November 2016

EXTENDING THE EUROPEAN FUND FOR STRATEGIC INVESTMENT

KEY MESSAGES

- The investment situation in Europe is slowly improving but the pace is still timid and the investment gap remains wide. Despite its strengths, the EU is still perceived an expensive and complicated place to do business. Only by addressing existing barriers to investment in Europe will we be able to attract investment in a long-term perspective.

- The EFSI is a welcome tool to help mobilising private investment in Europe, which brought about a greater risk culture in project financing and raised public attention to the problematic of weak investment. There are positive signs regarding implementation of the EFSI during the initial period, but it is still early to fully understand its real success. The EFSI is a policy instrument and should not be thought of as a policy in itself.

- Public investment also has an important role to play. Targeted increases in public investment are important, particularly when used to address key infrastructure and skills barriers. Some Member States need to increase their public investment, while others need to optimise it. The quality of public investment should guide the decisions in this regard.

- Businesses welcome the proposal to extend the EFSI and to substantially increase its financial capacity. But the revised regulation must incorporate the most recent evaluations and draw the necessary learnings from the experience so far:

    - Improve geographical coverage: Initial results reveal that member states with greater technical and administrative capacity are taking greater advantage of the EFSI. This shows that there is a greater role to be played by the EIB and the European Commission in supporting those lagging behind, through greater technical assistance, including on how to set up investment platforms; a more proactive advisory hub; adequately involving the regional level; and promoting cross-border projects.

    - Welcome focus on SMEs: the quicker than expected uptake of the SME Window makes it necessary to reinforce it in order to ensure enough available funds to have it run throughout the period. The existing products are well designed and we welcome the thoughts put forward for future steps, in particular in the area of equity products, where we welcome the proposal for the creation of a European Venture Capital Fund of Funds.

- Ensure greater additionality: the definition and implementation of additionality is raising some scepticism that can put at risk the credibility of the EFSI. Decisions to grant EFSI support should be better justified, and additionality must be ensured not only in relation to EIB "normal activities" but also by addressing market-gaps.

- Maintain a market-based logic: this is an underlying principle of the EFSI and very much welcome by business. It must be ensured that this instrument remains market-based, financing the best available projects, aligned with EU key objectives but without prioritising specific sectors or regions. The proposal to allocate 40% of the EFSI into projects related to COP21 objectives seems contrary to this principle.

- Sectorial inclusion: To remain confident in this plan, private investors need to see stability and certainty, especially where projects are already in the pipeline. It is important the EFSI covers key sectors for the EU, including a possible inclusion of defence, and avoids to exclude specific types of projects, such as the case of motorways and related projects.

- A welcome boost to industry: The proposal to boost lending to industry and services sectors for mid-size projects in less developed and transition regions, is an important improvement and can contribute to greater geographical coverage.

- Alternative funding for the extension of the EFSI: we regret that money is being taken from Connecting Europe Facility, a performing and already underfunded programme, instead of from less performing parts of the budget. We support the inclusion of new sectors, such as agriculture and fisheries, but the current guarantee must be topped-up with CAP funds, if these sectors are to be included.

- Easier blending of instruments and simplification: it is important to introduce the necessary regulatory changes to facilitate the combination of different sources of funding, particularly with European structural and investment funds. Moreover, lessons should be drawn from the easiness of mobilisation of the EFSI, and be translated into other existing programmes.

- A more proactive advisory hub: we support a more proactive advisory hub. In addition, the EIB should ensure a proper feedback loop of information with the European Commission regarding eventual regulatory barriers which may be preventing good projects of taking place at the different levels.

1. Where do we stand with Investment?

Investment levels in the European Union have dropped significantly during the financial and sovereign crisis and the investment gap, estimated at around €260 billion in 2014[1], remains wide. Investment is a key determinant for both present and future growth for what, if we fail to restore investment now, this will have long lasting effects in terms of potential output, growth rates, productive capacity, and employment creation in the years ahead.

The investment situation is slowly improving but the pace is still timid. Over 80% of BusinessEurope member federations from across Europe expect businesses to increase investment rates over the coming 12 months, compared to just over 50% when surveyed in spring[2]. However, while investment started slowly picking up at the beginning of the second half of 2013 and recorded an average growth of 3.3% last year, investment growth slowed slightly to 2.2% in Q1 2016 and to 1.9% in Q2 2016.

Europe remains the major global destination for global FDI inflows, but it has been losing ground to other destinations. With a cumulative shortfall in investment in the 2009-2015 period from the 2008 peak estimated at almost €2 trillion[3], it is urgent to quickly boost investment in Europe.

From a global perspective, competition for investment is high and increasing. Europe cannot take a backseat in this matter. The European Union has incredible strengths, including millions of skilled workers and innovative companies. But it is still perceived as a complicated and expensive place where to do business. It is therefore fundamental to create the right conditions for investment in Europe, with a strong policy commitment to set a stable and attractive business environment.

2. Addressing obstacles to investment: a top priority

Companies investment decisions depend on several variants such as certainty and predictability of the economic, political and legal environment, foreseen delays and costs in complying with regulations, costs of doing business overall, availability of the necessary skills, and access to markets, among others.

It is therefore necessary to analyse these different dimensions in detail to better understand the reasons for weak investment in Europe and adequately tackle existing problems. A BusinessEurope's report[4] from 2014 identified major barriers for investment in Europe. While part of the explanation behind the weak investment in Europe is related to the different crisis we are facing, including high uncertainty in the political, economic and regulatory fronts, many problems are structural. The costs of doing business in Europe remains very high, in terms of taxes, energy prices, and non-wage labour costs. The single market still has a burdensome regulatory environment with many existing barriers which hamper cross-border investment and hampers the internationalisation of companies.

[1] Bruegel, Measuring Europe's investment problem, 25 November 2014
[2] BUSINESSEUROPE Economic Outlook, Autumn 2016
[3] Committee of the Regions, consultation on obstacles to investment at local and regional levels, September 2016
[4] BUSINESSEUROPE expectations from an EU Investment Plan, November 2014

The European Commission is advancing, as promised, with its work on the digital single market, energy union and capital markets union. Moreover, further simplification of statistical implications of Public Private Partnerships has been done, state aid rules are being clarified, and proposal for further simplification in the use of European funds and programmes has been put forward.

But this addresses only a minor part of the problems and much more is needed in many other areas. Moreover, it is important to ensure coherent policies across the spectrum, and that implementation is adequate. Only by reducing existing barriers to investment in Europe will we be able to attract investment in a long term perspective and this is why business place most of their emphasis in the regulatory pillar of the Investment Plan for Europe. And action is needed not only at European level, but also at the national and regional one.

3. The role of the European Fund for Strategic Investment

The European Fund for Strategic Investment has been greeted by businesses. While it will not solve the problem of weak investment in Europe on its own, the EFSI brought about important changes to the way the problematic of investment is perceived and addressed.

First of all, it attracted considerable public attention to the issue of weak investment and helped raising the political debate regarding the urgent need to boost investment in Europe. It is also an innovative instrument that can open new windows and opportunities for riskier projects that would have not taken place in its absence, placing the emphasis on using small amounts of public money in order to mobilise private investment.

Very importantly, it also brought a greater risk culture and a new mentality regarding the use of EU funds, increasing the emphasis on the use of financial instruments in order to slowly decrease dependency on grants in specific areas. The EFSI serves moreover, not only as a financing vehicle, but also as a confidence boost to specific projects, by providing the “quality stamp” of the EIB which helps attracting private investors that would be otherwise reluctant to invest.

The EFSI must however be taken with some caution. It is early to fully understand the extent of the success of the EFSI, and further analysis will be necessary, including a broader analysis of other available instruments, also as part of the usual EIB activities. It must also evolve in line with market conditions and demand, as the situation has already changed since the EFSI launch with risk appetite starting to improve.

Moreover, the EFSI must be taken for what it is: a tool which can help mobilising private investment, and not a policy in itself, and therefore not tailored to address wider goals and structural improvements in EU Member States. Finally, while a greater use of financial instruments is to be welcome, it does not replace the absolute need for grants in some areas, particularly for very innovative projects and to address key infrastructure and skills barriers.

The EFSI should function in so far as there are clear market gaps, and efforts should be placed on financing quality projects, aligned with EU objectives, and on mobilising as much private investment as possible – with only 62%[5] of total investment mobilised by EFSI deriving from the private sector, the results achieved in this respect lag behind expectations. Meeting the famous €315bn figure should be a secondary objective and at no rate should a rush to meet this target put in jeopardy the credibility and good project selection which characterise the EIB Group.

Finally, the EFSI has far greater funding than other Community initiatives and, as such, it enables investment in large-scale European projects worth more than €10 billion. To implement these projects, the appropriate regulatory framework must be developed, especially in the sector of transport, energy and ITC networks, which have the highest GDP economic multipliers

4. European Commission' proposal on EFSI 2.0

BusinessEurope welcomes the Commission proposal to extend to EFSI beyond the initial 3 years' period. Initial results point to a positive start, but it is important that new figures and updates are released regularly, including independent assessments, drawing on the experience collected so far and which must be properly taken into consideration by the Council and the European Parliament during the legislative process.

BusinessEurope assessment and recommendations on the different aspects of the EFSI are presented below.

- ***Improve geographical coverage***

The EFSI put in evidence the fact that those Member States with stronger administration capacity, as well as financial institutions, and greater technical capacity to develop large projects, benefit disproportionally from the EFSI. In fact, the EFSI portfolio after one year of operations is highly concentrated. Approximately 63% of total EFSI financing within the Innovation and Infrastructure Window (IIW) was granted to three Member States, while the EFSI strategic Orientation foresees a maximum geographical concentration of 45%. The situation is less problematic when it comes to the SME Window as all Member States have experience in channelling EU funds through commercial banks. But even here, only three Member States account for 54% of total EFSI financing[6].

While we do not defend the introduction of geographical quotas, these results show clearly that there is a greater role to be played by the EIB and the European Commission in supporting the capacity of some countries in taking advantage of the EFSI. A number of measures should therefore be put in place:

- Technical assistance: greater technical assistance must be foreseen in several EU Member States in order to help kick-starting some projects. The special task force in Greece for instance, has helped starting on the process with some very interesting projects and the possibility of developing the same approach in other Member States should be considered. It

[5] EIB, Evaluation of the functioning of the European Fund for Strategic Investments (EFSI), September 2016
[6] EIB, Evaluation of the functioning of the European Fund for Strategic Investments (EFSI), September 2016

is important however, that this assistance builds capacity at national level rather than just being a one-off action.

- A proactive advisory hub and developing a net of advisory services: The proposal to make the advisory hub more proactive in order to support member states with greater difficulties can be helpful. However, the advisory hub has limited resources and must count with the support of a net of contact points at national level (with EIB offices which are proving very helpful), but also at regional level.

- Adequately involve the regional level: one objective of the EFSI is to contribute to strengthening the Union's economic, social, but also territorial cohesion. This means that a simple analysis at country level is not enough and it is important to understand the regional coverage of the EFSI where we are likely to find even greater concentration. Greater combination of ESIF and EFSI funds will be clearly fundamental but it is equally important to ensure that the regional authorities are apt for the changes, which entails a greater awareness and knowledge regarding the use of financial instruments. These actors will be particularly important in order to develop regional investment platforms, as a good way to bring together several small scale projects, and facilitate the mobilisation of private investment.

- Incentive and facilitate cross border projects: The difficulty to take forward cross-border projects is a general problem which is also reflected in potential projects eligible for EFSI support. As many barriers are mostly regulatory, it would be good that this dimension becomes a key priority in the work being carried out by the Commission in the third pillar of the Investment Plan. We therefore welcome the stronger focus placed by the Commission on the specific issue of cross border projects, reflected in the regulatory proposal.

- Investment Platforms: There is the need to better explain and exploit the investment platforms. Regional authorities must understand how they can have a role in promoting such platforms and in which way they can make it happen. This is necessary if the EFSI is to reach its objective of helping reducing regional disparities and have a good geographical coverage, not only at country but also regional level.

- In this respect BusinessEurope's members look with great interest at the recently launched Smart Specialisation Platform for Industrial modernisation where the Commission is considering possible ways to combine structural funds with the EFSI. Open to regional and national authorities as well as industrial actors, the Platform aims at starting partnerships in specific priority areas, scaling-up common innovation projects and investment platforms that have the potential to be a business driver across regions.

- ***A welcome focus on SMEs***

Regarding the SME Window, BusinessEurope is glad it focuses on improving SMEs access to innovation finance (under InnovFin schemes), and guarantees and equity finance for higher risk projects, in particular where the market response is absent or slow. The very dynamic response by financial intermediaries and by SMEs to the InnovFin and COSME schemes, show that these products are well designed and should be further deployed. BusinessEurope also supports the planned development of new equity products under the EFSI SME Window in the future.

The transfer of money into the SME Window, given its surprisingly fast uptake, was necessary and it is essential to ensure this Window has enough funds to run throughout the entire period. Moreover, it is very important that financial intermediaries properly communicate the fact that the financing is being made possible given the EU funds. While commercial banks are already required to do so, it is important to do an adequate marketing in order to promote the positive elements of the European Union.

We welcome the recent initiative regarding the European Venture Capital Fund of Funds, which will combine resources of the EU and EIB with private funds and private management expertise, which would be deployed under the umbrella of EFSI. If well designed, the Fund of Funds will help mobilising bigger tickets of private finance for venture capital in Europe. At the same time, continued attention needs to be paid to facilitating access of smaller projects to venture capital. In this respect, it is important to envisage a proactive role of the Advisory Hub in supporting SME in the use of these innovative financing schemes, also by strengthening territorial cooperation with National Promotional Banks, business associations, and other intermediaries.

From a strategic point of view, the main role of EFSI is to facilitate company financing pending the realisation of a true Capital Market Union, which must be seen as the ultimate goal.

- ***Ensure additionality***

The additional character of the EFSI is fundamental for its credibility and success. It means that the EFSI will not 'crowd-out' or replace lending which would have taken place anyway, in the absence of this instrument.

This specific point is, however, one of the more controversial points of the EFSI so far. The strengthening of the additionality criteria is therefore essential to generate a clear value added and not merely reach the investment target of the EFSI as it may end up by erasing the wide support for this tool.

The Commission, rightly so, tries to address this issue in its proposal. While we welcome the effort, and the clear commitment of both the Commission and the EIB to improve on this point, it is still not clear that the proposal adequately covers the issue.

The EFSI regulation foresees that an investment is considered additional if the EIB would not participate in it under its normal operations to the same extent or in the same period. However, some critics point out the insufficient nature of this definition and does not adequately cover the ned to intervene where market gaps are identified. Moreover, the fact that the EFSI is being concentrated in countries where the market gap on investment is less evident, leads to the conclusion that not enough attention is being paid to really addressing market failures. The proposal to make the justifications of the Investment Committee decisions public can help clarifying some of th issues.

It is also needed that the EFSI focus not on reaching the objective set as its investment target but in making private investors take risks where they would not otherwise. The EIB could also place a greater effort in mobilising private investment and keeping their share to a minimum. As referred to previously, the 62% of private investment mobilised for the EFSI so far lags behind expectations.

Moreover, to be able to monitor the condition of additionality, we welcome that an assessment by an independent evaluator will continue to look at the risk profile of EFSI projects compared to regular EIB activities and the degree to which market failures are mitigated.

- ***Maintain a market-based logic***

The EFSI was created as a market-based instrument, and therefore without sectorial or geographical quotas. This is an aspect of the EFSI that we absolutely agree on and that should be maintained. Projects should therefore continue being selected according to their individual merits, while meeting the main EU's objectives, as required by EIB activity.

The proposal to allocate 40% of the EFSI into projects related to COP21 objectives counters this principle of the EFSI. Energy related projects for instance, already account for 46% of the EFSI under the Innovation and Infrastructure project, the majority of which are conducive to meeting COP21 objectives[7]. While we stand behind the need of taking forward projects aligned with EU main objectives, deciding that one objective alone accounts for over a third of the EFSI counters the market logic principle of this instruments. An alternative solution would be to increase the indicative sector concentration limit, which is now set at 30% in the EFSI's Strategic Orientation.

- ***Sectorial inclusion***

It is important the EFSI covers key sectors for the EU and avoids to exclude specific types of projects. To remain confident in this plan, private investors need to see stability and certainty, especially where projects are already in the pipeline.

The proposal to exclude **motorways**, unless it is in cohesion countries or of cross border nature, will prevent a number of projects of great importance – which are not restricted to new motorways, but also includes upgrades, extensions, tunnels and bridges – many of which presenting high-risk profile. Therefore, in project where high-risks are identified which would not permit EIB financing under its normal activities, and where clear market-gaps are identified, the intervention of the EFSI could be important.

Considering the context towards the achievement of the Union's ambitious targets set at the COP21, it should be noted that the environmental impact of motorways mostly depends on the types of vehicles. Moreover, motorways guarantee mobility, growth and development in many regions while other transport modes may not have its efficiency and connectivity.

When it comes to defence, the possibility to enlarge the eligibility criteria of the EIB to fund defence projects should be further investigated in light of the renewed importance of the sector for the EU.

[7] EIB, Evaluation of the functioning of the European Fund for Strategic Investments (EFSI), September 2016

Finally, we welcome the inclusion of sectors such as agriculture, fisheries and aquaculture in the eligibility criteria of the EFSI although, as raised below, we believe the EFSI guarantee should be topped up by funds available from the Common Agricultural Policy.

- ***A welcome boost to industry and services***

The proposal to boost lending to industry and services sectors for projects above €25 million in less developed and transition regions is welcome and can contribute to greater geographical coverage. Many projects are being left out of the EFSI support for the type of projects presented which do not fit in the categories of research, development and innovation, energy, or environment, This inclusion aims at benefiting companies in manufacturing sectors with medium-low technology intensity and high capital intensity with plans for modernisation and upgrading, as well as companies with medium high technology intensity which face increased competition from abroad.

- ***Alternative funding for the EFSI extension***

BusinessEurope regrets that the money to finance the extension of the EFSI is taken from the Connecting Europe Facility. Not only this programme is already clearly underfunded, as the two programs should be seen as complementary as they aim at targeting investments with different risk profiles.

While we acknowledge the argument that the EFSI is multiplying the funding of the programmes where the money is being taken from, it still does not justify that the EFSI is not being funded from less performing areas of the budget.

The EFSI proposal also foresees new areas to start being eligible for EFSI finance, such as agriculture, fishery and aquaculture projects. While we fully support that projects in these areas should be supported, very much welcoming the idea to develop a more entrepreneurial mindset in these areas, the already squeezed resources of CEF (and H2020 and COSME still from the initial guarantee) should not be the means to do so. Therefore, the EFSI guarantee should be topped-up with funding from Common Agricultural Policy.

- ***Easier blending of EU funds and simplification***

The blending of funds and the synergies that can be created from putting together different forms of funding according to the needs of the projects can be very efficient and support the greater geographical coverage of the EFSI.

We call for a swift adoption of the proposals to change the general regulation of European Structural and Investment Funds (ESIF) in this regard, in order to accelerate this process. It is also important to showcase, with clear examples, how the blending can be done, not only with ESIF but also in relation to Horizon 2020 and CEF.

It is also fundamental and urgent to deal with the problems deriving from different funding mechanisms, aligning the procedures according to a simplification objective. In this regard, there are important lessons to be passed from the EFSI to other EU financial instruments. The EFSI cycle (from request for funding to approval) seems to be working much faster than other financial instruments existing in the EU budget, and event in normal EIB lending activities. Less paper work and bureaucracy might be part of the reason and, if the EIB is used to working with different checks and controls which prove working well, this expertise should be passed on in order to further simplify existing instruments in other policy areas. The lessons and simplification measures should be taken properly into account in view of the revision of the Multiannual Financial Framework.

The proposal of the High-Level Group on simplification presented by the European Commission last 27 September offers first concrete solutions to ease access to the EFSI, also through better synergies and an effective combination of funds.

- ***A proactive Advisory Hub***

The advisory hub is a very good and necessary asset of the Investment Plan for Europe as it supports a change of mentality towards making an innovative use of EU funds and provides information and technical support to advance with investment projects. However, the fact that these important functions are demand driven hampers their capacity to be well understood and communicated.

In order to foster this important asset, it would be helpful to provide a clear definition of the services and expertise that the Advisory Hub could mobilise – both internally and externally - to assist project promoters from the private sector, in particular SMEs and Mid-caps. Moreover, we believe it is good to make the Advisory Hub more proactive in helping countries and regions that are facing greater challenges to make use of the EFSI.

More broadly, it would be very important to create a feedback loop regarding barriers to investment between the EIB and the European Commission. During the development of projects with EFSI or in interacting with the operational staff of the EIB or the Advisory Hub, any regulatory barrier that may be identified should be properly communicated to the Commission which, in turn, should analyse it and follow-up.

The possibility of merging different existing technical assistance at EU level should be further investigated as more clarity to end users and less duplication might be possible.

The project portal, also part of the second pillar of the investment plan for Europe, is another important tool to boost investment and we welcome that it could start supporting projects above €5 million, instead of the current €10 million threshold.