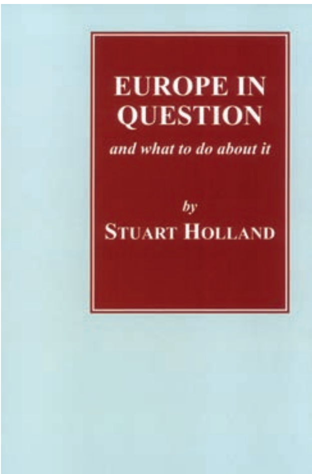
# Realising Europe's recovery proposals

*Stuart Holland*




*Stuart Holland's first book in 20 years,* Europe in Question – and what to do about it, *is published by Spokesman (£15). It develops the arguments advanced here.*

*There is concern not to increase debt. But European Investment Bank (EIB) borrowing does not count on national debt. The proposed European Fund for Strategic Investments displaces that such investments are within the statutory remit of the European Investment Fund (EIF) which also can issue bonds. The BRICS (Brazil, Russia, India, China, South Africa) are ready to invest in €bonds to promote European recovery since this is to mutual advantage in sustaining their trade. Both rating agencies and bond markets want recovery. There is no need for entirely new investment criteria. They already have been widely defined in the Amsterdam Special Action Programme.*

*It is misguided to rely heavily on private sector co-finance for investments when Europe is risking a triple dip recession. The private sector has spare capacity and will need to know that a recovery will be sustained before undertaking net investment. Multipliers from bond financed public investment can assure this, as in the US New Deal, which did so with an average fiscal deficit from 1933 to the onset of World War Two of only three per cent. A host of investment projects that already have planning approval can be jointly EIB-EIF financed without breaching the national 60 per cent debt criterion.*

## European Investment Bank borrowing does not count on national debt

Wolfgang Schäuble, Germany's Finance Minister, has stressed that there should not be an increase in debt. But EIB bonds and lending for project finance do not count on national debt. The authority for this is good – the European Investment Bank itself. In my cohesion report to Jacques Delors in 1993, I recommended that EU bonds should be issued by a European Investment Fund to offset the deflationary debt and deficit conditions of Maastricht and promote a European New Deal. A senior director of the Bank, Tom Barrett, rang me to say that the Bank had noted the case that I had made to Delors that EIF bonds need not count on national debt, with the parallel that US Treasury bonds do not count on the debt of California or Delaware. But that perhaps I, and maybe Delors, was unaware that of the then 12 member states only two (the United Kingdom and The Netherlands) counted borrowing from it.

I then advised Gordon Brown, who in office changed the rules, while it appears that The Netherlands also has done so. Even if some member states do count EIB lending against national debt, the precedent is clear. Especially, that Germany does not. While, also, it is recovery that can reduce national debt, as demonstrated by the second Clinton administration, aided also by new technologies, which can be integral to a public investment-led recovery.

## No need for a new institution

The intention to create a European Fund for Strategic Investments echoes Mateusz Szczurek's proposal in his recent address to Bruegel of a European Fund for Investment on the grounds that this role could not be fulfilled by the European Investment Fund. As Mateusz put it:

> 'The EFI's size, its direct investment in infrastructure and long-term investing horizon would be the key differences with the existing European Investment Fund, which has only 4.5 billion euros of capital and facilitates small and medium enterprises' (SMEs) access to finance through intermediary institutions with a shorter investment horizon.'

But this is only how, in *Gestalt* terms, the statutes of the European Investment Fund have been perceived. Thus Article 2.1 of the EIF's statutes determines that:

> 'The task of the Fund shall be to contribute to the pursuit of Community objectives.'

Intentionally, in my advice to Delors, this was as wide as the original open-ended remit for the European Investment Bank. There is no reference in the European Investment Fund's statutes to it being limited to financial support for small and medium enterprises. Article 2.2 specifies that:

> 'The activities of the Fund may include borrowing operations.'

This enables the Fund to undertake its own bond issues, which were to have been the EU Bonds that Delors included in his December 1993 White Paper.

Both the European Investment Bank and the European Investment Fund confirmed in evidence to the Economic and Social Committee for its 2012 Own Opinion Initiative, *Restarting Growth*, that the EIF therefore could issue bonds to finance an investment-led recovery – and for a European Venture Capital Fund, rather than only financial guarantees for SMEs – without a revision of its statutes or a new proposal from the Commission.

A new institution within the EIB Group therefore is not needed. Which also has been submitted in a paper from the Fondation Robert Schuman in September 2014.

The public debate on ‘where the money can come from’ has overlooked the case for recycling global surpluses, which is entirely feasible. Thus, the South African minister of finance declared at the meeting of the BRICS in Washington on 25 September 2014 that they would buy eurobonds if these were to finance European recovery. If the European Investment Fund were to issue bonds – or €bonds, as markets could quickly dub them – it could do so incrementally. Such as a €10 billion issue in the first instance, which would be likely to be over-subscribed and support the case for further issues.

Nor would this necessarily imply a major initial increase in the Fund’s subscribed capital. The European Investment Bank needed this because it is highly dependent on pension funds, which need AAA rating. But the BRICS do not. They need recovery of the European economy to sustain mutual trade. An increase of EIF subscribed capital of the proposed €5bn from its sister institution, the European Investment Bank, would more than double it.

When Standard & Poor downgraded Eurozone member states’ debt in January 2012, it stressed that key reasons were simultaneous debt and spending reduction by governments and households, the weakening thereby of economic growth, and inability of European policymakers to assure an economic recovery. In 2013, Bill Gross, at the time head of the trillion dollar Pimco fund, also called for European recovery, stressing that funds needed growth to secure retirement income, whereas low to near zero interest rates in Europe would not. His backing for bond-funded investment followed a year of inadequate performance by Pimco, despite his being ranked as one of the top bond managers over the previous 15 years.

Similarly, Norway’s sovereign wealth fund has cut its investments in private equity in Europe because of low growth. The China Investment

Corporation (CIC) fund also made losses on its private sector investments after the onset of the financial crisis, and declared that it wanted public investment projects with a maturity of at least 10 years.

There are questions on what the criteria should be for an investment-led recovery. Clearly, any new criteria could be proposed, such as fibre optic networks and renewable energy. And there also are criteria for uncompleted trans-European networks (TENs). But there is little need to set up panels of European experts to determine criteria for projects. The Amsterdam Special Action Programme of 1997 gained the agreement of the European Investment Bank that it would invest in:

- Health
- Education
- Urban regeneration
- Green technology
- Finance for small and medium firms

These cover a vast range of potential investments. Urban regeneration alone can mean renovation of existing buildings, new building, renewal of or new public transport including trams and metro systems, electricity, gas and water supply systems, and so on. Investment in health can mean renovation or extension of or new hospitals and health centres. In education, the same for schools, technical colleges or universities.

## EIB-EIF co-finance for recovery

In the decade from 1997, aided by the Amsterdam Special Action Programme criteria, the European Investment Bank quadrupled its investment finance. With lack of co-finance by member states from the onset of the Eurozone crisis, this then fell and put its triple AAA rating into question. Therefore arose the need for EIB re-capitalisation.

The European Investment Bank also has been averse to issuing eurobonds for a macroeconomic recovery programme lest it compromise the AAA rating needed by pension funds. But this is one of the reasons why I recommended the European Investment Fund to Delors and that it, rather than the EIB, should issue them to fund a recovery programme.

The European Investment Fund has next to no experience in project evaluation, but the European Investment Bank has more than half a century of experience of doing so well. Which merits a clear distinction. With its capital increase, the EIB can continue to gain pension fund finance and build on its reputation for sound project evaluation. The EIF, within its current statutes, can issue €bonds attracting uninvested global surpluses from BRICS and sovereign wealth funds, and co-finance investments on the range of criteria already agreed for the EIB in the Amsterdam Special Action Programme.

## The New Deal precedent

Roosevelt financed the New Deal by bonds shifting savings – high in a depression or recession – into investment. It is widely overlooked that from 1933 to the onset of the war economy in the US, the federal budget deficit averaged only three per cent, ie the Maastricht limit. In March 2014, *Initiative citoyenne européenne* (ICE) published a project called 'NewDeal4Europe'. The project anticipates project bonds of up to €50 billion per year with a multiplier of nearly three giving a total investment of at least 130 billion per year for three years 'based solely on the own resources of the Union'.

Yet the aspiration of the project that these should be 'based solely on the own resources of the Union' displaces that this is politically implausible. Such as a financial transactions tax and a 'carbon tax', both of which are excellent proposals. Plus a new European Value Added Tax, which might raise resources for investment but in the interim would further depress demand and be socially regressive. All of which, if feasible at all, would take years to achieve, whereas in the US New Deal Roosevelt did not raise taxes but shifted disposable savings into social and environmental investments. And got the programmes to initiate this deployed in its first Hundred Days. Which the European recovery proposal also could if it were recognised that this does not need new institutions, nor new investment criteria, nor further decisions by the European Council, granted its agreement to establish the European Investment Fund in 1994, and to extend the investment criteria of the European Investment Bank in 1997 through the Amsterdam Special Action Programme.

The case for multipliers, and thus leverage, as stressed by Mateusz Szczurek, and also by Olivier Blanchard of the International Monetary Fund, is good. But the expectation of leverage and multipliers for private sector investment in the present form of the recovery proposal is less than realistic. Private sector investment in Europe is a sixth below its pre-crisis levels. Firms simply will wait to see if a medium-term recovery occurs and their spare capacity met before they undertake net investment. Guarantees against losses will not change this. Besides which, where they have been investing on a major scale has not been in Europe but in Asia. Half of China's exports are from foreign direct investment by European, US, Japanese and Taiwanese multinationals investing in China.

What is needed to achieve a 'New Deal for Europe' are the social and environmental investments of the Roosevelt New Deal, which recovered confidence of the public and the private sector and which are enabled by the investment criteria of the Amsterdam Special Action Programme.

## Ready-to-go projects: the Delors precedent

There has been concern that an investment-led recovery would take longer than the three year target. This was claimed by the Directorate-General Economy and Finance as an objection to the Delors European Investment Fund bond proposal. But, before Delors retired, a trawl of national investment projects that had planning approval but been postponed since agreement of the Maastricht criteria revealed that these already totalled 750 becu. The European Commission could do a similar trawl of projects 'ready to go', which could be at least a trillion. And if co-funded by EIB and EIF bonds, they need not count on national debt and therefore not be constrained by the Maastricht 60 per cent national debt limit.

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