Overcoming obstacles to investment

Presentation of the 7th CoR Monitoring Report on Europe 2020 and the European Semester

Workshop INV12A94

European Week of Regions and Cities, 12 October 2016 – from 14:30 to 17:00 – CoR, Room JDE 53

S U M M A R Y

Moderator:
Ton Van Lierop, News Manager, VRT

Speakers:
Bert Kuby, Head of Unit, CoR ECON Commission
Markku Markkula, President, CoR
Grégory Claeys, Research Fellow, Bruegel
Claire Charbit, Coordinator Relations with Sub-National Governments, GOV/OECD
Haris Martinos, Local and Regional Development Expert
Michael Thöne, Managing Director, FiFo Institute for Public Economics – University of Cologne

Summary:
The 2016 European Semester has prominently focused on the need to bridge the investment gap by addressing obstacles to investment. This challenge has a significant territorial dimension that must be further taken into account in order to successfully boost investments across the EU. The objective of the workshop was to explore this issue more in depth which involved the presentation of the results of the recent CoR online survey on obstacles to investment at the regional and local level, the findings of the study commissioned to Metis GmbH on the same topic and the 7th CoR Monitoring Report on Europe 2020 and the European Semester. There was also a general discussion on the type of obstacles found at the local and regional level and on possible measures that could contribute in addressing them properly. As a general conclusion, no silver bullet exists as the challenges are wide ranging and thus require action from various fronts and from different actors to tackle them wholly. What follows is an overview of the major themes explored throughout the session:

Obstacles to investment: In the study on obstacles to investment at the local and regional level, the territory-related obstacles to investment (defined as those that have a differentiated impact within countries and where there is potential for local and regional authorities (LRAs) to contribute in easing or removing them) were classified into 5 different groups: a) deficiencies in multilevel governance and public administration; b) deficiencies in accessing and managing investment funds; c) shortcomings in public procurement and PPPs; d) unfavorable business environment due to burdensome regulations and procedures; and e) inadequate preconditions for investment. The scope of these obstacles is wide ranging and diverse, and indeed, LRAs play multiple and often inter-linked roles to address them as the planner, investor, partner, regulator, provider and promoter/facilitator of investment ventures. The overall message of the study was that not all of the obstacles are equally important in terms of their relevance to the competencies and functions of LRAs and intensity of their impact. Hence, Haris Martinos stressed that a more selective and targeted approach to easing/removing them is justified.

Debt burdens and tax considerations: Michael Thöne agreed with the other panellists that very low public and private investment persists, which is not a problem reduced only to the EU but stretches worldwide. He noted that in a high liquidity and a low interest rate environment, financing investments should not really be a problem. A significant problem still lingering today, though, is unresolved debt burdens. With high levels of government debt and very low investment, it means that a large portion of that debt is unfunded or in other words, there are not much productive investments behind backing it. In a sense, debt is not allocated for investment purposes. This translates into the difficulty today of financing future investments in infrastructure, human capital and the like. Such high debt burden is a sign of the lack of trust as to where the economy is heading. The problem is not a lack of money but that of trust in the general economic environment. So the question becomes how to finance the additional investment that is urgently needed without making the current situation worse (i.e. engaging in even higher levels of debt and with it, undermining the SGP). Thöne suggested that taxes could fill this void. Of course, taxes are a sensitive political issue and in general avoided when facing a weak economic environment like the one persisting today. But if the alternative is more debt, which would add to the already problematic issue of high debt levels, the consideration of tax measures should be on the discussion table. Based on the study's findings of a mismatch between local responsibilities and local resources, then attention should be given to the channelling of revenues to fill that gap, while also considering alternative measures such as restructuring of expenditure away from consumption or achieving higher efficiency. He agrees with the other measures put forward such as MLG, improved coordination, communication, and cooperation but questions should be raised as to whether they would increase or decrease complexity of decisions. For him, some of these solutions seem prone to increasing complexity instead of decreasing it. To finalize his intervention, he suggested he is not in favor of higher taxes but neither of higher debt. The ideal situation would be to increase efficiency up to the point that necessary resources are available for "doing government" without the need to increase taxes. However, if this is not possible, then taxes are one of the possible answers which, of course, need to be differentiated by country, affected group, etc.

EFSI and its additionality component: Grégory Claeys argued that the most important obstacle to investment in his view is that of funding innovative projects, despite accommodative monetary policy and cheap money available. Risky and innovative projects cannot find funding because of high risk aversion from private investors. His presentation focused on the main EU policy tool to address such problem – the Juncker plan. The idea behind EFSI is that the EIB needs to invest in *additional* risky projects (those that the EIB would not traditionally finance and which cannot find funding due to the high risk aversion from investors) in order to attract private investors as co-financiers and reach the overall target of €315bn in investment over the next three years. The small fraction of public funds used for the plan (€8bn) comes from research, innovation and infrastructure lines in the EU budget and as such, opportunity costs are involved (i.e. foregoing strategic investments for kick starting the plan). Hence, in order for the plan to be justified, EIB investments should really be *additional* – containing higher risk profile than usual EIB undertakings. To assess this additionality component, it becomes necessary to check the risk profile of EIB financed investments. However, the agency does not make that information public so an alternative route was taken: checking whether in the past the EIB had invested in similar projects (relying on project title and description) without the guarantee of the EU. If this was the case, then questions arise as to why funds should had be taken out of strategic EU budget lines to finance the plan, when the EIB would had been able to undertake such projects by itself anyway. The results: out of the 55 projects approved by the EIB in May 2016 (1 year after launch of plan), there was only 1 project for which no similar EIB projects were found in the past – the ECOTITANIUM project. Furthermore, official authorities strongly promote such project when it is not really representative of the overall EFSI project portfolio. A caveat is that even when the overwhelming majority of approved projects resemble past ones financed by the EIB alone, they can still be considered more risky due to specificities of the project or longer maturity of the loan for example. But again, this cannot be assessed since the EIB does not make this information public. To finalize, Claeys' main argument is not that the Juncker plan is not working or current projects are not worthy of investment, but due to opportunity costs from reshuffling of funds towards the EU guarantee, the EC and EIB should demonstrate to stakeholders that the projects are really additional and as such, should benefit from an EU guarantee. Otherwise, incentives could be problematic in the sense of applying the EFSI label to projects that are not rightly so in order to reach the plan's objective. Accountability is needed as well as further transparency from the EC and EIB. In order for the plan to be successful, three measures need to be taken: EFSI should only be used for innovative and truly riskier projects; the EIB should be ready to take first losses if the investment were to turn sour so to attract private investors as co-financiers; and the EIB should finance a much smaller share in each of its usual low-risk, non EFSI projects (currently at 33-50%) and for EFSI, instead of financing around 20% of the project, it should do much higher given the higher risk profile it aims at.

MLG and public investment: Claire Charbit made emphasis on the difficulties to connect available resources to investors (public or private). Local actors are not aware of the Juncker plan or knowledgeable of investment platforms where risks can be shared so to deploy investments with other partners. With regards to current economic challenges, and particularly to the overall theme of the workshop, the OECD's position is that there is a lack of trust in markets and governments and lack of risk-bearing capacities (actors cannot deploy investments on their own) which points to a problem of coordination and MLG. She highlighted the LRAs' role in public investment. A joint CoR-OECD study in 2015 found various challenges, which still remain today, with regards to the regulatory environment, administrative processes, and the need to facilitate investments. Furthermore, focus was given to coordination, into how to launch projects with other communes and regions; in essence MLG. Lastly, issues were found related to administrative capacity in handling procurement, PPPs, strategy design, etc. Charbit referred to the 12 principles the OECD developed on effective public investment across levels of government, organized around 3 pillars: 1) coordination of public investment across tiers of government; 2) capacity strengthening for public investment; and 3) ensuring proper framework conditions for public investment. These principles could serve as solutions so to make public investment effective. The OECD has developed indicators to track how countries have implemented these various recommendations and results will be ready in late-2016. Examples of good practices and solutions are available in the OECD toolkit (http://www.oecd.org/effective-public-investment-toolkit/)
She concluded by noting that not only do obstacles need to be identified and discussed on ways to address them but because experts agree that resources in regional funds will be more limited in the future as they are today, there is need to better target investments. In this sense, there is a need to develop "good" projects as they would have to attract loans and not as much grants. There is also work to be done in better informing and communicating with subnational governments and their partners like local banks, private operators and citizens. These agents need to be involved in the strategy of designing a good project at the local level and adapt to transparent local development objectives. Lastly, simplification and flexibility are needed (in national regulation and EU funds). EU funds management is complex involving conditionalities, target activities, measure performance and so on in which their implementation has made access to them more complex and burdensome for numerous LRAs.