Combine EU Budget And EIB Activities For Growth And Jobs

By Matthias Kollatz-Ahnen

Since the large recession some 84 years ago in the 20th century it has been known that strategies to overcome a deep crisis need three pillars: (i) to restore confidence in the financial sector, (ii) to do budget cuts notably in sectors where they can result in gains in productivity and efficiency of the economy and (iii) to boost investments (public and private), but those with strong economic viability, either on a short or on a long term. Looking at Europe today, one can find a clear focus on the second pillar, some action on the first, but close to zero on the third – and the wrong believe that growth will come automatically and rapidly. In the view of the author a vicious downward spiral seems more likely – as visible in Spain. But now the opportunity is there to go for a concrete, feasible and cost effective way of action for growth by utilising two existing instruments, the partly unspent and not optimally geared EU budget and the European Investment Bank (EIB).

One specific way of significantly stimulating European growth would be to expand in a major way lending by the EIB within Europe so that it could finance increased investment, especially but not only in the countries suffering most from the crisis. By boosting investment to help restructure those economies with viable projects and make them more competitive, a positive medium term supply effect could be generated; in the short term investment would also contribute to expanding aggregate demand in all European countries, boosting growth and employment.

One crucial advantage of this proposal is that with fairly limited public resources, a very large impact on investment, growth and employment can be achieved due to the benefits of leverage. A second major advantage is that, as an existing successful European institution – the EIB – can be used immediately. New measures can be quickly implemented.

There are two promising paths to use limited public resources to achieve important multiplier effects. The first is to achieve leverage with the EU budget. A very small amount (as proportion of the EU budget), equal to €5bn a year, could be allocated as a risk buffer. This would allow the EIB to lend an additional €10bn annually both for financing infrastructure projects (project bonds) as well as projects to promote innovation. The project bonds would imply that 25% of the project would be advanced by a private investor, the EIB would finance the next 25%, with a mezzanine tranche, the remainder would be invested by pension funds and insurance companies. Regarding the mezzanine tranche, the EU contribution would finance half the risk assumed by the EIB. Thus, €5bn from the EU budget – leading to financing by the EIB of €10bn – would lead to project finance of €40bn annually.

The second path is to increase EIB capital by EU member states. Only a very small proportion of capital, (5%) has to be paid-in. Therefore if this paid-in capital is doubled, it would require only a total of €11.bn from EU Member States. Rating agencies accept a leverage of eight for the EIB to maintain its AAA status. Therefore, an increase of paid-in equity of around €12bn would allow the EIB to expand its lending by €95bn, which is an impressive multiplier. If this additional EIB lending was spread over the next four years, additional €10bn could be lent in 2012, €35bn additional lending could be done in 2013, and €35bn could be lent annually in both 2014 and 2015. Because typically the EIB co-finances 50% of projects, with private sector or others contributing the other 50%, this would result in additional investment of €190bn.

To this programme of significantly enhanced EIB lending should be added some additional resources from the EU budget, to an important extent drawing from existing unused European Structural Funds – and to reallocate wherever possible funds to economically viable projects or SME finance for prefinancing orders. Further funds could be easily allocated to growth from the new EU budget from 2014 onwards of about €25bn annually.

In total the additional EIB and EU resources allocated to growth could reach €35bn in 2012 and rise to €60bn annually in the 2013-2015 period. The resources for 2013-2015 would correspond to around 0.5% of EU annual GDP. As they would be allocated to finance increased investment and working capital, the latter for small and medium enterprises, this would have a major impact on EU growth and employment. It is interesting that these resources, with a total dimension of almost 2% of EU GDP would be similar, though somewhat smaller, to those of the Marshall Plan after World War II. Hopefully they would also contribute to a significant reinstatement of dynamic growth in Europe.

After having discussed the shape and the feasibility of the programme Professor Stephany Griffith-Jones from the European Initiative for Policy Dialogue and Lars Andersen from the Danish Economic Council of the Labour Movement have estimated the impact that such a programme could have on EU growth and employment in 2013 and 2014 with the help of the international macroeconomic model HEIMDAL. They use conservative assumptions for impact on investment of half of the additional EIB and EU resources in 2013 and 2/3 in 2014. They also assume the most affected countries (such as Greece, Portugal, Spain, and Italy) would receive the greater part of the resources.

The modelling shows that such a programme would result in a minimum additional increase of average EU GDP of almost 0.6% in two years. Furthermore, more than half a million jobs would already be created in 2013, with accumulated additional EU job increases of over 1.2 million by 2014. The Southern European economies would have larger percentage increases than the average, though all EU countries would benefit due to the important cumulative effects of not just of increased investment at home but also of increased European trade.

This impact analysis doesn't include effects of increased EIB lending, via intermediated banks to provide much needed working capital to credit-constrained small and medium enterprises, which will stabilise or increase employment in the same order of magnitude in a range of another 1 to 1.5 million jobs. Last but not least growing confidence will result in increasing private investments which are not included here either.

It is urgent to act now and lay the foundations for European growth and job creation!

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