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THE MEMBER STATE COMPARTMENT OF THE INVESTEU FUND:
HOW DOES IT WORK? WILL IT FLY?

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Executive summary

For the next Multi-annual Financial Framework (MFF) covering the 2021-27 period, the European Commission proposes to bring together the multitude of EU budget programmes providing financing in the form of loans and guarantees into a single programme: the InvestEU Fund. Building on the success of the Juncker Fund, the goal of this new programme is to trigger at least 650bn of additional investment across the Union during the following seven years.

A novelty of this new programme with respect to the Juncker Fund is the possibility offered to Member States to make voluntary contributions from their cohesion policy envelopes (up to 5% maximum) to InvestEU. These national contributions will be pooled in the so-called 'Member State compartment' of InvestEU and used to finance projects taking place in their national territory and in line with their cohesion policy objectives.

This paper examines the proposal of the Member States' compartment of the InvestEU Fund. It describes in detail the functioning of this new mechanism, clarifies what distinguishes it from existing combination options in the current programming period (2014-2020) and discusses the potential advantages it offers to national and regional cohesion policy authorities.

INTRODUCTION

Five years ago, the creation of the "Juncker Fund" (EFSI) to respond to a major investment gap was a sort of revolution in the EU budget context. It was the first time the EU designed a product based on an EU budgetary guarantee and aimed at mobilizing large amounts of private investment across the whole Union.

Building on the experience with EFSI, the Commission and the Council have agreed to set-up a similar EU mechanism to mobilise private investment across the EU during the period 2021-2027, the InvestEU Fund . While there are still some unknowns – particularly the size of the instrument, which depends on the overall size of the MFF – we have already an idea of how this new EU mechanism will work. Like EFSI, it will be based on an EU budgetary guarantee but as explained elsewhere (see Rubio and Virel 2018) it will present some novelties such as the fact of opening up implementation to a plurality of eligible financial partners (instead of relying solely on the EIB).

A less-discussed and interesting innovation will be the possibility offered to Member States to transfer a part of their EU cohesion policy envelopes to this new EU investment mechanism. These national contributions will fill a so-called Member State compartment of the InvestEU Fund, and will be used to finance projects addressing country-specific market failures within the Member States' territories.

This paper examines the proposal of the Member State compartment of the InvestEU Fund. It starts by reviewing the various motivations raised by the Commission over time to encourage the combination of EU cohesion policy funds (managed at national level) with EU-level market-like instruments (that is, EU instruments providing market-type support – loans, equity etc. – and managed at the central level). It then looks at the various options that exist to combine EU cohesion policy funds with EU-level financial instruments in the current programming period (2014-20) and draws some lessons from the low take-up of these options. The paper then describes in detail the functioning of the Member State compartment and discusses the potential advantages this new mechanism may offer to national and regional cohesion policy authorities. The paper concludes with some general reflections on the role the InvestEU Fund´s Member State compartment may play in helping deliver Member States´ cohesion goals and aligning them with broader EU-wide investment goals – such as the financing of the transition towards carbon neutrality.

1 . WHY COMBINE EU COHESION POLICY FUNDS WITH EU-LEVEL MARKET-LIKE INSTRUMENTS?

Over the last two decades, there has been a general trend to increase the amounts of EU budget support provided through market-like instruments (i.e. loans, guarantees, equity or quasi-equity investments) instead of traditional grants. This has been motivated by efficiency concerns and a desire to increase leverage in a context of strong budgetary restrictions. This shift from "grants to loans", as it is popularly known, has also been a trend in EU cohesion policy. Since the early 2000s , encouraged by the EU commission, Member States have allocated a steadily increasing volume of EU cohesion funds to financial instruments (FIs). Allocations have risen from only 1.2bn in the period 2000-2006 to 16.4bn in 2007–13 and 18.8bn in the current programming period (2014-2020)[1].

This rapid expansion of financial instruments under cohesion policy, however, has been confronted with various problems. The first evaluations of the implementation of cohesion policy-funded FIs during the 2007-13 period[2] already raised concerns about the effectiveness and efficiency of these instruments. Three types of problems were detected:

- First, national and regional authorities lacked expertise in setting up and managing financial instruments, which are in fact more similar to private market products than to classic public grants. This provoked delays in launching and delivering the funds to final recipients and difficulties to find the most appropriate set-ups.
- EU cohesion policy regulations proved to be too complex and ill-designed to address some of the specificities of financial instruments (as they had been designed to plan, implement and control the use of EU funds in the form of grants).
- The strict geographical limits imposed on the use of EU funds under cohesion policy requirements resulted in the creation of many small-sized financial instruments (e.g. a multiplicity of similar small, regional-based SME loan schemes). This not only entailed high overhead costs and a loss of economies of scale but made it difficult to reach a sufficient level of risk diversification to ensure the sustainability of certain financial instruments.

To address these shortcomings, in 2014-2020 the Commission proposed some changes to the EU cohesion policy regulations (CPR). Among other novelties, the ESI authorities were given the possibility to transfer a part of their structural fund allocations to EU financial instruments managed by the EIB (art 38.1.a CPR). The main goal was to relieve national cohesion authorities from the task of setting up and managing their own instruments. These amounts would be implemented by the EIB group according to the rules of EU-level financial instruments, but would be ring-fenced as to support investments in the Member State's territory. In short, it would be a sort of delegation of executive powers to the EIB group.

1. European Commission (2017), Summary of data on the progress made in financing and implementing financial engineering instruments 2007-2013, Brussels October 2017; European Commission (2018), Summaries of the data on the progress made in financing and implementing the financial instruments for the programming period 2014-2020, situation at December 2017, Brussels November 2018.
2. European Court of Auditors (2012), Financial Instruments for SMEs co-financed by the European Regional Development Fund" special report 2/2012; European Commission (2012), Financial Instruments in Cohesion Policy, SWD(2012) 36 final, 27.2.2012

In 2013-2014, with the crisis and the ensuing debate on investment gaps, an additional argument was raised to combine EU cohesion funds with EU-level financial instruments: to increase the overall level of EU support in a given territory. Encouraged by the Council, the EIB and the Commission would explore the possibility to create joint products to strengthen the EU's support to SMEs by merging EU cohesion funds with other EU budget resources as well as with the lending capacity of the EIB. The result was the creation of a new combination option, the "SME initiative" (art 39 CPR). In short, regional and national cohesion authorities were invited to transfer cohesion policy resources to the EIB group, which would then merge them with other EU funds to create a single instrument supporting SMEs in the Member State´s territory. While this also offered potential benefits in terms of simplification (see below for more details) the main logic was to increase the overall volume of EU support to SMEs in a given country.

In 2015, a year after the start of the EU cohesion policy programmes for 2014-20, the EU created EFSI, a new EU-level instrument managed by the EIB and aimed at mobilizing large amounts of private investment across the whole Union. During the first year of functioning, EFSI attracted much criticism for the uneven geographical distribution of its use and in particular its low take-up in CEE Member States. Among the causes for this low take-up, the idea gained ground that EFSI and the European Structural Investment Funds (ESIF) – that is, the cohesion policy funds – were not used in a complementary manner in these territories and that they tended to duplicate or crowd each other out[3]. To resolve this problem, the Commission published some guidelines to promote the combination of EFSI and ESIF, either in a single project or through the set-up of investment platforms. This combination was further encouraged through some changes in the EU cohesion policy regulations introduced in 2018.

2 . COMBINATION OPTIONS IN THE CURRENT PROGRAMMING PERIOD

As seen in the previous section, there are currently three different ways to combine EU cohesion funds with other EU-level market-like instruments. They differ not only as regards their underlying purposes but also in many other aspects.

2.1 . Article 38.1.a CPR

The first option is described in art 38.1.a of the EU cohesion policy regulation ("Common Provisions Regulation", or CPR). This article allows EU cohesion policy authorities to transfer a part of their EU structural funds' allocations to the EIB group, which manages all EU-level financial instruments on behalf of the Commission. These amounts are then disbursed by the EIB group following the rules and procedures of EU centrally-managed instruments (such as COSME LGF or InnovFIN SMEG), but ring-fenced to support investments in the Member States´ territory.

3. EIB, Evaluation of the Functioning of the European Fund for Strategic Investments (EFSI) Operations Evaluation, september 2016; EY, Ad-hoc audit of the application of the Regulation 2015/1017 (the EFSI Regulation) Final Report, 14 November 2016

For national cohesion authorities, the main benefit is that they do not have to spend time and resources to set-up and manage a financial instrument: this is done by the EIB on their behalf. An additional benefit is that Member States are exempted from the obligation of co-financing (that is, the amounts of cohesion policy funds transferred to the EIB do not have to be topped-up with national funds). However, by delegating to the EIB group, national cohesion authorities lose all capacity to influence the design of the financial product.

2.2 . SME initiative

Another combination option is the SME initiative (art 39 CPR). As with art 38.1.a CPR, it offers to national cohesion authorities the possibility to transfer a part of their cohesion policy funds to an EU-level instrument (a national SME initiative) managed by the EIF. These contributions, like for art 38.1.a, are exempted from the obligation of co-financing. However, there are various aspects that distinguish the SME initiative from art 38.1.a CPR:

- When transferring cohesion policy resources to the SME initiative, national cohesion authorities are exempted from the obligation to undertake an ex-ante assessment (that is, an assessment proving the existence of market needs and sub-optimal investment situations that justify the use of cohesion funds to provide certain type of financial support to market actors).This type of assessment is compulsory both to set-up financial instruments and to transfer ESI funds to the EIB group under art. 38.1.a.
- Cohesion policy contributions to the national SME initiative are pooled with resources coming from centrally-managed financial instruments (COSME, InnovFIN) and with EIF own resources, thus ensuring a higher financial leverage for the cohesion policy funds.
- The financial products offered under the SME initiative are designed in a way to offer more generous conditions than the more "ordinary" national EU SME support schemes under COSME or InnovFin, thus having a greater leverage effect (Commission 2013, p.91)[4].

Overall, the SME initiative is conceived both as a mechanism to simplify the set-up of financial instruments and as a means to increase the leverage of cohesion policy funds by attracting other EU-level funds and using more risk-absorbing products.

2.3 . Combination of EFSI and cohesion policy funds

A third combination option is using part of Member States´ cohesion policy resources to contribute to the financing of projects or investment funds receiving support from EFSI (Juncker Fund).

The Commission has actively promoted this type of combination, as a way to exploit the synergies and complementarity between these two strands of EU funding on the ground. In particular, it has encouraged the use of cohesion policy funds to support the risk-bearing capacity of EFSI investments, either by combining cohesion grants with EFSI loans in an individual project (e.g. using an ERDF grant to cover the initial investment of a big transport infrastructure project receiving EFSI support) or through the creation of investment funds in

4. The SME initiative provides two types of products (or a combination of both, depending on the needs of each territory): an uncapped guarantee for SME loans or a joint securitisation instrument for SME loans. Under both the uncapped guarantee and the securitisation scheme, cohesion funds guarantee the most junior tranche of the portfolio (i.e. the highest risk), COSME, Horizon 2020 and EIF resources cover the mezzanine tranche and EIB funds or funds from national promotional banks can participate in the senior tranche.

which EFSI covers the senior tranche and the cohesion policy contribution covers the first loss tranche ('layered funds'). The purpose, in both cases, is to crowd in more private investment in territories in which there are economically viable projects but the level of regulatory or policy risk is too high for private investors. By absorbing the first losses, cohesion policy funds would lower this risk and allow private investors to go in[5].

From the point of view of cohesion policy authorities, the main advantage to combine cohesion funds with EFSI is the financial leverage, that is the capacity to mobilise additional public and private investment for projects in line with their cohesion policy objectives. Another advantage is that, contrary to the two mechanisms described above (art. 38.1. a and the SME initiative), the cohesion policy managing authority is fully involved in the design of the project or the investment platform co-invested with EFSI. However, compared with the former two options, there are no benefits in terms of simplification. On the contrary, preparing an investment project or financial instrument which combines EFSI and ESI funds can be particularly cumbersome. This is because the Cohesion policy regulations (CPR) do not allow "blending", that is, pooling cohesion policy resources with other EU budget resources in a single mechanism or scheme and subsequently implement these resources by following a single set of rules. Thus, any combination of EFSI and ESIF requires coordinating two different approval streams (the cohesion managing authority shall approve the cohesion policy contribution to the project and the EFSI investment committee shall approve the EFSI investment operation) and a separate management of the two strands of funding, in accordance to different regulations (the CPR for the cohesion policy funds and the EFSI regulation for the EFSI investment). This situation has changed somewhat with the "Omnibus regulation", a comprehensive simplification reform of cohesion policy rules adopted in 2018, but overall there are still two set of rules and two bodies implementing them (the cohesion policy authority and the EIB).

5. European Commission (2016), *European Structural and Investment Funds and European Fund for Strategic Investments. Ensuring coordination, synergies and complementarity*, February 2016.

Table 1 ■ Three different ways of combining ESI funds with EU-level instruments in the current 2014-2020 period

	TRANSFER TO EU-LEVEL FINANCIAL INSTRUMENTS (ART 38.1.A CPR)	SME INITIATIVE (ART 39 CPR)	COMBINATION OF EFSI AND ESI FUNDS
Main rationale	Simplify the set-up and management of FIs for ESI authorities	Increase EU financial support to SMEs in a given territory	Exploit the complementarity between EFSI and ESI funds
Policy domain	All domains	Only SME support	All domains (in line with EFSI and ESI objectives)
Financial leverage from the use of ESI funds	No higher leverage than implementing FI under shared management	Higher leverage, ESI funds pooled with contributions from COSME, InnovFIN +EIF own resources and no national co-financing	High financial leverage if ESI funds used as "first loss" tranche to crowd in EFSI and private investment in projects that would not have attracted this investment otherwise
Impact on national public finances	No, exempted from co-financing	No, exempted from co-financing	Yes, national co-financing required
State aid	Exempted from state aid rules	Exempted from state aid rules if implementation of SME Initiatives' standard products	Full compliance with state aid rules (even if "fast track" procedure)
Does it imply less of an administrative burden for ESI managing authorities?	Yes – set-up and implementation fully delegated to EIB group	Yes – set up and implementation fully delegated to EIF No need for ex ante assessment	No – ESI authorities in charge of preparatory and management tasks corresponding to the ESI funding stream, even if the Omnibus regulation has allowed for some simplification
Do ESI authorities participate in the design and monitoring of the financial instrument/ operation?	No- instrument is managed by the EIB group according to the rules and procedures of centralised FIs	Very little- instrument is managed by EIF, two standard products proposed, some capacity for ESI authorities to choose which product/ negotiate specific design	Yes – ESI authorities fully involved in the design and monitoring of the instrument

3 . LESSONS FROM THE USE OF CURRENT COMBINATION OPTIONS

Despite the theoretical advantages that the various combination options offer to cohesion policy authorities (in terms of administrative simplicity, leverage or impact on national public finances), very few Member States have made use of them. Only one cohesion regional authority (the Madrid regional government in Spain) has applied the art 38.1(a) CPR by transferring a part of their European Social Fund's envelope (€25m) to an EU guarantee scheme managed by the EIF (EaSI) that provides support to micro-enterprises and vulnerable groups. As regards the SME initiative, the take up has been considerably lower than initially expected. According to the preparatory documents[6], the initial target was to mobilise between €3bn (minimum case scenario) and €8-10bn of ESI funding, which was considered necessary to have a sufficient critical mass and achieve an impact. However, in practice only 6 Member States (Bulgaria, Finland, Italy, Malta, Romania and Spain) have signed up to it, mobilising around €1.2 bn of cohesion policy resources in total.

Table 2. National SME initiatives currently in place

	SPAIN	MALTA	BULGARIA	FINLAND	ITALY	ROMANIA
Launch of the initiative	February 2015	July 2015	May 2016	September 2016	October 2016	October 2016
Type of product	SME guarantee loan scheme	SME guarantee loan scheme	SME guarantee loan scheme	SME guarantee loan scheme	SME loan securitisation instrument	SME guarantee loan scheme
Amount ESIF	800m	15m	102m	40m	102.5m plus 100m from national funds	250m
Amount from COSME/ H2020	14.3m	0.228m	1.8m	0.840m	4.25m	2m

Source: Nykos 2016

As to the combination of ESIF-EFSI, by the end of 2018 there were 27 EFSI operations involving ESI funds, representing only 3.1% of total EFSI operations and 3.8% of the total signed EFSI financing volume. In terms of geographical distribution, around half of these operations have been implemented in Central and Eastern European countries, yet not necessarily in those countries having more difficulties to attract EFSI funding but in those more experienced in the use of financial instruments and having powerful National Promotional Institutions (e.g. Poland or Estonia). If we look at the description of these operations (see table in Annex), most of them have been set-up to finance big infrastructure projects (the construction or renovation of airports, highways, heat and power plants, high-speed digital infrastructure, medical or research facilities, etc.). Only 6 ESFI-ESIF projects consist of SME-support schemes.

6. European Commission 2013, Ex-ante assessment of the EU SME Initiative, SWD(2013) 517 final

What explains this low interest? And how well have these combinations worked in practice? In the following section we will try to answer these questions on the basis of data from existing evaluations and reports[7] and some interviews with officials from the Commission and from Member States[8].

3.1 . Misalignments with the calendar

According to various interviewees, part of the explanation of the lower uptake of these options lies in the misalignment with the calendars. Both the SME initiative and EFSI were initiatives that emerged very late in time and were not aligned with the EU cohesion calendar. The SME initiative was adopted in October 2013, just two months before the start of the EU cohesion programming period. By that time, most Member States had already prepared their Cohesion policy programmes. Changing the Operational Programmes was difficult: it implied submitting a request for amendment to the Commission and taking out cohesion policy allocations from already planned programmes and priorities. The costs of modifying OPs only appeared acceptable in countries in which there was a strong sense of urgency to "do more" to help SMEs (e.g. Spain, Italy) or in which the EIB group was already involved in the management of Cohesion policy funds and there was a willingness to continue this experience in 2014-2020 (e.g. Malta, Bulgaria, Romania).

As for the combination of EFSI with cohesion policy funds, the EFSI regulation was adopted in July 2015 and the first Commission´s guidelines on how to combine EFSI with cohesion policy funds were published in February 2016, at a moment when the programming of EU cohesion funds, at least for the first years of the programming period, was well advanced.

3.2 . Absorption vs. leverage

Another important factor that has been pointed out as a disincentive, particularly for the combination of EFSI with cohesion policy funds, is the so-called N+3 rule[9]. This rule states that Member States lose their cohesion policy allocations if payments are not completed by the end of the third financial year following the adoption of the budgetary commitment. According to some interviewees as well as some reports, the strong pressure to disburse money on time may have discouraged cohesion policy authorities to explore possibilities to leverage their cohesion policy funds further[10]. This is particularly true for less developed countries, which receive significant volumes of cohesion policy funding and struggle to implement all their cohesion policy envelope on time. Increasing leverage by crowd-in private investment appears attractive only for countries having more modest cohesion policy envelopes and/or experiencing acute investment needs (e.g. a recessionary context combined with very limited national fiscal capacity).

7. Nykos, G 2016, Financial instruments in the 2014-20 programming period: first experiences of Member States, research for the REGI committee of the European Parliament; Wishlade. F. et al 2017, Improving the take-up and effectiveness of financial instruments, Final Report, study conducted on behalf of DG Regio
8. We conducted ten interviews with representatives of national cohesion policy authorities, officials from DG Ecfin, DG Budget, DG Regio and DG Growth.
9. The n+3 rule states that Member States lose their ESIF funds if payments are not completed by the end of the third financial year following the adoption of the budgetary commitment.
10. EFSI steering board, *Study in response to European Court of Auditors' Recommendation 5: Improving the geographical spread of EFSI supported investment*, July 2019, p. 30

3.3 . Legacy effects

In some countries, the decision to use the SME initiative has been very much influenced by the existence of a strong and fruitful cooperation with the EIB group. This is the case in Bulgaria, Romania and Malta, three countries in which the EIB group was already involved in the management of financial instruments set-up by using Member States´ cohesion policy allocations. In effect, these three Member States had benefited from the JEREMIE programme[11] in the 2007-2013 period and, in this context, they had established an EIF JEREMIE SME holding fund (that is, a nationally or regionally based holding fund providing support to SMEs and managed by the EIF on behalf of the region or Member State) . As explained by a representative of a cohesion policy managing authority, this JEREMIE instrument had worked very well and thus there was an appetite to continue with an EIB-managed SME instrument in 2014-2020.

While less visible, legacy effects may have also played an important role in the set-up of projects combining EFSI and ESI funding. It is not surprising that many of these projects take place in countries having strong and dynamic NPBIs which have already experience collaborating with national cohesion authorities.

3.4 . Regulatory obstacles and uncertainty

Despite the promise to ease up things for cohesion policy managing authorities, in practice various interviewees (both cohesion policy authorities and EC officials) admit that the set-up and management of these instruments has been more difficult than expected. This has discouraged other national and regional authorities from using these mechanisms.

The main problem has been the need to apply different sets of rules. According to an interviewee, the Madrid regional government's experience with art 38.1.a CPR was "a nightmare" to set-up contractually because of the need to align two sets of rules (cohesion policy rules and the rules governing the EU-level instrument, EaSI) both to design the instrument and for reporting and auditing. In the case of the SME initiative, there was an effort to align ex-ante the rules from ESIF, COSME and InnovFIn in the design of the product (rules on leverage, eligibility, etc.) but there were still different rules to be respected for payments and auditing. In the case of projects combining EFSI and ESIF funds, as said above, despite some improvements introduced by the Omnibus regulation there is still a need to apply two sets of regulations (cohesion policy rules and EFSI regulation) and to follow two separate procedures to approve the use of funding.

Apart from the complexity of regulations, an additional problem has been regulatory uncertainty. These instruments being a novelty in 2014-2020, the regulations were not clear in many respects and, despite the guidance provided by the Commission at the beginning, there was room for various interpretations at the moment of implementing it. In the case of the SME initiative, after an audit conducted by the European Court of Auditors on the SME Initiative in Spain, the Commission corrected some regulatory loopholes and strengthened

11. The JEREMIE programme was an EIB/Commission initiative aimed at providing assistance to national cohesion managing authorities willing to use part of their cohesion policy funds to set up venture capital funds, guarantee or loan schemes to support SMEs. The programme included the provision of technical expertise but also, at the request of the national authority, the possibility for the EIF to manage these new investment funds or loan schemes.

auditing and reporting obligations for managing authorities. This obliged them to introduce changes to their administrative structures in the middle of the implementation.

3.5 . State aid rules

An specific obstacle has been the application of EU state aid rules. This has not been an issue for national SME initiatives, which are exempted from the application of EU state aid rules (see box 1) but has become a burden for operations combining EFSI and cohesion policy funds. Whereas EFSI support is exempted from EU state aid rules, cohesion policy contributions to EFSI projects are subjected to the obligations of state aid notification and clearance by the Commission. The Omnibus regulation has not changed that, even if a fast-track procedure has been put into place to assess state aid compliance in EFSI-ESIF projects.

As many of the EFSI-ESIF projects consist of big infrastructure projects involving important cohesion policy amounts, they cannot be subjected to the "de minimis rule" (which states that small aid amounts are exempted from prior state aid notification). Thus, unless these projects fall into one of the specific categories of aid exempted from EU state aid control and listed in the "General Block Exemptions Regulation" or GBER (which includes categories such as "support to research" or "support for environmental protection"), the cohesion policy authority has to notify the cohesion policy contribution to the EFSI project or investment platform and wait for the Commission's clearance before giving green light to the project.

Box 1. State aid rules in the case of SME initiative and EFSI-ESIF projects

The Treaty of the functioning of the EU (TFEU) prohibits Member States from providing any form or direct or indirect financial support to a private actor in a way that distorts competition in the market. The European Commission is in charge of enforcing this rule through a burdensome system of state aid notifications, controls and inquiries.

The decisive element in the classification of resources as "state resources" is not their origin but whether the state can exercise control over them. Cohesion policy funds managed by national and regional authorities are considered "state resources" even if they are coming from the EU budget, as they are managed with discretion by national authorities. Thus, they are subject to the same procedures of state aid notification and control as any other type of national public funding.

In contrast, other EU-level programmes are not considered "state resources" and are not subjected to EU state aid procedures, insofar as the Commission designs them in a way to ensure compliance with EU state aid rules.

For the same reason, Member States' cohesion policy contributions to the SME initiative or to other EU-level financial instruments (under art 38.1.a) are not "state resources" insofar as the Member States do not retain any influence over how these ESI funds are used. The logic here is that these cohesion policy resources will be implemented out of control of the Member State, and according to the legal framework governing EU level financial instruments which have been already designed by the Commission to be state aid compliant.

In the case of ESIF and EFSI combinations, on the contrary, the cohesion policy contribution is subjected to full compliance of EU state aid rules whereas the EFSI contribution to the project is exempted from state aid rules. This obliges the national cohesion policy authority to notify the cohesion policy contribution to the EFSI project or investment platform to the Commission (unless exempted by the "de minimis rule" or the GBER regulation) and wait for the Commission's clearance before giving green light to the project.

3.6 . Loss of control and political visibility

A particular criticism of the SME initiative raised by various cohesion policy managing authorities has been the loss of control that it entails. The perception by many of them is that "money is 'recentralised' to Brussels or Luxembourg, and once recentralised you lose control of it". This loss of control is seen as negative for two reasons.

The first is purely functional. According to Commission officials, for instance, some Member States would have refused the use of the SME initiative because the products proposed were seen as inflexible and less adapted to national circumstances than existing national FI implemented under shared management. In principle, in the case of the SME initiative the Member State can require some modifications. However, there is a sort of trade-off for cohesion policy authorities: if they want to retain influence over the use of "their" cohesion policy funding and tailor-make the products to their local needs they have to accept to be subject to EU state aid rules (see box 1). Alternatively, if they implement SME initiative´s standard products the latter will be excluded from the application of EU state aid rules.

The second argument is political. As pointed out by an interviewee, "structural funds are per definition regional: regional authorities are the ones who decide. Managing this money has the potential to bring political glory. With the SME initiative, they would have lost all influence, it would have been the EIF who delivered, so many of them wondered "why should I give all the political glory to Luxembourg?"

The lack of political visibility may also explain the low interest to combine cohesion funds with EFSI. Some cohesion policy authorities, may consider that using cohesion policy allocations to absorb the first losses of a project essentially labelled as an "EIB EFSI project" is not politically rewarding.

3.7 . Coordination of national and regional authorities

In large countries in which regional governments are in charge of managing an important part of cohesion policy funds, an additional difficulty for the set-up of an SME initiative has been the need to coordinate central and regional authorities. Since regulation states that the SME initiative shall be set-up at national level, through a single dedicated Operational Programme, the central government has to coordinate with regional governments to transfer part of their cohesion policy allocations to this new mechanism. In Spain, for instance, the central government had to negotiate with the 17 regional governments and in the end two of them declined to participate in this mechanism. Besides, for the participating ones, commitment was taken to secure a minimum return of investments per region, giving to all regions the possibility to request compensations if this minimum was not attained[12].

12. Marc, François (2016) Rapport d´information sur les instruments financiers en faveur des petites et moyennes entreprises gérés par le Fonds européen d'investissement, French Senate, Finance Commission, 6 July 2016, p.64

4 . THE MEMBER STATES COMPARTMENT OF INVESTEU FUND

In the following programming period (2021-2027), all EU-level market-based instruments (that is, EFSI and all the 13 EU thematic financial instrument currently managed by the EIB group) will be replaced by a new investment instrument, the InvestEU Fund. As EFSI, InvestEU fund will be based on an EU budgetary guarantee. The logic will be the same than for EFSI: using the EU budget guarantee to cover a part of the risk of investment projects of EU strategic interest, in view of mobilising additional amounts of private and public capital for these projects.

The InvestEU Fund regulation gives to Member States the possibility to transfer up to 5% of their EU cohesion policy allocations to this new instrument. These Cohesion policy contributions will fill a Member State compartment and will be used to support projects in the national territory mainly addressing country-specific market failures or sub-investment situations. This mechanism can be used to finance project in any of the four thematic areas in which the InvestEU Fund is structured: Sustainable infrastructure; Research, innovation and digitisation; support to SMEs or Social investment and skills. While benefiting from the EU-wide guarantee, the amounts invested in these projects will be ring-fenced. Thus, the risk incurred will not be mutualised among Member States.

How exactly will the Member State compartment of the InvestEU Fund work? At first sight it seems similar to the first two combination options described above (art 38.1.a and 39 CPR) but it is in fact quite different from them.

4.1 . Working with an EU budgetary guarantee

To understand how the "Member State compartment" will work, it is important to first understand the difference between an EU financial instrument (such as InnovFin, COSME, etc..) and an EU instrument based on an EU budgetary guarantee (such as EFSI or InvestEU Fund).

Financial instruments are just a different way to disburse EU money. They are 100% financed by the EU budget, meaning that the size of the financial instrument corresponds to the budget allocated to it. This budget is transferred to the EIB group or another financial institution in charge of implementation, which will disburse this money in form of loans, guarantees or equity investments, following the rules established by the Commission or the cohesion policy authority (e.g. the size of the loans, eligible beneficiaries, risk profiles, etc.). In this case the financial institution acts on behalf of the Commission or the cohesion policy authority: it does not invest its own funds but EU money and receives a payment for the service offered (in the concept of "management costs and fees"). Any possible losses from the operations incurred are covered by the EU budgetary allocation dedicated to this instrument and investments are treated as "off-balance sheet operations" in the financial institution´s report.

EU instruments based on an EU budgetary guarantee are quite different. There is no transfer of EU funds to the financial institution implementing them, but just the commitment by the EU to assume a part of the risks taken when investing in certain projects. In the case of EFSI, for instance, the Commission provides a guarantee of €26bn to the EIB. This guarantee covers a part of the risk of investment operations undertaken by the EIB under EFSI mandate. The goal is to push the EIB to invest in more risky projects of European interest (as the first losses are covered by the EU budget), and by doing this to mobilise further private investment for these projects. This means, however, that the EIB assumes part of the risks of these investment operations. It does not simply act as the Commission´s implementing partner but also as a co-investor.

Another important difference is that, while financial instruments are 100% financed by the EU budget, EU guarantees are only partially provisioned. There is a reserve of cash in the EU budget, a so-called "provisioning fund", equivalent to a percentage of the guarantee which is expected to be sufficient to cover potential losses. This is 35% in the case of EFSI and 40% in the case of the InvestEU Fund. The difference between this cash reserve and the amount of the guarantee is a contingent liability for the Union, that is, a potential liability that may materialize if the operations covered by the EU budgetary guarantee have losses above the expected ones.

These peculiarities of the instruments based on EU budgetary guarantees have implications when combining them with cohesion policy funds. With an EU budgetary guarantee, the combination cannot consist in creating more volume of public investment by pooling EU resources, as it is the case with the SME initiative. The goal shall be to mobilise more private investment by using cohesion policy funds to strengthen the EU´s guarantee in the Member States ' territory.

In addition to that, any combination of EU cohesion funds with an EU guarantee instrument must involve a financial institution acting not only as an implementing partner but investing on its own, that is, assuming a part of the risks of the "joint" operation. This is in fact what happens already with EFSI-ESIF operations. However, in the case of the InvestEU Fund, the picture is more complex than with EFSI as there will be a plurality of public financial institutions eligible to benefit from the InvestEU guarantee, and thus able to propose and manage operations combining the InvestEU guarantee with cohesion funds. This includes in particular national and regional promotional banks and international financial institutions operating in Europe, such as the Council of Europe Development Bank or the Nordic Investment Bank[13].

4.2 . A particular arrangement to combine with cohesion policy funds

The Member State compartment is a particular arrangement that allows Member states to use a part of their cohesion funding envelope to strengthen the Invest EU Fund´s guarantee

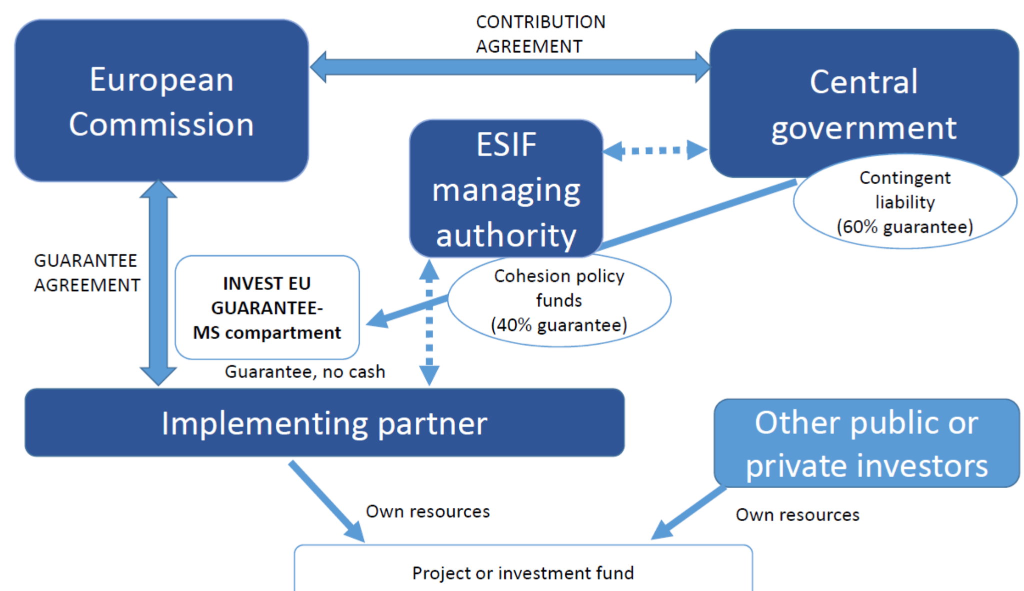
13. While the EIB group will remain the dominant partner of InvestEU Fund, a novelty with respect to EFSI is that other actors such as National Promotional Banks or some International Financial Institutions (the European Bank for Reconstruction and Development, the Council of Europe Development Bank, the Nordic Investment Bank) will be also able to present projects to InvestEU Fund and benefit from the EU budgetary guarantee. To become eligible partners they will have to pass a "pillar assessment", a sort of in-depth analysis of the organisation's internal procedures and systems of audit and control, undertaken by an independent auditor, in order to make sure the institution can be trusted to manage EU funds.

in their territory. In particular, cohesion policy resources are transferred to the provisioning fund of the EU guarantee. In exchange, the Commission allows the use of the EU guarantee to cover certain operations taking place in the Member State and in line with their cohesion policy objectives. As the amounts of cohesion policy funds transferred to the provisioning fund will only partially cover the amount of the EU guarantee received for these projects, the Member States will also assume the remaining contingency liability related to the use of the guarantee.

The design and set-up of the mechanism is quite complex and involves at least four actors : the Commission, the central government, the implementing partner (EIB, national promotional bank or other) and the national or regional cohesion managing authority (figure 1):

- As a first step, the Commission signs a "contribution agreement" with the Member State's ministry of finance. This agreement establishes: a) the overall size of the Member State compartment, the type of operations to be supported and the implementing partner(s) who will carry out the operations covered by the EU guarantee; b) the amount of cohesion policy funds to be transferred to the "provisioning fund" of the InvestEU Fund, which shall be equivalent to 40% on average of the amount of the EU guarantee and c) a "back-to-back guarantee" of the central government to the Commission, by which the Member State assumes the remaining contingency liability related to the use of the EU guarantee (that is 60%).
- Once the contribution agreement is signed, the Commission signs one or more "guarantee agreements" with one or more financial institutions. These institutions must be eligible to participate in the InvestEU Fund and are proposed by the national or regional cohesion managing authority. With these agreements, the Commission extends the InvestEU Fund´s guarantee to certain projects or operations planned by these financial institutions, which are in line with the cohesion policy´s objectives in the country and have been agreed with the cohesion policy managing authority.
- Once the guarantee agreement is signed, the financial institution (the EIB group or other) implements the project or investment operation. It invests its own resources but, with the EU guarantee, it can take riskier positions and crowd in other public or private investors in the operation.

Figure 1 ■ Member State compartment of InvestEU Fund



source: own ellaboration

4.3 . Discussing the potential advantages

The Member State compartment presents some advantages with respect to current combination options as well as to the implementation of financial instruments under shared management. The most important one is the **higher financial leverage**. Cohesion funds are not directly invested in a project or operation but used to increase the EU guarantee. As a result, with a given amount of EU cohesion funds (say, €40m), the Member State can obtain an EU guarantee which is 2.5 times the amount of funds provided (€100m). However, this assumes that cohesion policy authorities have a strong incentive to leverage their cohesion policy resources further. As mentioned above, this may not be the case in countries receiving massive amounts of EU cohesion funds, in which the main concern is to disburse money on time. The pressure to spend on time may be even higher in the next programming period, as we will come back to the classic "N+2 rule" (meaning that cohesion policy authorities will have two years to execute planned spending, instead of the three years period that applied in this programming period).

Another aspect to take into account is the difference between directly investing cohesion policy money into a project or providing a public guarantee to a public promotional institution investing in it. The second option implies the existence of a promotional institution eligible for the InvestEU Fund, interested in the project and willing to put its own resources and assume part of the risks. Besides, from the point of view of national and regional authorities, there may be some fear of losing **political visibility** if they are spending the EU cohesion funds through an EU guarantee. These fears, however, may be lower if the project is set-up and managed by national or regional promotional institutions working under the public mandate of the same cohesion policy authority.

Another advantage of the Member State compartment is that it will have almost zero **impact on national public finances**. Cohesion policy funds transferred to the InvestEU Fund will be exempted from national co-financing. While the country will assume a contingent liability, it will be small and in principle excluded from the national debt calculus[14]. However, it is worth reminding that the SME initiative was already exempted from national co-financing and the level of take-up was very low, despite the fact that it was launched in the middle of the crisis with many national governments implementing harsh austerity policies. In other words, the lack of national co-financing did not work as a strong incentive to opt for the SME initiative. A possible explanation is that the advantage existed mainly for central finance ministers, not for national or regional cohesion managing authorities, whose consent was needed to transfer cohesion policy resources to the SME initiative. The same may occur for the Member State compartment: the proposal of projects susceptible of being covered by the InvestEU Fund shall in principle come from national or regional cohesion authorities, which are indifferent to the impact that the use of this instrument will have on the central government's public finances.

Commission officials also stress that, contrary to the SME initiative, the use of the Member State compartment **will not imply a loss of control for Member States**. National cohesion policy authorities will propose the financial institution in charge of implementing the project, they will define the relevant elements of the investment operation together with the implementing partner (e.g. amount, objectives, eligibility criteria for the final beneficiaries) and will be invited to participate in the monitoring of the use of the guarantee. However, some

14. Contingent liabilities are liabilities they may occur in the future. As long as they remain contingent, they must be disclosed but are not included in the calculation od debt. If they cease to be contingent, they shall be counted as debt.

caveats should be noted on this point. First, operations under the InvestEU's Member State compartment will be exempted from state aid procedures only if they are based on the InvestEU Fund's standard products. Thus, if Member State authorities want to use the EU guarantee to support a specific, tailor-made investment operation in their territory they will have to be in compliance with EU state aid rules. If the operation is big and not part of one of the domains exempted from EU state aid notification (according to the GBER regulation), the Member State's cohesion policy authority will have to notify the operation to the Commission and wait for the Commission's clearance before giving green light to the project. Second, the Commission has been rather vague with regard to how exactly Member States' cohesion authorities will be involved in the monitoring of the implementation of the EU guarantee. It seems that the details will be negotiated with the Member States at the moment of preparing the contribution agreement. However, the contribution agreement will be signed between the Commission and the central government. In countries in which regional governments manage part of cohesion policy funds, it will be key to secure appropriate representation of regional authorities in the preparation of the contribution agreement and in the monitoring of the EU guarantee.

Finally, it is also argued that the Member State compartment will be relatively **simple to implement** for national and regional authorities. Apart from the fact of being exempted from EU state aid rules (if implementing standard products, see above) Member State authorities will be largely spared from the tasks of reporting and monitoring. The Member State compartment will be implemented by following InvestEU rules, and thus it will be the Commission (DG ECFIN) in charge of interacting with the implementing partner and reporting. In particular, it will collect the data directly from the implementing partner and will write bi-annual reports, which will be sent to the cohesion policy authority. DG ECFIN will also be in charge of monitoring the use of the EU guarantee, even if cohesion policy authorities will be invited to participate. However, drawing lessons from the experience with the SME initiative, cohesion policy authorities may view these promises of low administrative burdens sceptically. As the Member State compartment is a totally new construct, they may be wary about possible regulatory loopholes leading to the introduction of additional administrative charges in the middle of the implementation process.

Table 3 ■ Differences between the MS compartment, the SME initiative and the EFSI-ESIF combination

	MEMBER STATE COMPARTMENT OF INVESTEU FUND	SME INITIATIVE (ART 39 CPR)	COMBINATION OF EFSI AND ESI FUNDS
Main rationale	Use ESI funds to extend the InvestEU guarantee to operations taking place in MS´s territory and in line with ESI objectives	Increase EU public support to SMEs in a territory	Exploit the complementarity between EFSI and ESI funds
Policy Area	Sustainable infrastructures, R&I and digitalisation, SMEs and social investment and skills	Only SME support	All domains (in line with EFSI and ESI objectives)
Financial leverage	Higher financial leverage: with 40% of ESI funds the Member State benefits from an EU guarantee of 100% In countries with weak credit ranking, possibility to mobilise higher volume of private investment being covered by a Union's guarantee	High financial leverage, ESI funds pooled with other EU budget funds and EIF own resources and no national co-financing	High financial leverage if ESI funds used as "first loss" tranche to crowd in EFSI and private investment in projects that would not have attracted this investment otherwise
Impact on national public finances	No co-financing but assumption of a contingent liability	No national co-financing	National co-financing required
State aid	Exempted from state aid procedures if use of InvestEU Fund's standard products	Exempted from state aid procedures if use of SME initiative´s standard products	Full compliance with state aid rules (even if "fast track" procedure)
Does it imply less of an administrative burden for ESI managing authorities?	Yes operations under the MS compartment will follow InvestEU implementation and reporting rules. Commission (DG Ecfin) responsible of reporting and monitoring	Yes Set up and implementation fully delegated to EIF	No ESI authorities in charge of preparatory and management tasks corresponding to the ESI funding stream, even if the Omnibus regulation has allowed for some simplification
Do ESI authorities participate in the design and monitoring of the financial instrument/operation?	Yes - ESI authorities can propose their preferred implementing partner to the Commission They can use InvestEU's standard products but also design specific, tailor-made products through exchanges with the Implementing Partner to address specific needs of the country ESI authorities can participate in the monitoring of the guarantee agreement if they wish	Very little-instrument is managed by EIF, two standard products proposed, some capacity for ESI authorities to choose which product/ negotiate specific design	Yes – ESI authorities fully involved in the design and monitoring of the instrument

FINAL REMARKS . WILL IT FLY?

It is too early to know whether the Member State compartment will attract the attention of Member States or, on the contrary, will remain largely unused. Contrary to what happened with the SME initiative, the InvestEU Fund's proposal was presented early in time and this has allowed the Commission to exchange with Member States' authorities and potential implementing partners and clarify possible doubts. However, there are still many open issues (such as the amounts of EU cohesion funds allocated to each Member State or the overall budget for the InvestEU Fund) which make it difficult for Member States to assess the opportunities and implications of using this mechanism. In addition, many Member States may prefer to wait until the InvestEU Fund is fully operational, to see how much investment they are able to attract to their national territory through the EU compartment before deciding whether or not to opt for the Member State compartment.

Another open issue is the role the Member State compartment will play in the context of the new "Just Transition Fund". This new fund will have its own budget and will provide support to the territories most affected by the transition towards climate neutrality. It will cover all EU countries but, to benefit from this new EU funding programme, Member States will have to make ERDF and ESF contributions to the Fund and complement them with national co-financing. As pointed out in the Commission´s communication on the European Green Deal investment plan, countries may decide to do these contributions via the Member State compartment. This may look attractive, particularly for countries having small ERDF and ESF envelopes.

Leaving aside these various unknowns and open issues, however, if we judge from past experiences we should not expect a strong demand for the use of the Member State compartment. There may be a limited number of initiatives gradually taking place, especially in those countries more experienced in the use of financial instruments, having more dynamic national public promotional institutions or maintaining a strong and fruitful collaboration with the EIB group. If successful, these first experiences may convince others to implement it. For this to happen, a crucial factor will be to make sure that the Member State compartment allows national and regional authorities to retain control of the use of "their" resources while bringing real simplification gains.

ANNEX . LIST OF PROJECTS COMBINING ESIF AND EFSI FUNDING AS OF END 2018

NAME	COUNTRY	DESCRIPTION
IF TRI Nord Pas de Calais	France	Loan to a public-private investment company to invest in low-carbon economy in the Nord Pas-de-Calais region
D4R7 Slovakia PPP	Slovakia	Design, construction and financing of a motorway
TI - Accelerated Fixed High Speed BB rollout	Italy	Investment plan of Telecom Italia generation networks
Kujawsko-Pomorskie Healthcare Program III	Poland	Replacement construction, rehabilitation and equipping of a hospital
Alsace Très Haut Débit	France	Deployment of a telecommunications network in the Alsace region
Lietuvos Energija Vilnius CHP project	Lithuania	Construction of two biomass-fired and waste-to-energy-fired combined heat and power (CHP) plants
Novamont Renewable Chemistry	United Kingdom	Financing of investments for the development of an integrated supply chain in the field of bio-chemicals and bioplastics
Tallinn Airport Upgrade	Estonia	Infrastructure reforms in Tallinn airport
Krakow By-Pass - Lagiewnicka Route	Poland	Extension of the Krakow internal by-pass including tunnels and other structures, and 1.7 km of tram line
Portugal Water Supply & Sanitation	Portugal	Investments of the Águas de Portugal group in the water and wastewater sector across Portugal
Energa's hybrid bond	Poland	Hybrid bond for the modernisation and extension of ENERGA'selectricity distribution network
University of Latvia Research and Study Centre	Latvia	Construction of a new research and technology centre and a new study centre on the university campus
AQP-Water Sector	Italy	Financing of the promoter's investments in the water network and upgrading the southern wastewater network of Puglia
Roland Garros Airport development plan	France	Infrastructure reforms in Roland Garros Airport of La Réunion
Warsaw Medical simulation centre	Poland	Construction and equipping of a new state-of-the-art medical simulations centre at the Medical University of Warsaw
Poznan Medical University		Construction of a new University building for the Faculty of Pharmacy
Gironde Haut Mega		Construction of a fibre optic broadband network to the Home (FTTH) in the rural areas of the Gironde département
Aeroport de la Guadeloupe		Infrastructure reform Pointe-à-Pitre/Le Raizet International Airport (PTP), in Guadeloupe
Walbrzych Urban	Poland	Framework loan to co-finance investments identified by the promoter and contributing to the Sustainable Development Strategy of the city of Walbrzych

Budapest District heating strategic investment	Hungary	Investments in the district heating system of Budapest
Reseau Canopee Logement Social	France	Construction of more than 1200 new social and affordable housing units as well as the rehabilitation of existing housing units
ESIF – Estonia: Equity United PE 1	Estonia	Three financial products offered by ESIF-Estonia, a €60m equity fund of funds ("EstFund"), created through cooperation between the Republic of Estonia, the national NPI KredEx and EIF and offering equity financing to selected funds operating in the region
ESIF- Estonia Tera Ventures Fund II	Estonia	
ESIF Estonia United Angels Co investment Fund	Estonia	
Swedish Venture Initiative ("SVI")- Brighty ventures	Sweden	Three financial products offered by Swedish Venture Initiative ("SVI"), a SEK 582m fund of funds launched in close co-operation with the Swedish Agency for Economic and Regional Growth to effectively support first time or emerging venture capital funds focused on early stage investments.
Swedish Venture Initiative (SVI) Luminar Ventures	Sweden	
Swedish Venture Initiative (SVI) Spintop Investment Partners III	Sweden	

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