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EFSI as a Driver towards Convergence

Economic, social and territorial cohesion and convergence are key pillars for the European model. Since the codification of these principles in the Treaty of Rome, they have been drivers and crucial preconditions for a sound economic development, a positive perception of European integration and the political stability of the European Union.

A positive economic perspective and an efficient cohesion policy are no contradiction, but rather go hand in hand. A study by the World Bank entitled "Golden Growth: Restoring the Lustre of the European Model" shows how economic growth and convergence have been inseparable over the last 50 years. It concludes: "Adjustments are needed to restart the European convergence machine in order to improve competitiveness and raise living standards".

The European Investment Bank (EIB) was founded in 1958 exactly for the purpose of economic and social cohesion. As the bank of the EU, the EIB is tasked to support EU policy priorities: competitiveness, cohesion, and climate protection. It does so by providing finance to eligible projects, including small and medium-sized enterprises (SMEs) as well as midcap companies, infrastructure, innovation and environmental protection.

2014, at the beginning of the current multiannual financial framework (MFF 2014–2020), Europe and its economy were in a difficult situation. As a result of the financial and economic crises growth was severely hit and the perspective for renewed growth was bleak, unemployment was rising, and overall investment was decreasing by –15% compared to pre-crises level, even more in many individual regions. Europe lost competitiveness compared to its main international counterparts. As a matter of fact the positive trend to close cohesion gaps within the Union stalled, and the gaps started to widen again.

Jean-Claude Juncker therefore launched the "Investment Plan for Europe" to tackle the key challenges: to close the investment and competitiveness gap, to fight the credit crunch via increased risk taking, to attract private capital to finance infrastructure as public resources are limited and to remove investment barriers via structural reforms. The "Investment Plan for Europe" is based on three pillars:

- to create an investment friendly environment via structural reforms and to improve the regulatory conditions for investment;
- to advise on investment opportunities via the European Investment Advisory Hub (EIAH) and the European Investment Project Portal (EIPP);
- to mobilize investments via increased financing provided by the EIB Group, with the guarantee support of the European Fund for Strategic Investments (EFSI).

EFSI is not a separate legal entity providing finance. It is a guarantee facility supported by the EU Budget (EUR 26 billion) and augmented by a contribution from the EIB's own capital reserves (EUR 7.5 billion). Together, these contributions have enabled the EIB Group to expand rapidly the scale and scope of its financial support for eligible, worthy and economically sustainable investments throughout the entire EU; developing new financial products and intensifying the cooperation with national partners to provide financing for risky projects that could not have been supported before.

Given its impact, EFSI was recently extended until the end of 2020, combined with an increase of the investment target from EUR 315 billion to EUR 500 billion as key challenges remain.

Despite the much improved economic perspective the EU continues to face significant competitiveness and productivity gaps, which have grown in recent years as Europe has been looking inwards. There is comparatively low EU spending on research and development and a huge digital gap which interrelates with low innovation capacity. The risk-taking capacity of commercial banks remains constrained based on stricter regulatory requirements and the frequent need to repair balance sheets and build up capital buffers. Public and budgetary resources remain limited and the capital market in Europe is still underdeveloped which limits alternative sources of long-term financing for willing investors. Nevertheless, competitiveness, cohesion and climate protection need further investments on a significant scale.

There are still clear and persisting investment gaps in Europe. The figures may vary by source but the amount of investment needed to secure Europe's future remains enormous. The EIB's latest figures indicate annual investment gaps of approximately EUR 160 billion for innovation, EUR 155 billion for energy and energy efficiency (already before the recent increase of EU 2030 targets) and EUR 88 billion for sustainable infrastructure. Overall, this points to an investment gap of more than EUR 400 billion every year till 2030. Investment that would be needed in order to achieve EU policy priorities, prepare for long-term demographical trends and respond to new challenges such as migration.

Table 1

Investment gaps remain significant
Annual investment gaps through 2030

	Investment Gap	Range
	billion EUR per year, EU-27	
Innovation	160	150–170
R&D	110	
Broadband and Digitalisation	50	
Energy[1]	155	145–165
Generation and grids	17	
Energy efficiency	138	
Sustainable infrastructure	88	85-90
Water supply, sanitation, solid waste	7	
Social and affordable housing	6	
Education	8	
Health	17	
Mobility	50	
Total	403	380–425
Total in % of the EU-27 GDP (2018)	3	

Quelle: EIB.

[1] *Before the increase of the EU 2030 targets agreed in June 2018.*

Specifically for SMEs access to finance remains both critical and often sub-optimal, as financial markets still are very fragmented and financing is largely limited to banks. While there has been a welcome improvement of financing conditions of SMEs in many of the larger Member States, many small firms still find it difficult to obtain sufficient finance to prosper and grow. This is especially the case if they are young, innovative, and therefore risky, or if they are based in less developed or cohesion regions.

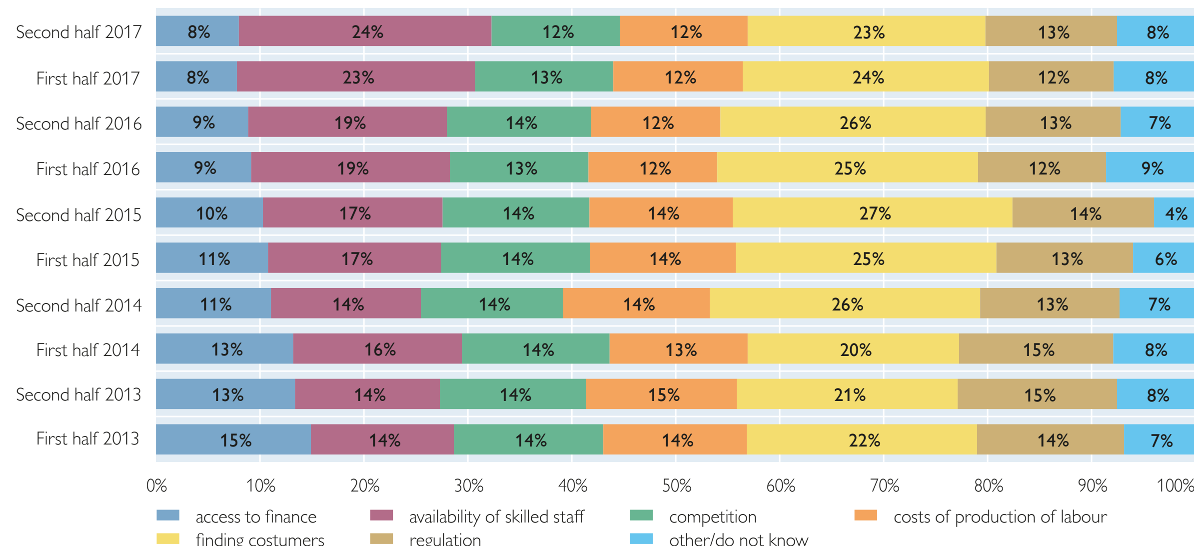
Specific needs are evident: venture capital, midcap and growth companies, innovative firms and riskier investments in Research & Development as well as equity or quasi equity finance would be needed. Another aspect that has come to the forefront of SMEs' concerns is the availability of skilled staff, which is currently the most important problem cited in ECB SAFE survey. To grow the potential of Europe and its businesses, investment into education has become at least as crucial as direct SME financing.

The Investment Plan for Europe has lived up to its name. Amongst its three pillars EFSI, implemented by the EIB Group, has exceeded its ambitious initial targets and is a story of success:

- EUR 334.8 billion of investment were already incentivized by July 2018.

Chart 1

The most important problems faced by euro area SMEs



Source: ECB Survey on Access to Finance for Enterprises (SAFE).

The EIB Group remains on track to achieve the target of EUR 500 billion by end of 2020.

- EFSI is a market driven instrument without sectoral or geographical quotas. It is encouraging to see that EFSI financing has reached important target areas for growth and the growth potential of the EU: 31% for SMEs, 21% for Research, Development and Innovation (RDI), 21% for energy infrastructure, 19% for digital and transport infrastructure.
- EFSI financing provided by the EIB Group has reached all 28 Member States, proving that it is possible to structure projects that are both worthy and economically sound "bankable" throughout the Union.

There was some criticism of the geographical distribution of EFSI funding on a nominal basis early on, which was both premature and shallow. For a market-driven instrument, the sheer size of the underlying economies is naturally liable to influence the nominal size of intervention, and the speed at which new and unfamiliar instruments are accepted by project sponsors varies with the specificities of each market. However, after three years of experience and adjusting for the size of the respective economies, it is encouraging that the top 10 countries, which benefited most from investments supported by EFSI relative to their GDP are headed by Greece, Estonia, Lithuania, Bulgaria and Finland, followed by Poland, Spain, Portugal, Latvia and Italy.

The current investment mobilized of EUR 334.8 billion has been achieved with EUR 65.5 billion of financing approved by the EIB Group based on EFSI guarantee. Close to EUR 270 billion of financing will be co-financed by other sources: private and public project promoters, national promotional banks and institutions, partner banks across the EU and many other co-investors – around two-thirds from the private sector.

The EFSI works and is already having a macroeconomic impact. Short-term effects and long-term structural impacts are evidenced by the EC's RHOMOLO model, which has been

adapted by the EIB to model the results of EFSI. The current stock of EIB financing with EFSI support is already expected to have a positive effect of 1.3% on EU GDP and to create 1.4 million jobs by 2020. This immediate investment effect will gradually give way to a long-term structural impact, which is estimated at 0.9% of GDP and 780,000 jobs by 2037.

The macroeconomic analysis shows another qualitative effect that had been overlooked by the initial criticism focused on nominal financing volumes. The economies of less developed and cohesion regions are typically more labor intensive than those in the most developed Member States. Relative to their nominal amount, investments in these regions have on average a higher immediate impact on jobs, a higher relative impact on the capital stock employed and therefore potential productivity gains, and are expected to lead to a longer lasting structural impact on growth and employment.

The impact on cohesion regions as well as those hardest hit by the economic and financial crisis is therefore expected to be over proportional to the nominal absorption of EFSI financing. Based on these positive results financial instruments will play a bigger role in the next MFF (2021–2027). On the one hand this is to increase the economic impact of budget sources (to do more with less), on the other hand this innovative concept is used to support cohesion and convergence in a more efficient way.