A New Architecture for Public Investment in Europe
The Eurosystem of Investment Banks and the Fede Fund

Natacha Valla*, Thomas Brand*, Sébastien Doisy* *

July 2014

*: CEPII. **: Fonds de Réserve des Retraites.

Overview

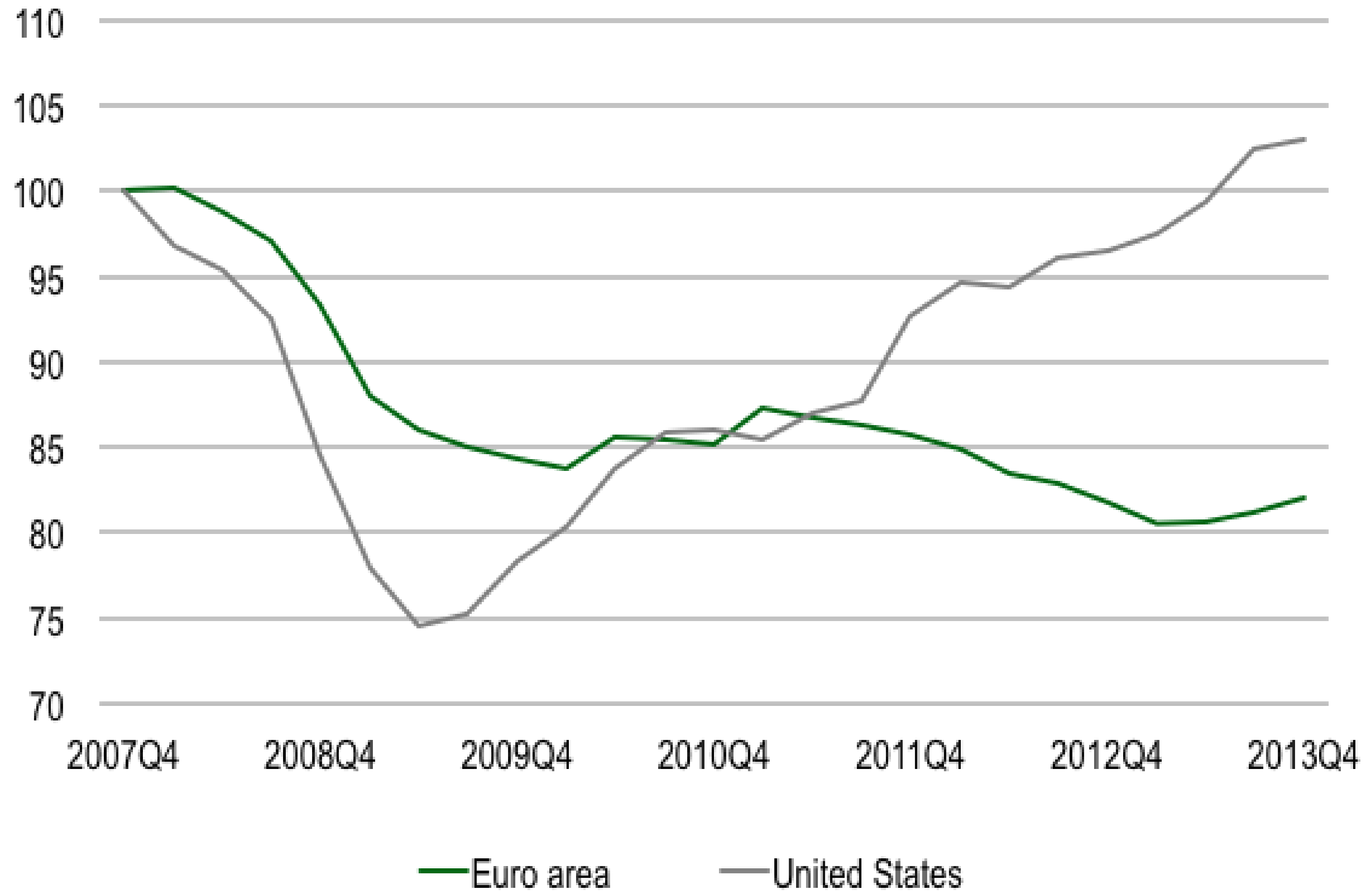
1. Private and public sector investment in the euro area (historical perspective)

2. Empirical evidence on interaction public-private (crowding-out, crowding-in, fiscal multipliers)

3. Proposal: Eurosystem of Investment Banks (ESIB) & EIB/Fede Fund

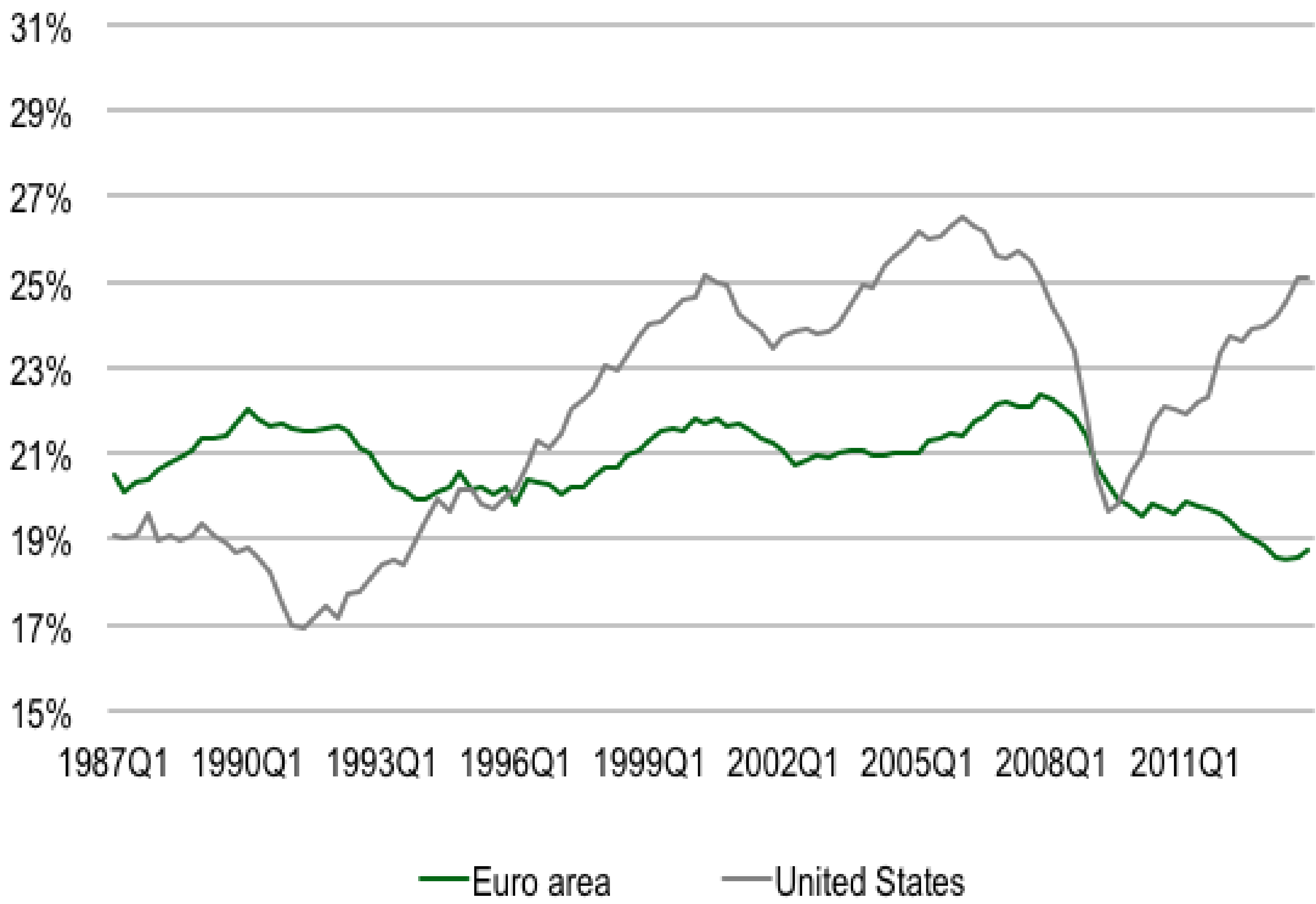
4. Discussion: Facts on National Investment Banks (KfW, CDC, CDP, ICO) & Open Questions

Euro area private investment per capita down more than 15% from pre-crisis peak (Q4:2007=100)



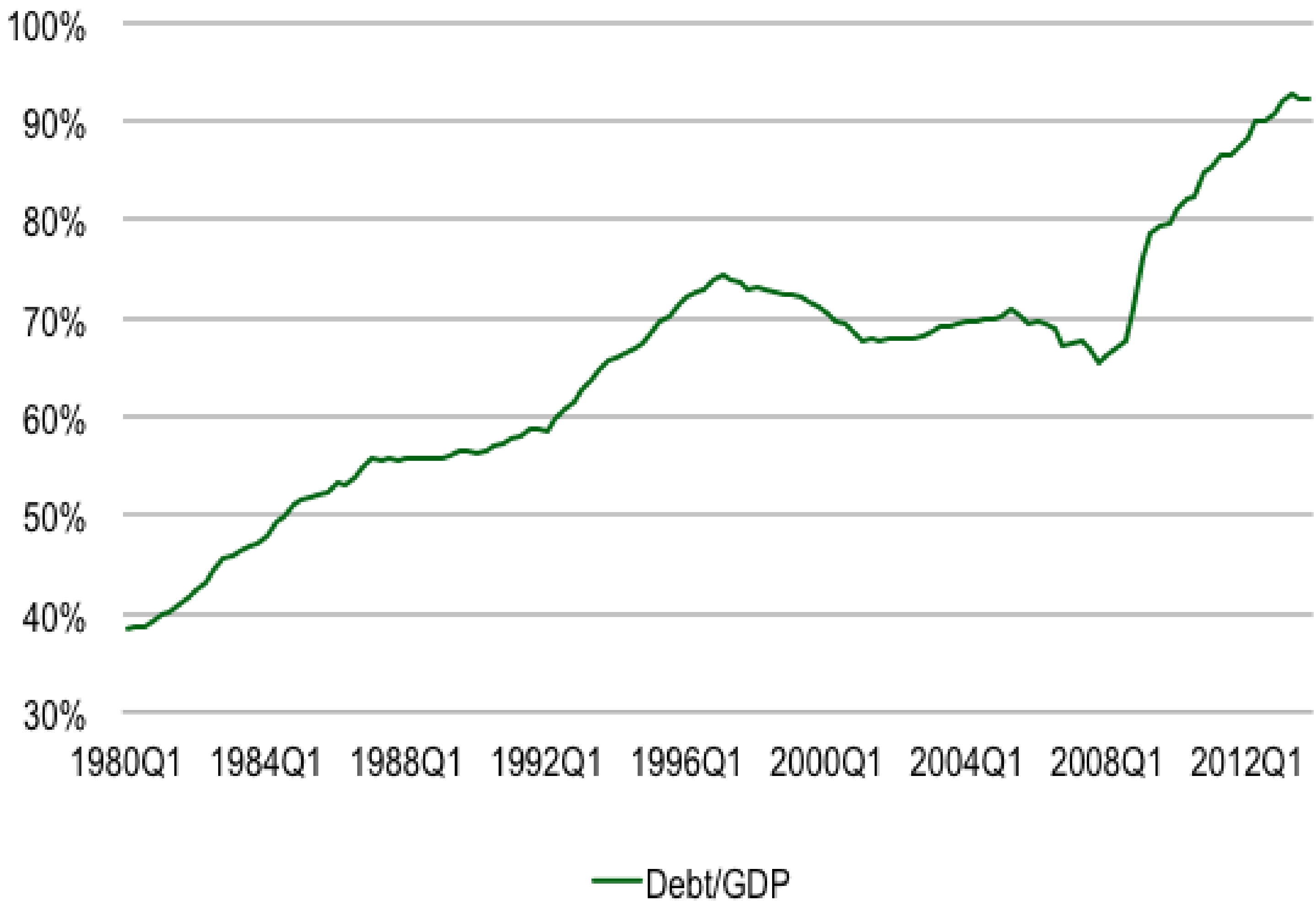
Source: Fred, Eurostat. Last data: Q4:2013. Q4:2007=100.

Euro area private sector investment now less than 20% of Euro area GDP



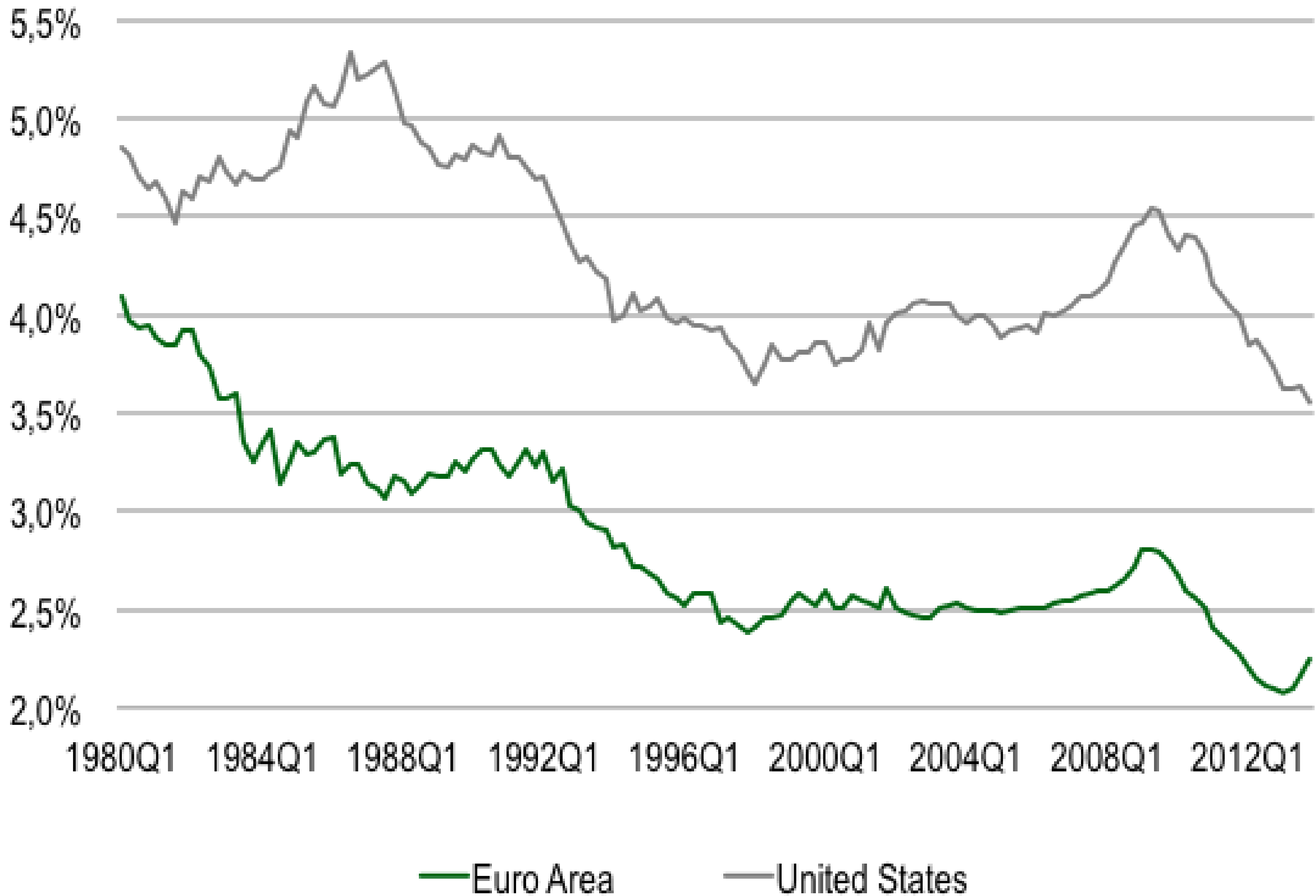
Source: Eurostat, Giannone et al. (2012). Last data: Q4:2013.

High public debt (% GDP), a constraint on public sector capex



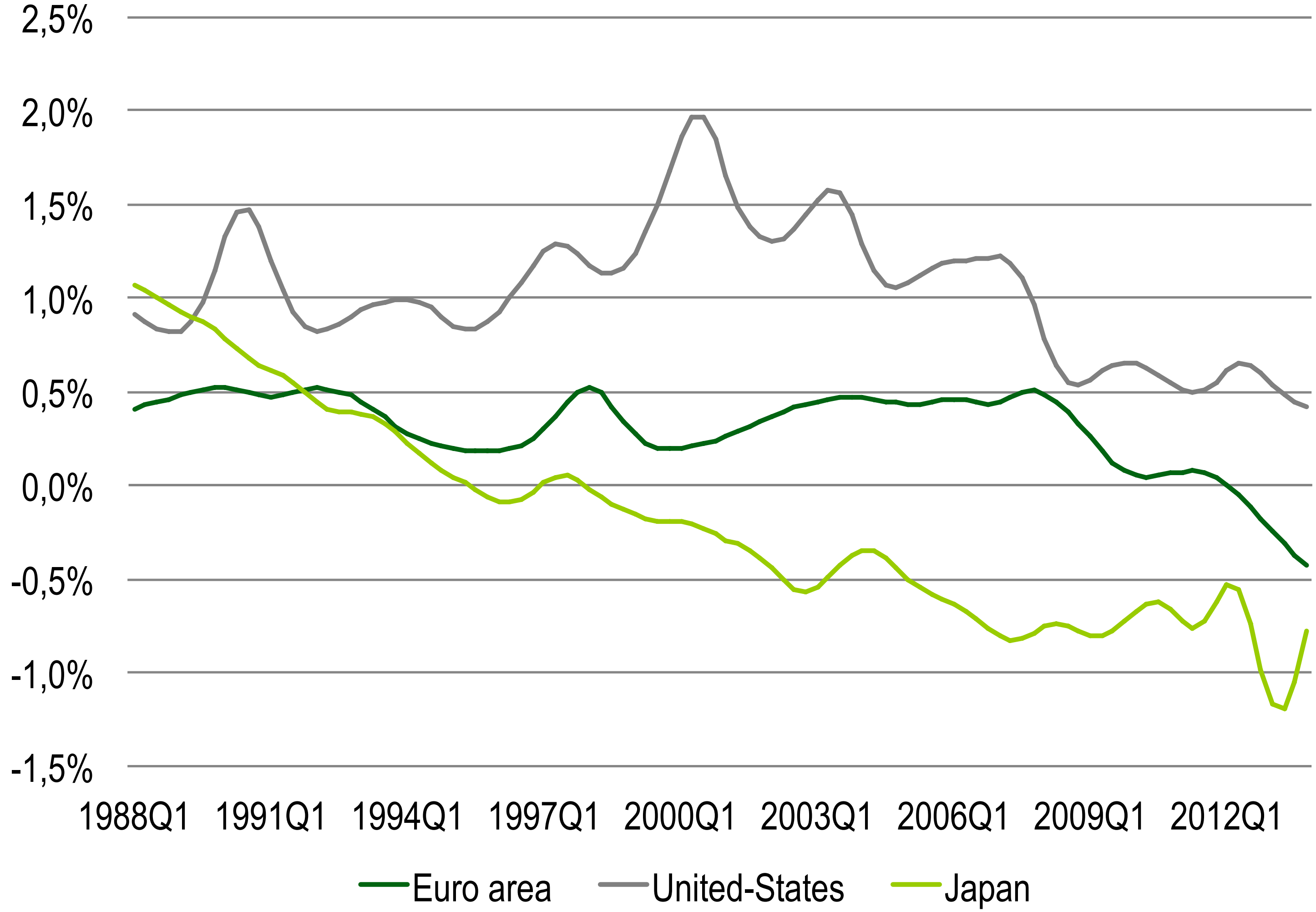
Source: Fred, Eurostat. Last data: Q4:2013.

Euro area public sector investment halved to 2% of GDP in 35 years (% GDP)



Source: Fred, Eurostat, Paredes et al. (2009), Giannone et al. (2012). Last data: Q4:2013.

Demographic developments have become adverse also in the Euro area



Source: Fred, Eurostat. Working age population 15-64 years old, smoothed. Last data: Q4:2013.

Overview

1. Private and public sector investment in the euro area (historical perspective)

2. Empirical evidence on interaction public-private (crowding-out, crowding-in, fiscal multipliers)

3. Proposal: Eurosystem of Investment Banks (ESIB) & EIB/Fede Fund

4. Discussion: Facts on National Investment Banks (KfW, CDC, CDP, ICO) & Open Questions

Empirical evidence

- Literature: Old & New – Aschauer (1989), Gramlich (1994) → (…) → Summers (2013)

- Framework: ECB's New Area Wide Model (2008) (neo-Keynesian model with real + nominal rigidities) & « public capital » as explicit input

- High fiscal multiplier on public investment. Persistent effects

(Positive effect on long-term growth)

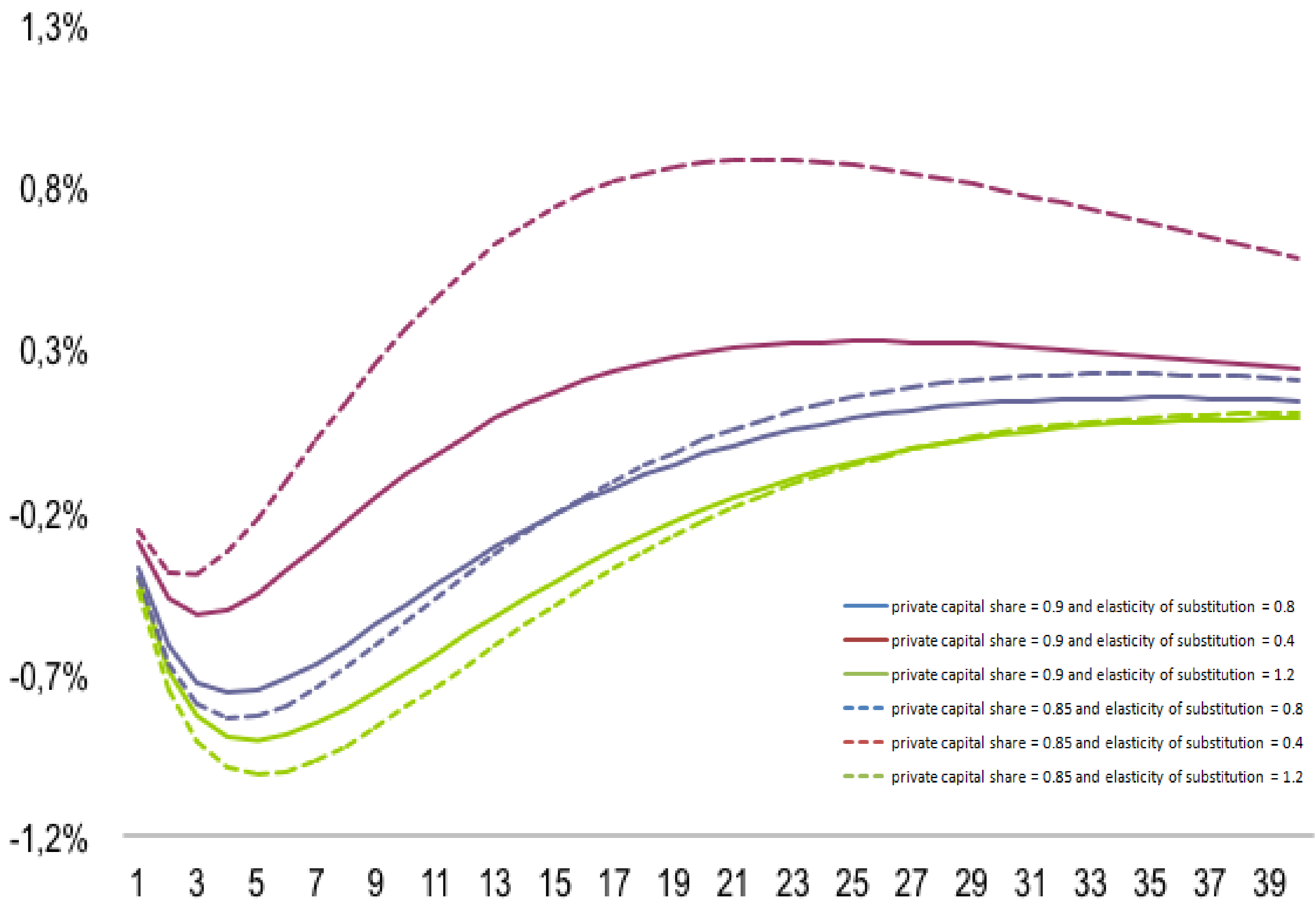
- Strong multiplier compounded by *complementarity* public/private (in the long run, public investment crowds-*in*, and not –*out*, private investment)

Fiscal multipliers by specific instrument for the Euro area

	Immediate	One year later	Two years later	Five years later
Government investment	1.42	1.53	1.57	1.46
Government consumption	1.38	1.4	1.41	1.38
Targeted social transfers	0.92	1	1.03	0.89
Taxes on consumption	0.55	0.8	0.87	0.71
Social contributions of employees	0.37	0.45	0.46	0.25

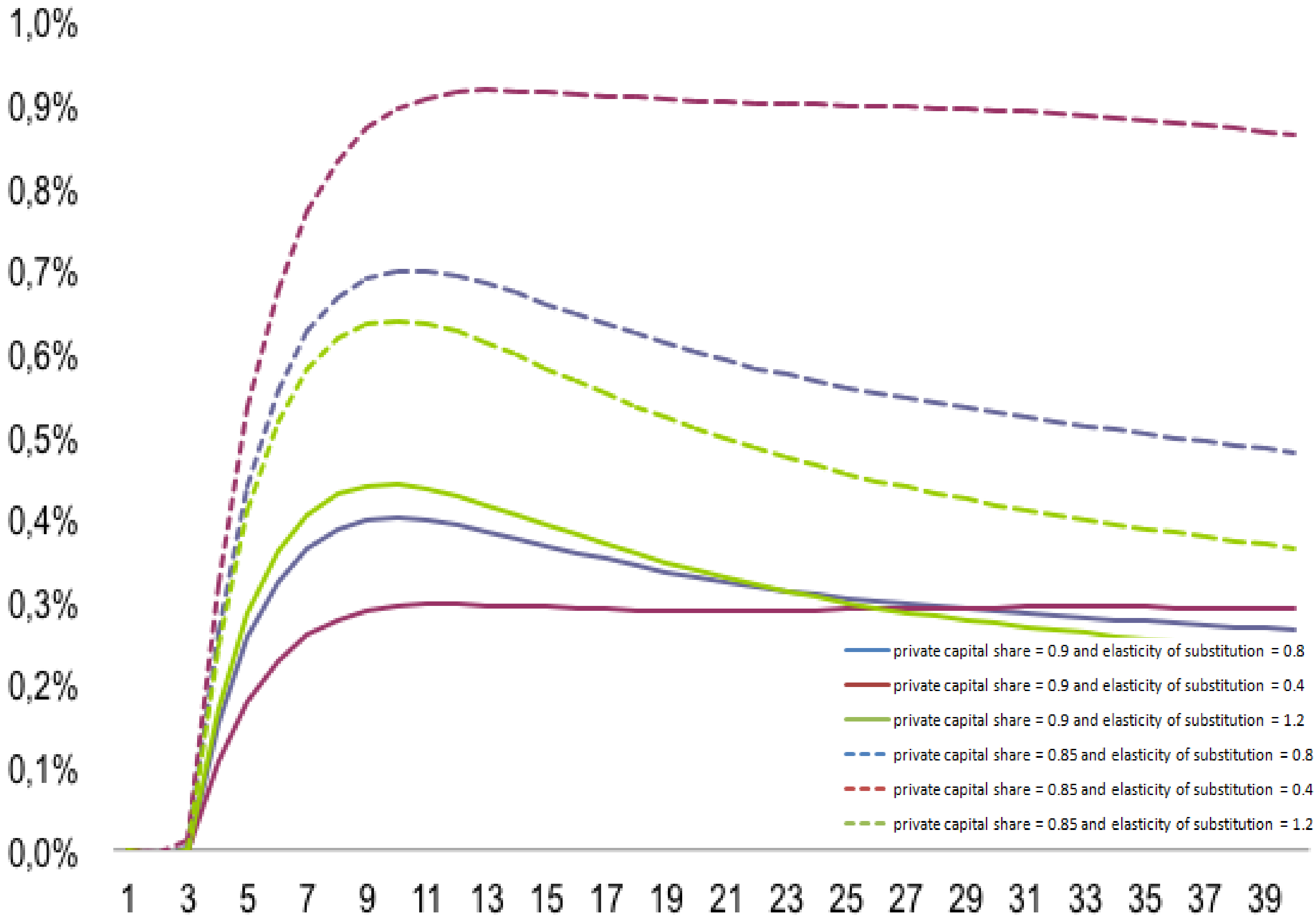
Source: Authors' calculations.
Note: The numbers shown in the table represent cumulative, net present value multipliers, ie, the sum of output variations up to the indicated year, divided by the sum of fiscal variations up to the indicated year, both discounted at the risk-free short-term interest rate.

Complementarity between private and public investment limits crowding-out in the short term



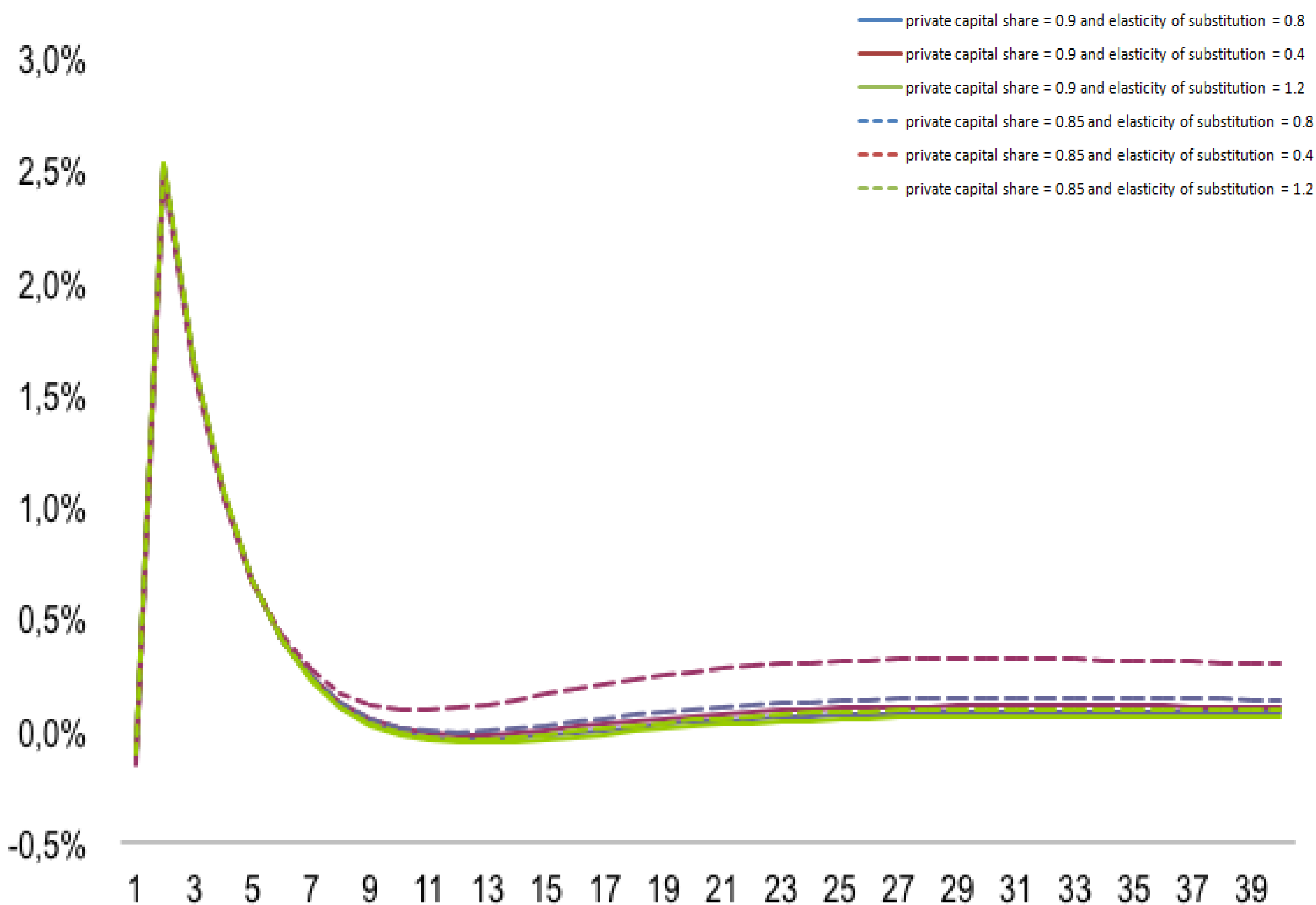
Source: Authors' calculations.

An increase in public investment always yields higher capital stock levels



Source: Authors' calculations.

Positive output effects of increased public investment are persistent (2 years, and beyond if the stock of public capital is high)



Source: Authors' calculations.

Overview

1. Private and public sector investment in the euro area (historical perspective)

2. Empirical evidence on interaction public-private (crowding-out, crowding-in, fiscal multipliers)

3. Proposal: Eurosystem of Investment Banks (ESIB) & EIB/Fede Fund

4. Discussion: Facts on National Investment Banks (KfW, CDC, CDP, ICO) & Open Questions

Proposal

- **Proposal**
  - Create the Eurosystem of Investment Banks (ESIB)
  - Central node (the EIB revisited → the Fede Fund)
  - Enshrined in the EU Treaty (key)
- **Mandate**
  - Political choice, democratic emanation of the People
  - Promote growth, well-being and employment in Europe
  - Treaty
- **Conditionality**
  - Public investment needs to be economically and financially viable
  - Conditionality on receiver countries: foster good reform!

Proposal

- **Investment criteria**
  - Fundamental, strategic choice
  - Robust through time
  - Five criteria
    - Be long-term
    - Strategic dimension
    - Foster European integration
    - Serve as anchor for non IG countries
    - Structurally help countries with impaired socio-economic environments

- **Investment areas**
  - Can vary over time (➔ cf conclusion)

Proposal

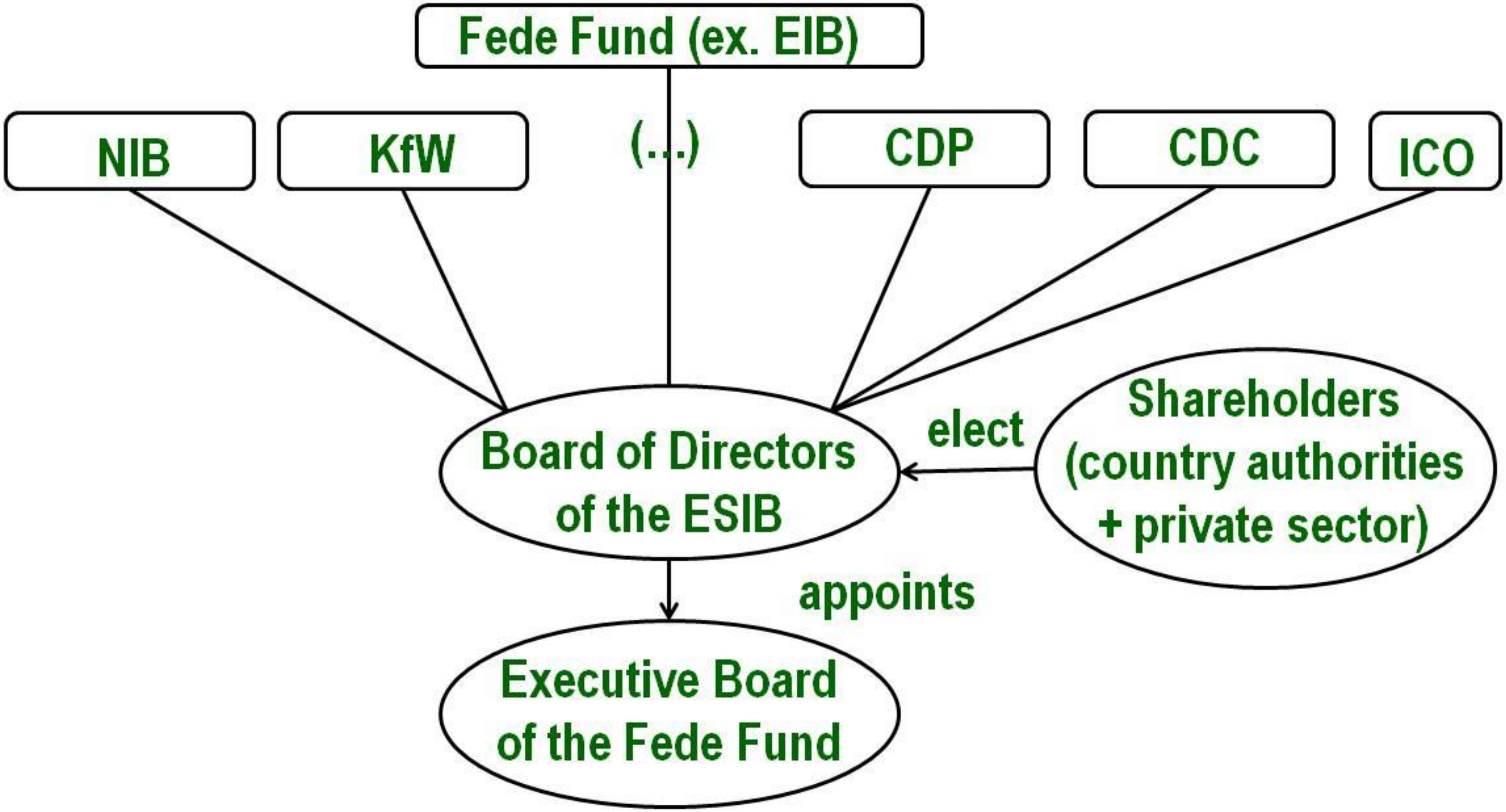
- **Ownership**
  - Aim: ring-fence ESIB from national political political agenda
  - Euro area member states to become ESIB members
  - Predetermined and irrevocable contribution to EIB/Fede equity (endowment)
  - Private shareholders key –close to / above 50%

A	L
Loans Project fin. Equity stakes etc (EU)	Equity (euro area, public/private) Bonds (worldwide)

- **Size**
  - IF public investment target 2→4% euro area GDP (+2% via EIB/FEDE)
  - IF equity 50/50 public/private
  - IF respect the EIB principle of 2.5 leverage limit

➔ About 10% of euro area GDP (€1tn)

PROPOSAL
ESIB governance: immune to political hold-ups



Source: Authors.

Overview

1. Private and public sector investment in the euro area (historical perspective)

2. Empirical evidence on interaction public-private (crowding-out, crowding-in, fiscal multipliers)

3. Proposal: Eurosystem of Investment Banks (ESIB) & EIB/Fede Fund

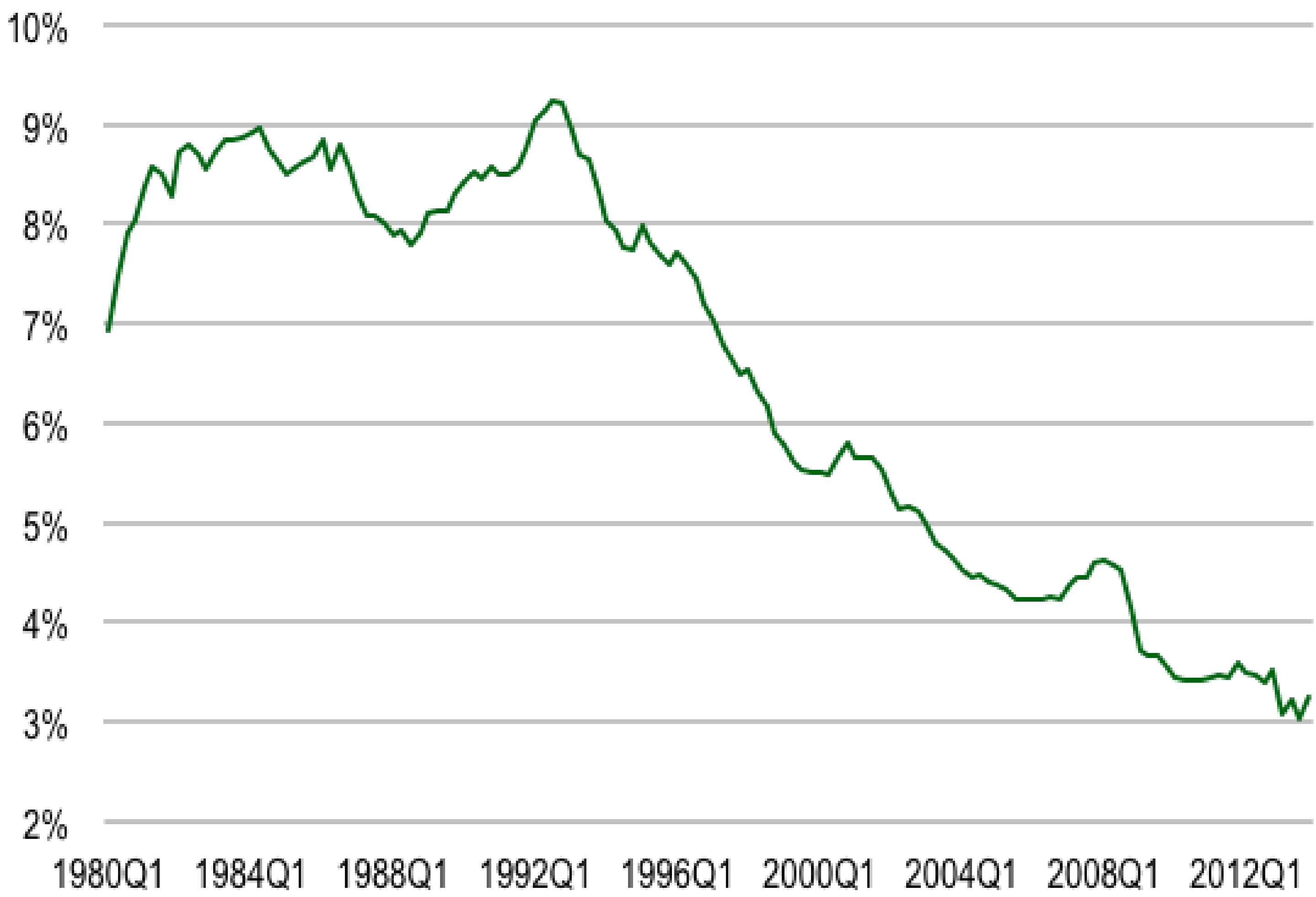
4. Discussion: Facts on National Investment Banks (KfW, CDC, CDP, ICO) & Open Questions

Why now? The current landscape

- **There is a missing « brick » in the Architecture of the Euro area**
  - National Public Investment Banks do a lot
  - But full potential still to be exploited
  - Cross-border investment opportunities (externalities)
  - Were created in specific historical contexts
  - Ambiguous relationship with the political sphere / governments

- **A historical opportunity**
  - Reform momentum
  - Political window
  - Historically low financing costs
  - Could contribute to many dimensions of integration

Euro area sovereign financing costs at historical lows (interest rate, %)



Source: Eurostat, Paredes et al. (2009). Apparent debt cost, defined as the ratio between interest payments and the outstanding stock of public debt.

National Investment Banks differ in size

EUR bn (2012)	KfW	CDC	BPI France Financement	Cassa Depositi e Prestiti	ICO
Balance sheet total (Total Assets, 2012)	497,5	393,7	29,9	305,4	115,2
Total loans	118,5	155,6	15,6	100,5	88,8
Country	Germany	France		Italy	Spain
Long-term credit rating	AAA/Aaa/AAA	AA/AA1/AA+		BBB/Baa2/BBB+	BBB/Baa2/BBB+
Memo					
Nominal GDP (2012)	€ 2 666	€ 2 032		€ 1 567	€ 1 029
MFI Loans to NFC	€ 909	€ 876		€ 875	€ 729
Balance sheet/GDP	19%	21%		19%	11%
Total loans/GDP	4%	8%		6%	9%
Total loans/MFI Loans to NFC	13%	20%		11%	12%

Source: Bloomberg, Annual Reports, Authors' calculations. ICO: Instituto de Crédito Oficial. MFI: Monetary and Financial Institutions. NFC: Non-Financial Corporations. Note 1: Except MFI Loans to NFC, for which the aggregate field is the Euro area. Note that in the case of CDP, total loans include loans to banks.

National Investment Banks and the EIB: Scope to catch-up

EUR bn	NPIB loans outstanding	Country public loans to Country MFI loans Ratio	Country public loans to Country GDP	Country MFI Loans to NFC	Country GDP
	EIB	EIB to MFI loans ratio	EIB to GDP ratio	Euro area	
2008	176	3,8%	1,4%	4 673	12 549
2009	203	4,2%	1,7%	4 790	11 816
2010	233	5,0%	1,9%	4 682	12 337
2011	258	5,5%	2,0%	4 727	12 711
2012	293	6,3%	2,3%	4 674	12 960
	Euro area 5 NPIB	Euro area 5 NPIB to MFI loans ratio	Euro area 5 NPIB to GDP ratio	Euro area	
2008	499	10,7%	4,0%	4 673	12 549
2009	546	11,4%	4,6%	4 790	11 816
2010	618	13,2%	5,0%	4 682	12 337
2011	700	14,8%	5,5%	4 727	12 711
2012	772	16,5%	6,0%	4 674	12 960

Source: Bloomberg, Annual Reports, Authors' calculations.

The Euro area "to do" list - a subjective assessment of where the ESIB could (also) help

	ESIB / Fede Fund	ECB / Monetary Policy	ESM	European Policies	National Policies	Market Initiatives
Address financial market fragmentation	**	***		*		*
Create a benchmark euro area yield curve	***		**	**		**
Reduce information asymmetry and the cost of due diligence for investment	***			***	**	**
Encourage the passporting, cross-border acquirability of assets	**			***	**	***
Reduction of barriers for cross-border investment (tax, regulation, legislation)				***	***	*
Effective take-off of bond market for infrastructure projects	***	**	**	**	**	**
Support SME financing	**	***		**	**	
Foster good, benchmark securitisation	*	***		**	**	**
Offset the effect of bank/insurance regulations and accounting standards on the availability of financing	*	***	*			*
Offload banks balance sheets to preserve their role in financing	*	***	**			
Encourage long-term investment by insurance companies	***			***	*	
Foster the development of pan-european retail savings products	**			***		***

Source: Authors. One star means "could help a little". Three stars means “could help a lot".

OPEN QUESTIONS FOR DISCUSSION

- **Creating NIBs in countries where there aren't?**

- **Designing the ESIB: what is the right balance?**
  - Preserve national specificities
  - But trigger changes when needed
  - Example: DE model issue bonds to « redistribute » loans to banks
  - Example: FR model to use postal savings for social housing

- **Which investment areas? How to quantify needs?**
  - Energy and climate change
  - Human capital (education) / innovation
  - Infrastructure
  - Digital

  ➔ Independent evaluators essential!

OPEN QUESTIONS FOR DISCUSSION

- « Psschtt » risk (yet another institution…)?
- Procrastination risk (political hurdle)? ➔ How did they manage to create the ESCB !?!
- Allocation of tasks within the System?
- Implications for public finances accounting?
- Can « complementarity » public/private be a target?
- Concretely, what needs to change in EIB statutes & practice?
- EIB/Fede private shareholders: more than 50% of equity?

LAST OPEN QUESTIONS FOR DISCUSSION

• ECB	→	Frankfurt
• ESM	→	Luxembourg
• EIB/FEDE	→	?

LAST QUESTION

ECB:	Frankfurt
ESM:	Luxembourg
EIB/FEDE:	?

Thank you

Source: Bloomberg, Annual Reports, Authors' calculations.

Annex: Articles of the Treaty (TFEU) Relevant to the EIB

Article 308
(ex Article 266 TEC)

The European Investment Bank shall have legal personality.
The members of the European Investment Bank shall be the Member States.
The Statute of the European Investment Bank is laid down in a Protocol annexed to the Treaties. The Council acting unanimously in accordance with a special legislative procedure, at the request of the European Investment Bank and after consulting the European Parliament and the Commission, or on a proposal from the Commission and after consulting the European Parliament and the European Investment Bank, may amend the Statute of the Bank.

Article 309
(ex Article 267 TEC)

The task of the European Investment Bank shall be to contribute, by having recourse to the capital market and utilising its own resources, to the balanced and steady development of the internal market in the interest of the Union. For this purpose the Bank shall, operating on a non-profit-making basis, grant loans and give guarantees which facilitate the financing of the following projects in all sectors of the economy:
(a) projects for developing less-developed regions;
(b) projects for modernising or converting undertakings or for developing fresh activities called for by the establishment or functioning of the internal market, where these projects are of such a size or nature that they cannot be entirely financed by the various means available in the individual Member States;
(c) projects of common interest to several Member States which are of such a size or nature that they cannot be entirely financed by the various means available in the individual Member States.
In carrying out its task, the Bank shall facilitate the financing of investment programmes in conjunction with assistance from the Structural Funds and other Union Financial Instruments.

Source: Bloomberg, Annual Reports, Authors' calculations.