficult.

However, the differences in lending between countries appear to be more a consequence than a cause of differences in economic conditions. Evidence from ECB surveys shows that banks' risk perceptions about 'overall economic activity as well as industry and firm-specific developments played an increased role in the tightening of credit standards' (European Central Bank 2013: 45). Thus, reluctance to lend reflected banks' fears that demand would remain depressed and credits would not be repaid (see the comment on Ireland in Bain *et al.* 2013: 28) – a logical fear in countries faced with the most severe austerity policies and a logical fear in relation to SMEs that tend to be domestically-oriented rather than export-oriented. A restoration of bank lending therefore depends to a great extent on increasing demand in those countries where it has been the most depressed.

The barriers to public sector investment can be deduced from the list of projects submitted to the Special Task Force. Of the almost 2000 projects in the main list, the report took a more in-depth look at an illustrative sample of 46 projects, including 'purely' public sector projects, some mixed and some that were to be run by private companies but with close links to public policy issues. Funding is strongly dependent on public provision or, at the minimum, implicit public guarantees. Finance appears explicitly as the key barrier in all but three. One of these was a complex cross-border project and the other two were airport extensions requiring difficult political decisions. As far as the others are concerned, for some the barrier was a lack of long-term finance, for others it was the effects of Eurozone budget rules and the cuts that had been imposed while for some others it was the unattractiveness of the projects to private lenders. Remarkably, regulatory issues appear very rarely, even in a secondary role, one of the few examples being a German off-shore windfarm development with private involvement where the issue was said to be uncertainty over future government support. Thus, it is not excessive regulation that constitutes a barrier, even if this is a frequent complaint from business, but rather possible changes in implicit subsidies at a time of potential energy price volatility.

So, despite Juncker's references to three strands in his policy for increasing investment, including fiscal consolidation and structural reform alongside direct support for investment, the key issue for the post-2008 decline comes down to demand in the private sector, which could be increased by a public-sector stimulus, and to finance for the public sector. The next two sections therefore consider how the plan is to be financed and how credits could be repaid.

3. The investment plan in action: funding and repayments

3.1 How would the investment plan be financed?

A central argument behind the Juncker plan is that there is no shortage of long-term finance seeking safe outlets. There is indeed evidence to support this claim. It could even be argued that a considerably larger investment plan could be financed with little difficulty. That is indicated, for example, by the views of long-term investors, such as pension funds, expressed in response to a Green Paper on long-term financing issued in April 2013 (European Commission 2013b). The amount needed annually to meet the Juncker plan's needs, the equivalent of 0.8% of EU GDP, is about 2.5% of what EU governments borrow annually, in several cases at interest rates around zero in real terms, and should therefore be comfortably manageable.

However, mobilising this private finance would depend on a public financial contribution to provide a guarantee against the possible failure of a borrower to repay a loan. One means to achieve this, in line with past practice, would be to use the EIB, the EU's non-profit long-term lending institution. Its capital is contributed by Member States, roughly in proportion to their levels of GDP. Increased lending would normally require an increase in its capital and, to keep in line with past practices, all Member States would be expected to contribute and would come under strong pressure to do so. These capital requirements are not enormous when set against the likely returns from investment, but reluctance to contribute could be expected from some if not many Member States. Once capital is increased, the EIB can issue bonds on commercial markets. Interest rates have been low thanks to its cautious investment policy.

Armed with these financial resources, the bank lends to both commercial and public-sector projects, with each in the recent past representing about half of total lending. The latter are the responsibility of that country's government. The former often require a government guarantee so that a significant body of EIB investment is already guaranteed by governments. The practice has been to seek co-financing, meaning that investments are also partly financed by a private bank or investment fund, although this is not a statutory requirement. This gives the potential for a multiplier effect, with considerably more total investment than that promised from the EIB alone. Thus in June 2012 the European Council launched its Compact for Growth and Jobs and increased the EIB's capital by €10 billion. This compact, it was claimed, would enable the EIB to borrow on financial markets at low interest rates and lend €60 billion which, with established co-financing practices, would lead to a total investment of €180 billion.

However, the Juncker plan assumes no addition to the EIB's capital. Instead, it proposes the establishment of a new fund, the European Fund for Strategic Investment (EFSI), with a starting value of €21 billion, of which €5 billion will come from the EIB, €8 billion will be gradually transferred from other parts of the EU budget and the remainder will be a guarantee from the European Commission. This guarantee will then be used to insure credits from the EIB, and possibly also private-sector investors, reaching the value of €315 billion, fifteen times the original commitment. Thus the hope is for almost as large a multiplier effect as has been achieved from EIB credits to very low-risk projects. It is also hoped that the initial sum will be increased by contributions from Member State governments.

Thus the use of EFSI is conceived as playing a similar role to an increase in EIB capital. European Commission Vice President Jyrki Katainen has referred to the EIB using the €21 billion guarantee as a basis for issuing AAA-rated bonds, thereby strengthening its ability to lend and hence to set the direction for investment (Katainen 2015).

This alternative to an EIB capital increase has three obvious attractions for the European Commission. The first is that it avoids putting any demands on Member States, which would not be the case for an increase in the EIB's share capital. The second is that there will be no need for extra finance, as it uses resources already available in the EU budget. The third is that it can be done fairly quickly, with hopes of getting the plan under way in 2015.

However, these advantages to policy makers come with considerable costs. The EU is committing only a small guarantee and counting on a high leverage rate. For reasons explained below, the total investment will therefore either be strongly focused on countries in the least difficulty, or which fall well below the target level. Moreover, the scale of the plan will remain limited. 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 (European Commission 2015a) without any promise of return, with no guarantee that their projects would be financed and without any direct ability to influence investment decisions. A small number of governments (Spain, Finland, and Slovakia) came forward quickly to say that they would be willing to contribute. German Finance Minister Wolfgang Schäuble was reported on 27 January insisting that his country would not contribute but should provide financial help for investment within Germany. That is not a surprising view and one likely to be followed by other governments. The initial funding of €21 billion is therefore unlikely to increase much, if at all.

3.2 Repaying the credits: conditions and timing

Where investment is commercially viable, repayment of credits should come from future returns. However, most public sector investment will provide returns in the form of social rather than private benefits and often quite far into the future. The obvious solution is to repay the credits out of the state budgets of the governments responsible for the investment, but that is bound to be difficult for countries constrained by Eurozone debt rules. The only solution proposed is 'an increased adoption of the user-pays principle' (Special Task Force 2014: 48), meaning higher charges for public services. Although not explicitly linked to privatisation, this could be expected to favour provision of such services as health and education from the private sector, thereby encouraging trends towards further privatisation.

For some important areas of investment there is no realistic basis for repaying out of user charges. This applies for urban transport and regeneration of urban neighbourhoods, for which the EIB has in the past judged financial viability by governments' commitment to provide and continue subsidisation (European Investment Bank 2011), something which has become much less certain since 2010. The implication is that investment will be biased towards projects offering quick financial returns and towards countries free from the constraints of the Stability and Growth Pact or, if already covered by Eurozone rules, facing the smallest budget difficulties.

This bias is a highly unfortunate by-product of the Eurozone budget rules as it can easily be demonstrated that repayment should present no serious problem once growth resumes. Indeed, it may be because the calculations are so simple and the results so decisive that they are rarely considered or presented. The issue receives no comment in the Task Force report, but it is worth demonstrating that state budgets would not be threatened even by a considerably larger investment programme.

The ease of repaying credits can be demonstrated with an example related to the investment plan proposed by the European Trade Union Confederation (ETUC), referred to in section 5 below. This plan assumed an additional investment equivalent to 2% of GDP over a 10 year period (thus increasing slightly in absolute terms as GDP increases), financed by credits to be repaid over 10 years – a reasonable figure when set against EIB past practice – meaning that all repayments would be completed in 20 years. To simulate the effects, various growth and interest rates are assumed along with tax revenue equivalent to 40% of GDP, this being approximately the average tax burden in the EU in 2014. Table 2 shows the results of calculations.

Table 2 **Simulations for repayment of credits out of higher taxes**

Growth rate, % (1)	Interest rate, % (2)	Total to be repaid, % of GDP (3)	Total interest payments, % of GDP (4)	Extra tax revenue, % of GDP (5)	Extra tax/ repayment needs (6)
3.5	2.5	29.3	5.9	166	5.6
3.5	1	25.8	2.3	166	6.4
2.5	2.5	28.0	5.6	222	7.9
2.5	1	24.6	2.2	222	9.0
1.2	2.5	21.7	5.3	104	4.78
1.2	1	20.4	2.1	104	4.84

Source: author's calculations.

Outcomes are calculated for a GDP growth rate (column 1) of 3.5%, near the top of the range in years prior to 2008, and for more modest rates of 2.5% and 1.2%, the latter being the level achieved in 2014. In each case, investment is increased by 2% of this growing GDP level. That builds up the total to be repaid after 10 years, in all cases to somewhat more than 20% of the initial GDP level. Interest also needs to be paid on a total level of debt, which at first increases and then decreases and the effects of two different interest rates are included (column 2). The figure of 1% is comfortably above the level for 10-year government bond spreads in the better placed EU Member States in 2014. The figure of 2.5% is above the equivalent level for all but a very few countries. The fourth column of Table 2 shows the resulting total interest payments over the whole 20-year period. The fifth column shows the increase in tax revenue over the 20-year period thanks to the increasing level of GDP, assuming that 40% of GDP is taken as tax revenue. The final column relates this to the total debt-service needs, showing that the former is several times greater than the latter. In other words, debts can be repaid out of increased tax revenues leaving a substantial surplus that can finance other government activities.

Increasing the interest rate increases the amount that needs to be paid in interest, but it would need a very large increase to threaten the financial viability of the investment programme. Reducing the growth rate presents a bigger threat, because it reduces the additional tax revenue. However, even with a growth rate of 1.2% and an interest rate of 2.5%, the last column in Table 2 shows that the extra revenue is still almost five times the level needed to cover the total repayment needs over the 20-year period.

It should be noted that there is no assumption here about the sources of this growth. The aim is simply to show that plausible rates of growth lead to tax revenues that more than cover the needs of debt repayment. There is also no assumption about inflation. Adding in inflation makes debt repayment easier in the same way as does an increase in the GDP growth rate. Thus an inflation rate of 2.5% per annum alongside zero economic growth would have exactly the same implications for debt repayment as a GDP growth rate of 2.5% with zero inflation. The most likely scenario is a combination of GDP growth and some inflation, together ensuring the affordability of debt repayment. This scenario is in line with past international experiences. As demonstrated by case studies in the IMF's *World Economic Outlook* of October 2012, repayment is most difficult in the context of lasting economic stagnation and falling price levels (IMF 2012: 101-126).

Finally, to repeat a point already made, this simulation assumes that all credits need to be repaid out of taxation. If up to half of credits were for commercial projects, then repayment needs out of tax revenues would be greatly reduced. Shifting to a more optimistic scenario, with a substantial share of commercial projects, some inflation and a reasonable real GDP growth rate, the needs for debt repayment appear quite trivial when set against the expected extra tax revenue.

4. Managing the investment plan: EU and domestic architecture

4.1 What kind of governance will be needed at EU level?

The Juncker plan is conceived with a minimal need for new institutions. Decisions are to be taken by an Investment Committee of the EFSI made up of 'independent market experts' (European Commission 2015a). The EFSI in turn will formally fall under the EIB but it will have its own distinct financial profile and decision-making procedures such that it does not affect the EIB's overall credit rating. The general picture is that of a very simple organisational and governance structure with investment decisions well removed from direct political influence. Early discussion of the role of the EFSI left ambiguity over its precise relationship with the EIB. This was clarified in early 2015. The EFSI would play a role only in response to proposals submitted to the EIB, approving for guarantee those it considers acceptable subject to criteria it will formulate, but which, it was stated, would exclude reference to any geographical or sectoral priorities. The EIB will then be free to decide how to use that guarantee. It will be able to grant a credit for a project, take an equity stake in a company or give a guarantee for a private-sector investor. The emphasis is likely to be on credits, in line with past practice.

Despite early insistence that there would be no geographical bias, a central role for the EIB might give some hope for a small bias towards countries in the greatest difficulty. In the past, although the EIB did invest significantly in higher-income countries, it also directed investment towards those in greatest difficulty. Past lending practices show considerable variations between countries in per capita credit levels, with Spain doing particularly well (Myant 2015, p.8). In 2013, the expectation was that four programme countries, representing 4.2% of EU GDP, would receive 5.6% of investment, up from 5.2% in 2012 (calculated from European Commission and European Investment Bank 2013: 9). Final results showed a figure of 5.3%, so there was some bias and some increase. It was small but, at the equivalent to almost 0.7% of those countries' GDP, made some contribution to countering the negative effects of austerity policies imposed in recent years (Bouget *et al.* 2015) and halting the decline in investment levels and credits to businesses from banks.

However, the problem of the conflict between the volume of investment that can be undertaken and its risk profile remains. The Juncker plan is billed as enabling the financing of projects with a higher risk profile than those previously financed by the EIB, which has been determined to maintain its AAA rating. To achieve that rating, the EIB would need to accept a lower leverage ratio and would need to offer a larger guarantee to private investors. In short, the Juncker plan will either be biased towards the safest projects and safest countries, or will fall far short of the predicted investment volume.

4.2 What kind of governance at the national level?

An EU investment plan depends on proposals for projects coming from the Member States. There are financial barriers that affect some countries more than others. Where co-financing from public authorities is needed, it is obviously most difficult for countries with the most constrained budgets. However, even if that were overcome, various institutional barriers would remain for a project aimed at reducing divergences across the EU, notably the capacity of institutional infrastructures to produce plausible and viable project ideas. The experience of EU Structural and Cohesion Funds has revealed difficulties, with substantial variations between countries and regions in the speed of take-up of what is being offered. Wide variations are also revealed by the project proposals in the Task Force report. Some countries seemed able to produce very few proposals, notably Bulgaria, while some were ready with a large number of often expensive projects, notably Greece, Estonia and Belgium (Myant 2015: 9).

The report of the Special Task Force offers a step towards a solution, referring to the benefits of advising and sharing best practice and of countries developing their own coherent plans for future investment. The problem is deeper than these solutions suggest. Institutions that can formulate projects need to be developed. Part of the solution could be provided by national investment banks and bodies at the regional level that can coordinate and formulate plans for economic development.

4.3 What 'accompanying measures' are proposed?

The emphasis on accompanying measures implies a preference for deregulation wherever conceivable and a continuation of existing rules on budget deficits and public debt levels, albeit allowing for some (limited) flexibility in their interpretation. The continued focus on austerity makes the financing of public sector projects extremely difficult where co-funding is required. It makes repayment of credits potentially very difficult, especially in the early years before any sustained growth can be restored. The focus on austerity also raises questions over the usefulness of investment: there is, as already indicated, little point in building and equipping new schools and research facilities or constructing new transport networks if there is no funding to run or subsidise them once completed.

In two small concessions towards reducing the effects of austerity in the Juncker proposal, Member States that contribute to the EFSI will not be penalised for a resulting breach of the Stability and Growth Pact, provided that the breach is small and temporary, and some co-financing may also be viewed with benevolence in a country with negative growth or a GDP level judged to be 'well below its potential' (European Commission 2015b: 7-9). That is far short of allowing exemption from the Stability and Growth Pact for all activities linked to the investment plan, a step that should not, as indicated above, carry any risks of escalating public debt levels. On the contrary, by helping to restore growth it should work to reduce budget difficulties.

4.4 Why a 'European' plan?

A final remarkable feature of the Juncker plan is that it does not provide convincing arguments for such a programme to be managed at the European (rather than the national) level. There are some cross-border projects, but they are only one part of the total. For the most part, the same effect could be achieved by programmes run separately in individual countries. Countries and businesses will have no new access to finance beyond what could be financed from their own budgets with, in a few cases, a very slight relaxation in budgetary rules. Thus the programme will allow countries contributing to a fund to circumvent those rules without facing penalties, while using those resources directly to support projects of their own choice would not be allowed.

Juncker plan misses a unique benefit from a plan coordinated at the European level, which is that it can bring investment to countries that need it the most, raising finance from private investors who will be able to trust an EU-level institution. Thus the 'South' could benefit from the credit-worthiness of the EU as a whole. If investment is then biased towards countries in the greatest need, that need be no more than a temporary transfer between countries. Even if economically stronger regions contribute more to financing than weaker regions, loans will have to be repaid out of the resulting higher GDP levels, so that there would be no net transfers between countries.

The Juncker plan gives no such basis for ensuring support to investment in countries that need it the most. A reasonable forecast is that it 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. Alternatives can be found that offer more investment, counter the geographical bias that would follow from leaving decisions to the financial markets, and that give a clearer role to institutions at the European level.

5. Developing an alternative investment plan

The Juncker plan can be read as a serious effort to move in a new economic policy direction. However, it suffers from serious weaknesses that will limit its effectiveness. These can be explained in terms of recent EU political realities. The plan has been developed essentially in the framework of policy continuity. No sacred cows of the immediate preceding years are to be challenged and no Member State governments are to be troubled. There is a pragmatic logic to this reasoning, but the result is a programme that lacks economic coherence.

A number of alternatives have been proposed in recent years that provide a basis for overcoming the weaknesses in the Juncker plan, albeit with the recognition that they would require some degree of political battle before they could be implemented. Such alternatives can be put into four groups.

The first set of options emphasise investment within one country only, avoiding all the political and other difficulties involved in creating a programme at European level. That also has the advantage of allowing a more balanced programme that includes both investment and current spending. However, the benefits across the EU as a whole are relatively small when, as is likely to be the case, investment is focused on activities with a high labour intensity. Thus, for example, a proposal from Swedish trade unions (LO Sverige 2013) for a boost in public spending equivalent to 2% of GDP foresaw a leakage into imports equivalent to only 0.25% of GDP. Spending was well targeted to increasing domestic demand with a forecast reduction in unemployment of 2 percentage points, but there was little impact on other EU Member States.

The second group focus on the EIB providing a relatively rapid stimulus to demand. This was proposed by Kollatz-Ahnen (2012) and Griffiths-Jones *et al.* (2012). They foresaw higher investment coming from the EU budget and from the EIB, with a possible capital increase for the latter, within an investment plan equivalent to 0.5% of GDP and running only for a few years. The focus was to be on projects that show immediate effects and bring commercial returns (Kollatz-Ahnen 2012: 14-15), making repayment appear much easier. Their predictions, using the Heimdal model (Economic Council of the Labour Movement, undated) were for an increase in GDP of slightly under 0.6% and employment creation of up to 1.2 million. Thus, in scale, this was a modest proposal and had much in common with the Juncker plan, seeking a means to provide a stimulus without breaching EU or national budget rules.

A third approach was adopted by the ETUC (2013), which proposed a more substantial investment plan, set to increase investment by the equivalent of 2% of GDP over a 10 year period. This does not assume unchanging budget rules, as that would rule out co-financing, debt repayments and utilisation of investment once completed, but it does start from investment as the central element in economic revival. The plan would require contributions from Member States to increase the EIB's capital, a step certain to be politically difficult, but the greater scale means that the programme could be linked to more ambitious long-term objectives, including energy transformation and reducing the growing divergences across the EU. Using the HEIMDAL model it was possible to predict the effects of the investment stimulus as leading to an increase in GDP of almost 5% over 5 years, with an accompanying increase in employment of nearly 6 million. Longer term effects cannot be estimated with any serious degree of confidence.

The fourth type of approach, setting investment explicitly within a broader alternative policy, is embodied in the so-called 'modest proposal' from Varoufakis *et al.* (2013). These ideas include measures to overcome difficulties in banking systems and in relation to sovereign debt. Alongside this, the authors of the approach emphasise in general terms the need for investment, and propose to use the EIB and its subsidiaries as the investing agents. Financing issues are not dealt with in detail, but the authors have proposals for relaxing some existing rules and are confident that debts can be repaid by the recipients of credits so that no transfers between states will be required. Dealing as they are at a high level of generality, the authors also do not provide any precise forecasts of the results of their proposals, should these be put into practice.

In conclusion, moving on from the previous criticisms of the Juncker plan and from the alternatives that have been proposed, the basis for a coherent alternative can be summarised in the five points below.

— Clear objectives could be set: to provide an immediate stimulus, to satisfy identifiable needs for economic and social modernisation and to start to reduce the divergences across the EU. This would point immediately to the logic of linking investment with other demand-enhancing measures and of finding an organisational structure to encourage an investment bias towards countries in the greatest difficulty.

— The scale could be tailored more to the needs of the above objectives. The volume of projects identified by Member State governments and included in the preliminary list is equivalent to approximately four times the volume initially proposed for the Juncker plan. This justifies a larger project running over a longer period. That in turn raises further questions about governance and the organisational forms that would be required for its implementation.

— Ensuring that investment is undertaken and biased towards the areas that need it the most requires criteria that reflect those aims. Commercial viability is adequate for many private-sector projects. Criteria that relate to wider development objectives, difficult to evaluate in precise financial returns and not providing revenue streams to the investor, should also be used. The EIB has used cost-benefit analysis where possible, but that too encounters difficulties for long-term projects with complex social consequences. Evaluation criteria that take full account of wider development effects should therefore be used. This does not need to be incompatible with past EIB insistence on maintaining its AAA rating provided governments are not unnecessarily hampered from repaying debts by the budget rules.

— An ambitious investment plan requires a strong and well-equipped organisation to coordinate and evaluate projects. The EIB has the most experience, but mostly in supporting relatively small numbers of projects. It will need to take on a larger role and there will need to be clear outside control over priorities and guidelines. Moreover, consideration would need to be given to the difficult task of creating organisational forms within Member States, to come forward with project proposals and monitor and evaluate implementation of past projects.

— Above all, the success of such an investment plan depends on relaxation of the rules underpinning 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 exceeded the 60% debt quota and many of those below that level pay more to borrow than many above. Rules should be relaxed, to give, at least, clear support to the investment plan and economic recovery. Logically, that should include contributions into an investment fund or to an increase in EIB capital, public co-funding of projects, repayment of debts and of the current costs of running projects once they are in operation.

With these conditions met, an investment plan could play a central role in reviving economies across the European Union.

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