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Bringing Europe back to life using investment

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There is growing consensus that it will prove impossible to restore growth on a sustained basis in the EU without stimulating investment. The European Council of Heads of Government firmly asserted that the Union needs bold steps to step up investments, create jobs and encourage reforms for competitiveness. They called for immediate mobilization of the right mix of private and public funding using both existing and new financial instruments. To this end, in his recent speech in front of the European Parliament, Commissioner Jean-Claude Juncker argued for the mobilisation of up to 300 billion euros in additional public and private investment in the real economy over the next three years.

In a recent study we made a specific proposal for how an additional expansion of EIB capital and lending, accompanied by complementary measures, can lead to a major boost in investment in the EU (Griffith Jones and Cozzi, 2014). This would both, on the supply side, encourage innovation and structural transformation essential for long-term growth and competitiveness, as well as contribute to stimulate aggregate demand for more rapid growth, and higher employment, especially in periphery countries.

There are two promising paths to use limited public resources to achieve important gains in terms of investment. The first is to increase paid-in capital of the EIB and the second is to achieve leverage within the EU budget.

In mid-2012, in a visionary step, all EU leaders doubled paid-in EIB capital by 10 billion euro. The measure was very successful, and has led to the EIB increasing its level of lending significantly; EIB EU lending went up in 2013 by almost 20 billion Euros, that is by 42 %, if compared with 2012. Lending aimed at SMEs almost doubled.

Therefore, because the measure was successful and because private credit is still severely constrained, especially in countries most hit by the crisis, we suggest a further increase of another 10 billion euros of the paid-in capital of the EIB. This would allow another increase of up to 80 billion euros of EIB lending, and a total increase of up to 160 billion euros of total lending and investment for the next years.

Such additional lending could be focused on investment linked to innovation and structural transformation and applied more, but not only, to countries hit by the crisis. Because EU countries are so integrated through trade, increased growth in the periphery would benefit

all EU countries.

The second route to achieve leverage is with the EU budget. Large projects can be co-financed by the EIB alongside with investment from pension funds and insurance companies. A small part of the EU budget could be used as a risk buffer to allow the EIB to lend additional resources. A very small amount (as proportion of the EU budget), equal to 5 billion euros annually could be allocated to such purpose. This would allow the EIB to lend an additional 10 billion euros annually for financing infrastructure projects (project bonds) and to promote innovation, which could generate up to 40 billion of investment.

If both these avenues are pursued the EU could increase lending and investment at approximately 60 billion euros per year for the period 2014-2020.

What would be the impact of such a strategy on EU growth, employment and investment, as well as on debt-to-GDP ratios and fiscal deficits?

Using the Cambridge-Alphametrics Model (CAM) we estimate that such a lending and investment plan would lead to the creation of an additional 5 million jobs in the EU during 2014-2020 and to an additional average growth rate of 1.2 percent over the same period (Table 1).

Our investment strategy would also lead to favourable results in terms of both government debt-to-GDP ratios and fiscal deficits. In the absence of a serious investment plan, debt-to-GDP ratios for the South Eurozone (Greece, Italy, Portugal and Spain) are projected to increase to over 140 percent by 2020 as a result of poor growth. Instead, our proposed investment strategy would not only lead to increased growth but also a significant decline in government debt ratio, to 100 percent of GDP in the South Eurozone by 2020 (figure 1).

In addition our investment scenario would not lead to a further deterioration of fiscal deficits despite the fact that public investment would be maintained. Instead these will gradually decrease to reach the 3 percent threshold imposed by the Fiscal Compact.

The results generated by our proposed investment strategy are impressive economically, leading to much higher levels of growth and employment in Europe, and financially viable. They would give a sense of hope to the millions of unemployed in the EU, and could help lead to a rebirth of enthusiasm for a Europe that delivers for its citizens. The time to do it is now!

TABLE 1 - TOTAL EMPLOYMENT (IN MILLIONS)

		2012 (actual)	2020 (projections)
South Eurozone	Business as usual	52.8	51.4
	investment led		54.3
	difference		2.9
North Eurozone	Business as usual	86.3	87.4
	investment led		88.5
	difference		1.1
United Kingdom	Business as usual	28.9	28.6
	investment led		29.4
	difference		0.8

FIGURE 1 - DEBT-TO-GDP RATIO SOUTH EUROZONE