DUFFERENTIATED EUROPE

POLICY BRIEF

26 SEPTEMBER 2018

#INVESTEUFUND

NOTRE EUROPE
JACQUES DELORS INSTITUTE

INVESTEU FUND: A REBRANDED JUNCKER FUND?

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Almost four years ago, EU leaders endorsed the idea of the then recently appointed president of the Commission Jean-Claude Juncker to launch an "Investment Plan for Europe". The main element of this Plan was the creation of a new type of instrument, the "European Fund for Strategic Investments" (EFSI), popularly known as the "Juncker Fund".

In June 2018, the Commission released its proposal of a "InvestEU Fund", the EU's investment instrument which will replace the "Juncker Fund" after 2020. According to the Commission, the new Fund builds on the experience of the EFSI but how similar is it to it? Is it just a rebranding operation or are we in front of a different instrument?

This paper describes the main features of the InvestEU Fund, analyses what it changes with respect to the "Juncker fund" (EFSI) and provides a first assessment of the Commission's legislative proposal. Overall, we find that:

- There is a move from a system composed of 15 EU Financial Instruments and one EU guarantee (EFSI) to a single EU investment support scheme (InvestEU Fund). This is positive, as it will allow for more flexibility and will eliminate duplicities between EU instruments identified in EFSI evaluations.
- Various aspects of the InvestEUFund (a lower investment target, more policy steering) reflect the willingness to shift from a focus on quantity (mobilizing a major volume of private investment) to quality (crowding in private investment in specific sectors suffering from persistent market gaps). This is a coherent move given the improvement of investment conditions in Europe.
- The implementation of InvestEU Fund will not be exclusively entrusted to the EIB group (as it is the case for the Juncker Fund) but offered to a plurality of eligible implementing partners. While this is a transformational decision, it may entail little changes in practice given the strict conditions and limits imposed to new actors and the fact that the European Investment Bank (EIB) remains the "privileged partner".
- Whereas the "Juncker Fund" is organized in two windows, InvestEU Fund has four thematic "policy windows" (sustainable infrastructure research; innovation and digitisation; SMEs

and mid-caps; and social investment and skills). Whereas a more detailed breakdown allows better targeting policy-specific investment needs, the proposed allocation of resources is not well-justified in the proposal. As it currently stands, the new InvestEUFund will cover almost half of the existing investment gap in SMEs and mid-caps in Europe but only 10% of the gap in sustainable infrastructures.

- The new Fund offers more incentives to transfer part of member states' cohesion funds to the EU level. In particular, under InvestEUFund national authorities can appoint their own National Promotional Bank to set-up and implement financial instruments covered by the EU guarantee.

1. A single EU Instrument

Whereas the provision of grants still constitutes the main form of EU budget support, the use of EU market-based instruments (providing support in form of loans, guarantees or equity investment) has significantly expanded over time. The "Juncker Fund" (or EFSI) is the most important of these EU market-based instruments, but there are currently 14 other financial instruments (FIs) playing a similar role (such as COSME, providing soft loans to small firms, or InnovFIn, supporting innovation projects). Each FI is governed by a specific regulation, which defines the target group–small SMEs, big infrastructure projects, innovation firms…–, the type of financial support provided–loans, guarantees, equity or quasi-equity investment–, the budget and the mode of delivering (e.g. whether the instrument is managed directly by the Commission or by other actors such as the EIB or the European Investment Fund – EIF).

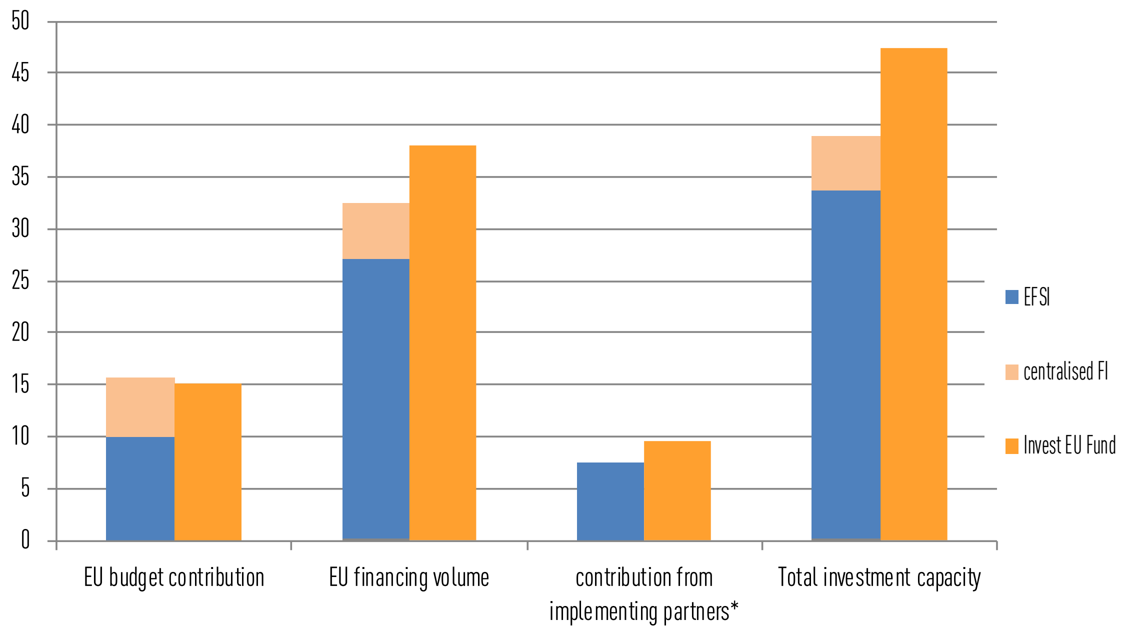
A major novelty of the InvestEU Fund is that it merges all these different financial instruments plus EFSI into a single scheme. Creating a single instrument has clear advantages. It eliminates overlaps and duplications between different investment schemes which have been reported in various evaluations of the Juncker Fund. It allows for more risk diversification and offers more flexibility: it is easier to modify the financial products offered, or to re-allocate resources across policy areas, to better adapt to market needs. Finally, having just one set of rules and procedures renders things easier for potential beneficiaries and facilitates policy guidance, accountability and control by harmonizing and streamlining reporting requirements and performance indicators.

The drawback of merging is the risk of having strong concentration in those sectors with a lot of ready-to-invest projects at the expenses of others with important investment gaps but where projects are more difficult to structure and the private sector is less developed. This is partly what happened during the first years of EFSI, when support was heavily concentrated in some sectors (at the end of 2016 energy projects represented 34% of total support under the Infrastructure and Innovation window). In the case of the InvestEU Fund, this risk of concentration is minimized with the establishment of four policy windows (see point 4).

2. Smaller size but more leverage

While there were expectations of seeing an increasing amount of EU budget resources deployed in form of market-based instruments, in fact the "InvestEU Fund" is slightly smaller in size than the "Juncker Fund" (EFSI) and the current FIs together. The EU budget allocation for the new Fund is €15.2bn, 3% lower than the total amount currently earmarked to EFSI and centralized FIs (€15.6bn). The €38bn guarantee, however, is 17% higher than the total EU financing volume provided by the EFSI guarantee and the 14 existing EU financial instruments (figure 1, column 2). If we add the expected contribution from the implementing partners (the EIB group and other possible partners participating in the implementation of the scheme–see section 5–, which are expected to put part of their own resources in InvestEU operations), there will be a 27% increase in public risk-bearing capacity to finance projects of European interest.

FIGURE 1 ■ Comparing the InvestEU Fund with current EU investment instruments



*source: own elaboration, based on data from European Commission´s working document "InvestEU Fund – comparison of allocations to the 2014-2020 corresponding elements", 15 june 2018. *for EFSI: contribution from the EIB group. For the InvestEU Fund: expected contribution from all implementing partners*

This increase in leverage capacity is due to a shift from a system composed of different FIs and one EU guarantee scheme (EFSI) to a single EU budgetary guarantee scheme (InvestEU Fund). Whereas in the case of Financial Instruments all the potential financial liabilities authorized are funded (meaning that the volume of investment authorized cannot exceed the amount of EU budget resources committed), in the case of budgetary guarantees the EU budget only covers a percentage of the guarantee provided. In other terms, budgetary guarantees create unfunded financial liabilities for the EU budget and, in doing so, allow the Commission to "do more with less".

3. Less emphasis on volume

Whereas the "Juncker Fund" (EFSI) aims to mobilize 500bn of additional investments from 2015 to 2020 (multiplying by 15 the amount of the EU guarantee), the InvestEU Fund's target is to mobilize 650bn additional investments over seven-year period (a 13.7 multiplier rather than EFSI's 15).

The choice for a lower investment target and a more conservative provisioning rate (the InvestEUFund´s guarantee is provisioned at 40% compared to EFSI´s 35%) reflects the Commission´s willingness to shift the focus from quantity (mobilizing a major volume of private investment in a short period of time) to quality (crowding in private investment in specific sectors or projects of high policy added value which suffer from persistent market failures). This is coherent with changes in the investment context. EFSI was launched in 2014 to reverse a low-growth, low-investment dynamic following the crisis. Now, GDP growth is relatively robust and investment levels in Europe are practically in line with pre-crisis levels. In this context, public intervention in support to investment is not justifiable if not well- targeted to projects or sectors having a clear policy added value and if it does not provide strong additionality compared to the market.

4. Shift in policy allocations

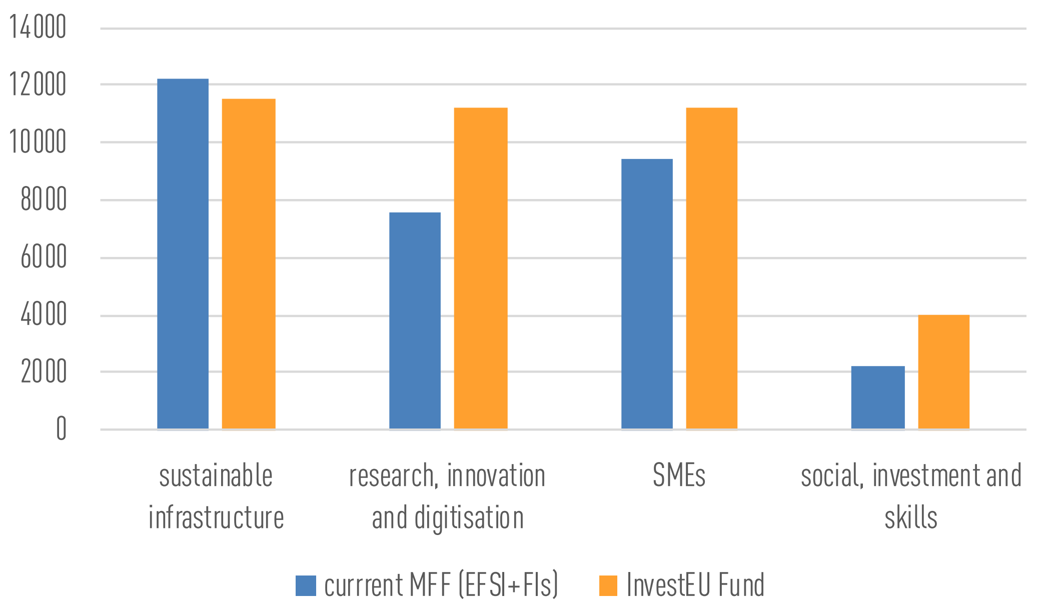
While the "Juncker Fund" (EFSI) is organised in two windows ("infrastructure and innovation" and "SME and mid-caps") the InvestEU Fund is structured in four policy windows: sustainable infrastructure; research, innovation and digitisation; SMEs and mid-caps; and social investment and skills. Each window has a separate budget, even if the Commission holds the right to adjust these amounts by up to 15% to adapt to evolving policy needs and market demands.

A more detailed breakdown of sectors is positive, as it can reduce the risk of sectoral concentration and allows to design financial products adapted to the investment needs of each area of intervention. However, the Commission provides very little explanation of the proposed distribution of funding per window. The InvestEU´s impact assessment only mentions that "the split is based on policy prioritisation, absorption capacity, and the size of the investment gaps".

Figure 2 compares the allocation per policy window under the InvestEU Fund to the allocation per sectors in the current MFF[1]. As can be noticed, there is some re-shifting: in the new scheme less resources are earmarked to "sustainable infrastructures" (-6%) and the remaining three areas receive more resources. A particular emphasis is put on "research, innovation and digitisation" and "social investment and skills", with increases by +33% and +44% respectively.

1. That is, the allocation to different thematic FIs and the amounts spent so far by EFSI in different policy areas

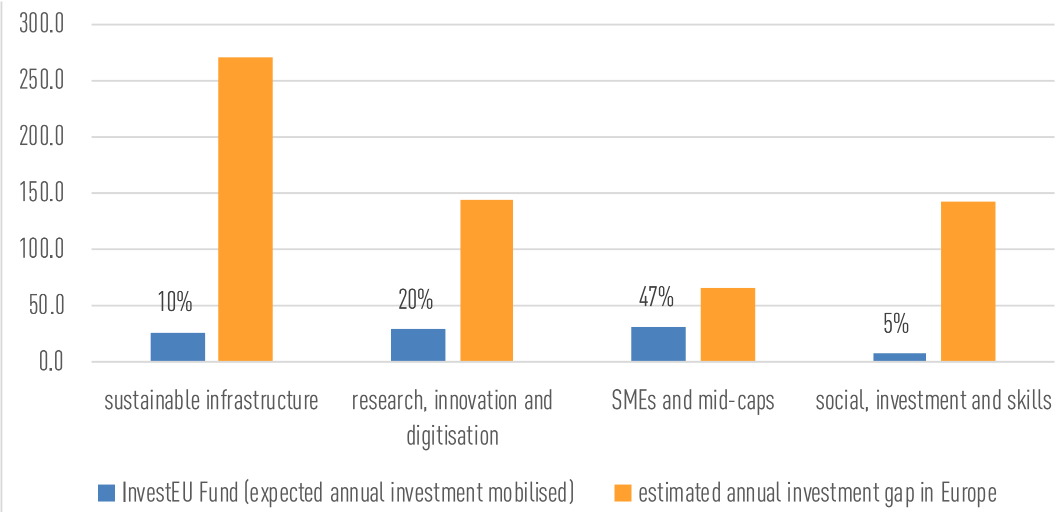
FIGURE 2 ▪ Allocation per thematic area: comparing current MFF (FIs and EFSI) and InvestEU Fund (in bn euros)



Source: own elaboration based on data from table 2, page 23 of Commission Staff Working Document, Impact assessment accompanying the proposal of EUInvest Fund (SWD(2018) 314 final)

Policy re-prioritisation seem to explain the significant increase of funding for "social investment and skills". This is in line with the recent report of the High-Level Task Force on Investing in Social Infrastructure[2], which recommends boosting investment for inclusive growth now that Europe's economy is recovering. More funding for "research, innovation and digitization" is also coherent with the Commission´s intention to boost this category of spending in the next MFF. However, there is no clear policy argument to explain the reduction of amounts for sustainable infrastructures and the increase of to support SMEs. The respective size of the investment gaps in these two sectors does not offer a good explanation either. With the proposed distribution of funding, the new InvestEU Fund will cover almost half of the existing investment gap in SMEs and mid-caps in Europe but only 10% of the gap in sustainable infrastructures (figure 3).

FIGURE 3 ▪ InvestEU Fund: comparing expected annual investment mobilised and annual investment gaps per sector (in €bn)



Source: own elaboration. Expected annual investment mobilised is calculated on the basis of Commission's estimations of investment mobilised per thematic windows (in the InvestEU Fund proposal) and annual investment gaps are those reported in the Commission's Impact assessment accompanying the proposal of the InvestEU Fund (SWD(2018) 314 final).

Overall, what seems to explain this re-allocation of resources is "absorption rates". Existing EU loan guarantee schemes in support to SMEs (such as COSME LTG or InnovFin SMEG) have a lot of success among financial intermediaries. They are easily deployed and the level of take-up is very high. In the case of sustainable infrastructures, on the contrary, a lack of a strong pipeline of projects is a recurring concern. Developing and implementing these projects is not easy, and in many cases it requires technical assistance. Despite the differences in investment needs, hence, the Commission seems to have made a safe bet by putting the money where she knows it will be fully used.

5. Additionality strengthened on paper

The additionality of the "Juncker Fund" (EFSI) has been object of strong criticism. Part of the problem stems from a bad definition of additionality in the original EFSI regulation (article 5), which stated that operations having a higher risk profile than normal EIB operations should be considered automatically additional. As it was pointed out by an EIB evaluation of EFSI published in 2016[3], taking the risk profile of the financial operation as proof of additionality of the project is questionable: there can be situations in which EFSI decides to finance a risk tranche of a project but the same project could have been financed by

2. Fransen, L, Bufalo, G. and Reviglio, E. (2018) *Boosting Investment in Social Infrastructure in Europe*, Report of the High-Level Task Force on Investing in Social Infrastructure in Europe chaired by Romano Prodi and Christian Sautter, European Economic Discussion Paper No.74, January 2018

3. EIB, *Operations evaluation: Evaluation of the functioning of the European Fund for Strategic Investments (EFSI)*, September 2016

other public and private investors adopting less risky alternative structures.

The definition of additionality was improved in 2017 with the extension and reform of EFSI. Today, the risk profile is still taken as a "strong indicator of additionality" but there is an obligation to prove the existence of a market failure or sub-optimal investment situation to grant EFSI support. Yet, there is no clear definition of what constitutes a market failure or a sub-optimal investment situation, and in practice the EIB does not give information on whether the project promoter has tried to obtain market financing before asking for EFSI support. Moreover, the new regulation stipulates that EFSI should not crowd-out or substitute other EU sources of funding (EIB or EIF own resources, other Union financial instruments) but says nothing on the need to ensure additionality vis a vis other national investment schemes.

The proposed InvestEU Fund regulation does not include an article defining the criteria of additionality. However, the new EU Financial Regulation (FR), adopted in July 2018, lists some principles and criteria to ensure the additionality of all EU financial instruments and budgetary guarantees. In particular, according to article 202 of the new FR regulation, all EU investment instruments shall prove that they address market failures or sub-optimal investment situations and shall achieve additionality "by avoiding replacing potential support from other public or market sources".

The definition of additionality as the avoidance of all types of crowding-out effects constitutes an improvement with respect to the current situation. Ultimately, however, the level of real additionality will depend on how exactly these criteria of additionality are interpreted by the InvestEUFund's governance bodies and assessed in the selection procedure.

6. A plurality of implementing partners

A major change of the InvestEU Fund with respect to the "Juncker Fund" (EFSI) is that implementation will not be exclusively entrusted to the EIB group but offered to a plurality of eligible implementing partners.

EFSI is basically a EIB-managed program backed by a budgetary guarantee from the EU budget. The EU budget guarantee, combined with some EIB own funding, allows the EU bank to finance a higher volume of high-risk projects or riskier tranches of projects of strategic importance for Europe. With the InvestEU Fund, the Commission wants to offer direct access to this guarantee to new partners, particularly International Financial Institutions (IFIs) active in Europe (such as the European Bank for Reconstruction and Developments,EBRD, the World Bank or the Council of Europe Development Bank) and National Promotional Banks and Institutions (NPBIs).

Offering to the Commission the possibility to work with other implementing partners is a good decision. Whereas EFSI financing has further diversified over time, support still remains concentrated to some countries and sectors[4]. Giving access to the EU guarantee to other public players with different expertise and geographic scope can help extend the reach of the new Fund to sectors or regions under-served by EFSI. Directly working with national promotional banks can also facilitate the combination of EU-level instruments and national and regional promotional schemes, thus avoiding competition and crowding out effects that were detected in EFSI evaluations[5].

Having said so, one may wonder how much real change there will be on the ground. To start with, not all eligible partners may be willing to play this role. In a survey conducted among 16 NPBIs in Europe, only 5 declare to be interested in having direct access to EU

4. At the end of 2017, three Member States accounted for 38 per cent of EFSI financing signed and the energy sector accounted for 33 per cent of the total EFSI signed operations under the IIW, exceeding the indicative concentration limit of 30 per cent in a given sector set by the EFSI Steering Board (Commission Staff Working Document, Evaluation of the European Fund for Strategic Investments, of the European Investment Advisory Hub, and of the European Investment Project Portal accompanying the proposal of InvestEU Fund , SWD(2018) 316 final)
5. EIB (2016), op.cit. and EY (2016) *Ad-hoc audit of the application of the Regulation 2015/1017* (the EFSI Regulation), Final Report 14 November 2016

funding instruments.[6] Second, interested eligible partners will have to pass the so-called "seven pillar assessment" that applies to any institutions implementing the EU budget on behalf of the Commission. This assessment entails an in-depth analysis of the organisation's internal procedures and systems of audit and control in order to make sure it can be entrusted to manage EU funds. At present, only 2 NPBIs fulfil these seven-pillar conditions. Third, while opening up to new partners, the Commission intends to keep the EIB as "privileged partner". In coherence with this, there is a commitment to reserve 75% of the EU guarantee for "implementing partners offering financial products in all member states" (which is basically a hidden reference to the EIB group). Fourth, according to article 12.2 of the legislative proposal, NPBIs will only have direct access to the EU guarantee to finance operations covering at least three member states, even if they may form a group for that purpose[7].

While the effort to encourage NPBIs to form groups and apply together to the EU guarantee is welcomed, article 12.2 requirement (to cover three Member States) seems a bit restrictive. Under this rule, NPBIs will not be allowed to use the EU guarantee to co-invest in projects of EU strategic interest located in their own national territory whereas the EIB group will be allowed to participate in these same projects with the EU coverage. If the intention is to ensure geographical diversification the rule looks redundant: article 12.1 already includes "adequate geographic and sectorial coverage" as criteria to take into account in the selection of projects.

Overall, given these various conditions and limits, it is probable that only a few number of actors having a strong willingness and capacity to act become implementing partners. These new partners will at most play some role in the implementation of 25% of the EU guarantee.

7. Governance: a pivotal role for the Commission

The governance of the InvestEU Fund differs from that of the "Juncker Fund" in many respects. EFSI is basically governed half-half between the Commission and the EIB. The Commission has a dominant position at the strategic level (the Steering Board is composed of three members from the Commission and one from the EIB) but the EIB plays an important "gate-keeping role" at the operational level (the selection of projects is made by an independent "Investment committee" but the latter receives the project proposals from the EIB, which first assesses the economic viability of the operation and consistency with relevant national and European legislations).

With the InvestEUFund, the Commission's intention is to provide for more policy steer and ensure equal representation of all implementing partners. This translates into a reinforcement of the Commission's role and a weakening of the EIB's role.

At the strategic level, the Commission becomes the only decision-making actor. The InvestEU Fund Steering Board is entirely composed of members from the Commission. This Board works in conjunction with "Policy Boards", also exclusively composed of Commission members, in charge of designing financial products and monitoring the performance of the implementing partners within a given policy window. Implementing partners do not have a say in strategic decisions: they only participate on consultative basis, as members of an "Advisory Board" supporting the work of the Steering and Policy Boards.

At the operational level, the EIB loses the "gate-keeping" role played in EFSI. The selection of projects is made by an independent Investment Committee (which will meet in four different configurations corresponding to the different windows), but it is now the Commission who first receives the project proposals

6. Rubio, E. (2018) *Making better use of public funding: the role of National Promotional Banks and Institutions in the next EU budget*, Report No.115, Jacques Delors Institute, July 2018

7. This refers to NPBIS acting as implementing partners in the EU compartment.

and checks their compatibility with EU rules and policies. After this first check, projects are sent to a "Project Team" composed of banking and risk management experts seconded by the different implementing partners. The Project Team assesses the quality and risk profile of the projects submitted to the InvestEU Fund by the different implementing partners and decides whether or not sending them to the Investment Committee. To prevent conflicts of interest, experts seconded to the Project Team will not evaluate projects submitted by their institution of origin.

The governance proposed by the Commission has been strongly criticised by the EIB. The Bank has criticised its exclusion from the Steering Board and considers that a Board 100% composed by Commission representative will not have sufficient banking expertise to monitor the overall risk profile of the Fund"[8]. A recent draft opinion from the European Parliament's Committee on Industry, Research and Energy Committee makes a similar point, and proposes to give representation to the implementing partners into the Steering Board "to ensure the right balance between policy and banking experience"[9]. The EIB also considers that the proposed process for project approval is extremely complex, and criticises the role of the Project Team which sees it as redundant with the EIB role.

8. More incentives to transfer part of member states' cohesion funds to the EU level

The InvestEU Fund regulation offers to member states the possibility to make voluntary contributions from their cohesion policy envelopes (up to 5% maximum) to the new Fund. These national contributions will be pooled into a "member state compartment"[10] and will be used to finance projects addressing country-specific market failures within the member state's territory.

The possibility to make cohesion funding's contribution to EU-level instruments is not new. National cohesion authorities can currently transfer part of their structural and cohesion funds to EU instruments managed by the EIF (e.g. COSME LG, InnovFin SMEG, the "SME Initiative").However, few member states have made use of this option, despite the advantages that it offers: the fact of being covered by a Union-wide guarantee, the possibility for managing authorities to save time and resources in the set-up phase (as they do not have to undertake an ex-ante assessment, design the instrument and select financial intermediaries) and –in the case of the "SME initiative" - the fact that national co-financing is not required.

The InvestEU Fund offers additional incentives to transfer national cohesion funds to the EU level. First, all funds transferred to the "Member State compartment" will be exempted from national co-financing . Second, State aid rules will be simplified (cohesion allocations channelled through the InvestEU Fund will be declared compatible with EU State aid rules as long as certain clear conditions are fulfilled).

Finally, and equally important, national cohesion authorities will have more say on how to use the transferred resources. At present, the cohesion contributions to EU-level instruments are managed by the EIF according to the rules governing the EU instrument (which define the target groups and type of financial support provided). Under the InvestEU Fund, there will be a contribution agreement between the Commission and the member state concerned defining the main elements of the transfer (size, provisioning rate, type of financial products offered, population targets). As for the delivery, it will not necessarily be the EIF (as it is the case today): the Commission will select the implementing partner based on a proposal by the member state.

8. Agence Europe, July 18

9. DRAFT OPINION of the Committee on the Environment, Public Health and Food Safety on the proposal for a regulation establishing the InvestEU Programme, 16.7.2018.

10. Each policy window will have one "member state compartment". This will be composed of one sub-compartment per member state which decides to contribute part of its cohesion funds into the InvestEU Fund.

This will allow national governments to appoint their own National Promotional Banks to design and implement these EU-wide guaranteed financial operations. In return to this greater say on how to use the funds, member states will assume part of the risk incurred by these EU-wide covered operations. The Union guarantee will cover these operations up to a level, and member states will assume losses above the expected losses, by issuing a back-to-back guarantee in favour of the Union.

9. Final remarks

While building on the experience with the "Juncker Fund" (EFSI), the InvestEU Fund addresses a totally different investment context. Even if the Commission continues to talk about a "sizeable investment gap in Europe"[11], the fact is that investment conditions have significantly improved since the Juncker Plan was launched. Investment levels are now very close to pre-crisis levels and they should continue to grow at a robust pace in 2019. Against this backdrop, the focus in the coming years should be less on quantity (catalyzing a big volume of additional private investment) and more on quality (crowding in private investment in specific sectors of strategic importance).

The InvestEU Fund reflects this reasoning, with the establishment of a lower investment target, more emphasis on guaranteeing the additionality of operations and more policy steering from public institutions on how to spend the money.

The Fund also presents important changes in the structure, governance and modes of implementation. Most of the changes seem justifiable as they aim at correcting weaknesses detected in the functioning of EFSI. Thus, the decision to move from a system composed of 15 EU Financial Instruments and guarantees to a single EU investment support scheme is aimed at eliminating overlaps and duplications between EU instruments identified in EFSI evaluations. Likewise, the opening up to new implementing partners may help extend the reach of the Fund to sectors or regions with low EFSI presence and avoid replacement effects with national or regional promotional schemes.

Finally, the new Fund also differs from EFSI in that it is organized in four policy windows (sustainable infrastructure research; innovation and digitisation; SMEs and mid-caps; and social investment and skills). The creation of thematic windows is welcomed as it can allow the Fund to better target policy-specific investment needs. However, the proposed allocation of resources among the windows is not in line with the respective size of market gaps. As it currently stands, a new InvestEUFund will cover almost half of the existing investment gap in SMEs and mid-caps in Europe but only 10% of the gap in sustainable infrastructures.

11. See European Commission, press release "EU Budget: InvestEU Programme to support jobs, growth and innovation in Europe", Brussels, 6 June 2018

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