5 Towards a European fiscal policy strategy to boost and safeguard public investment and support the recovery

5.1 The EU Commission’s insufficient strategy for public investment and fiscal stimulus

It is by now widely accepted on the EU level that a more expansionary fiscal policy against the imminent deflationary stagnation is necessary, because monetary policy alone will not be able to spark off the recovery. In his by now famous Jackson Hole speech Mario Draghi called for a more expansionary fiscal stance for the Euro area as a whole and a public investment programme on the European level insisting, however, that the existing rules of the Stability and Growth Pact be respected (Draghi 2014). The European Council at its meeting in June 2014 also saw the need to enhance growth within “the possibilities offered by the EU's existing fiscal framework to balance fiscal discipline with the need to support growth” (European Council 2014: 7).

The new Commission has launched mainly two initiatives substantially enlarging its predecessor’s efforts (European Commission 2014b and 2015b). For expositional purposes they can be divided into three main sets of measures. The first two of them are particularly concerned with promoting (public) investment in Europe. First, the so-called ‘investment clause’ under the preventive arm of the treaty is specified and will potentially be made applicable on more occasions. Second, an Investment Plan for Europe, the ‘Juncker-Plan’ has been launched, i.e. a European Fund for Strategic Investments (EFSI) to finance investment on a large scale. Third, the interpretation of the SGP has been clarified with the aim of providing more fiscal leeway for member states under adverse economic conditions and/or implementing structural reforms.

As to the first measure, the underlying idea of the ‘investment clause’ dates back to the Commission ‘blueprint for a deep and genuine economic and monetary union‘, which envisaged allowing a temporary deviation from the MTO or the adjustment path towards it under the preventive arm if it was the result of ‘non-recurrent, public investment programmes with a proven impact on sustainability of public finances’ (European Commission 2012b: 25), e.g. projects co-financed by the EU.[9] However, the Commission made clear from the very beginning that this would have nothing to do with a

[9] See Prota and Viesti (2013) for a summary of the developments around and the debate about the ‘investment clause’.

Golden Investment Rule which it called ‘an indiscriminate approach [that] could easily put in danger the prime objective of the SGP by undermining the sustainability of government debt’ (European Commission 2012b: 25). In this spirit the implementation of the idea was very restrictive, and it continues to be even under the clarifications made by the new Commission:

> “Member States in the preventive arm of the Pact can deviate temporarily from their MTO or adjustment path towards it to accommodate investment, provided that: their GDP growth is negative or GDP remains well below its potential; the deviation does not lead to an excess over the 3 per cent deficit reference value and an appropriate safety margin is preserved; investment levels are effectively increased as a result; the deviation is compensated within the timeframe of the Member State’s Stability or Convergence Programme. Eligible investments are national expenditures on projects co-funded by the EU under the Structural and Cohesion policy, Trans-European Networks and the Connecting Europe Facility, as well as national co-financing of projects also co-financed by the European Fund for Strategic Investments.“ (European Commission 2015b: 9).

The only improvement compared to the earlier interpretation is that the adverse economic conditions that have to apply now refer only to the member state in question and not to the overall situation of the EU or the Euro area (European Commission 2015b: 9). In the past the ‘investment clause’ provided support for Bulgaria, Romania and Slovenia (European Commission 2015b: 9) while it was denied to Italy (Barbiero and Darvas 2014: 6). The EU Parliament had passed a resolution that the ‘investment clause’ was too narrow and might therefore be extended to completely exclude expenditures for co-funded public investment (European Parliament 2013), but obviously its initiative as to a ‘small-scale Golden Investment Rule’ has not been taken up by the Commission to date. Even if it had, the overall impact on public investment in the EU would have been extremely limited, as the volume of eligible projects is relatively small. However, particularly the CEE member states might have profited substantially (Barbiero and Zarvas 2014: 7).

The second and most prominent measure is the Investment Plan for Europe with – according to the Commission’s hopes – a European-wide total investment impact of 315 bn. Euros from 2015 to 2017 (European Commission 2014b). This is supposed to be reached without additional public debt on the national or European level and without any additional EU expenditures by the creation of a European Fund for Strategic Investments (EFSI) which is guaranteed by 21 bn. Euros from the EU budget (16 bn. through reallocation from existing resources) and EIB reserves (5 bn.). The fund is to mobilise finance for investments in key areas such as infrastructure, education, research and innovation. For this purpose, an investment pipeline of strategic projects supported by a specialist investment hub of technical assistance will be provided. Finally, barriers to investment are to be removed and improvements in the regulatory regime achieved. As a leverage effect of 15 through the use of financial instruments by the EIB is expected, the 21 bn. Euros are supposed to deliver the overall investment volume of 315 bn. Euros. Funding shall be provided to both public and private investors mostly for long-term large scale investment (240 bn. Euros) and to a smaller extent (75 bn. Euros) to support investment by small and medium sized firms. An even larger investment volume is suggested to the extent that contributions from the private sector or from the member states increase the guaranteed capital. Indeed, in order to enable member states to contribute, the Commission has made it clear that such contributions will be excluded from both the preventive and the corrective arm of the SGB (European Commission 2015b: 6-7).

It is difficult to evaluate the prospects of the Investment Plan for Europe as it is still in its very early stages. However, there are many open questions and whether the Plan will really deliver is quite doubtful. First of all, one may call into question whether the volume of the plan is large enough. Even if it really led to 315 bn. Euros of additional investment that would be about 2.25 per cent of EU GDP or 3 per cent of Euro area GDP spread over three years, i.e. 0.75 or 1 per cent of GDP per year, respectively. Given the depth of the economic crisis, particularly in the euro area, this may well be too little. Furthermore, given the long term character of many of the large scale investment projects it will probably take quite a long time before a significant number of projects will be realized.

The most important doubts, however, relate to the question whether the Plan will really be able to mobilise sufficient additional investment: If it is to stimulate private investment, particularly in the crisis countries typically animal spirits will be low, which means that it will be difficult to find investors irrespective of the terms of the programme. If investors are found, then the danger of windfall gains, i.e. that the investors would have chosen the project, anyway, could be large. And if they really invest because of the favourable conditions of the programme, the question as to the efficiency of the programme arises, especially if it is a PPP project: If the fund offers private investors attractive returns then these returns will have to be paid for, either directly by the public contributor involved or indirectly through charges to the private sector that might otherwise have been avoided. If the fund is to stimulate public investment, one may wonder why this could not be realized by national governments' regular investment. If it is because of fiscal constraints due to the stability and growth pact, an obvious alternative would be removing or loosening those constraints. All in all, therefore, the risk is high that the Investment Plan for Europe will deliver disappointingly little too late.

The third set of measures consists of different clarifications and formalisations of the interpretation of the SGP (European Commission 2015b: 9-17). First, structural reforms may justify temporary deviations from the MTO or the adjustment path towards it under the preventive arm.

> "The Commission will take into account the positive fiscal impact of structural reforms under the preventive arm of the Pact, provided that such reforms (i) are major, (ii) have verifiable direct long-term positive budgetary effects, including by raising potential sustainable growth, and (iii) are fully implemented." (European Commission 2015b: 12).

Even under the corrective arm structural reforms may be considered as a 'relevant' factor, which may lead to the decision that no excessive deficit exists or that the deadline for correcting an existing excessive deficit may be postponed under certain conditions. Second, a clarification of cyclical conditions has been provided. Under the preventive arm adverse cyclical conditions may lead to a diminishing of the adjustment requirement towards the MTO. In exceptionally bad times no structural adjustment is required, in very bad times it is only 0.25 per cent of GDP instead of the previous standard value of 0.5 per cent. For member states under the corrective arm, an unexpected fall in economic activity may now be better accommodated, as fiscal effort will be assessed in a more differentiated way using measures of discretionary fiscal effort that do not suffer from the endogeneity bias of the structural budget balance. Third and finally, the Commission has stated that a severe downturn in the Euro area or the EU as a whole may justify slowing down the pace of consolidation for all member countries both under the preventive and the corrective arm.

All in all, the measures introduced or proposed by the new Commission constitute some progress with regard to counter-cyclical fiscal policies and (public) investment. However, it must be doubted that they will lead to a substantial increase in (public) investment. And the clarifications concerning the SGP may contribute to relieve the pressure from fiscal consolidation and slow down the pace of consolidation somewhat, but obviously they are only designed to permit a slightly less restrictive fiscal stance but not to provide a truly positive fiscal stimulus.