EUROPEAN UNION
Committee of the Regions

Information brochure

An investment plan for Europe: joining forces

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Information brochure on the European Commission proposal and draft regulation for the "Investment Plan for Europe". This brochure was edited by the European Committee of the Regions (CoR) and includes the main conclusions of a high-level conference the CoR held in Brussels on 15 April 2015.

This brochure is only for information purposes and does not represent positions of the CoR or the other conference partners.

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Content

Introduction

Shortly after starting its 2014-2019 mandate the European Commission proposed a new Investment Plan for Europe. Commission President Juncker considered it a top priority to **strengthen Europe's competitiveness and to stimulate investment** for the purpose of creating jobs.

The backbone of the Investment Plan is a joint strategy of the Commission and the European Investment Bank to **mobilise EUR 315 billion** for additional investments. This operation is a response to the decreased level of investment (minus 430 billion euro, or 15%) since its peak in 2007. Priority would be given to the areas of infrastructure (broadband, energy networks, transport in industrial centres), education, research and innovation, and renewable energy and energy efficiency. Some 2,000 potential projects have been identified so far at national and subnational level. According to the political guidelines of the Commission President, there would be specific focus on projects that fight the problem of youth unemployment. Starting with a basic investment of EUR 21 billion, the Commission is counting on a multiplier effect of 1 by 15 to come to the total of 315 billion in the next three years. An advisory service ("European Investment Advisory Hub") will be put in place as a single point of entry through which authorities and promoters can access support in preparing and developing projects.

The Investment Plan explicitly mentions the **role regional authorities** play in supporting or managing the investment projects, making finance reach the real economy and improving the investment environment. Regions and cities need to bring in their know-how to channel public and private money (including the European Structural and Investment Funds) to viable projects with real added value for the European economy. In terms of improving the investment environment, all levels of government have a part to play in providing greater regulatory predictability, removing barriers to investment and creating the optimal framework conditions.

This brochure briefly introduces the Investment Plan from a local and regional perspective and gives an outline of the needs and expectations of Europe's regions and cities. This document looks back at the **conference organised by the European Committee of the Regions (CoR) on 15 April 2015**, where policy makers discussed the potential of the Investment Plan with experts from the European Commission, the European Investment Bank (EIB), the Organisation for Economic Co-operation and Development (OECD) and other stakeholders. During its plenary session on the next day the CoR discussed and adopted its opinion on the Investment Plan and the European Fund for Strategic Investments, an opinion prepared by rapporteur Claude Gewerc.

Markku Markkula *(left)*, President of the European Committee of the Regions, welcomed on 13 April 2015 European Commission Vice-President **Jyrki Katainen** *(right)*, together with **Dominique Riquet**, Member of the European Parliament. Meeting the Parliament's Intergroup on Long Term Investment and Reindustrialisation President Markkula said: "Our local and regional politicians are ready to join forces so we can improve existing EU investment tools, including the European Structural and Investment Funds, through a better understanding of the needs and potential of regional economies." Vice-President Katainen replied that he was pleased to engage constructively with MEPs, regional stakeholders and civil society about the Investment Plan for Europe and how it can help give the EU economy a boost.

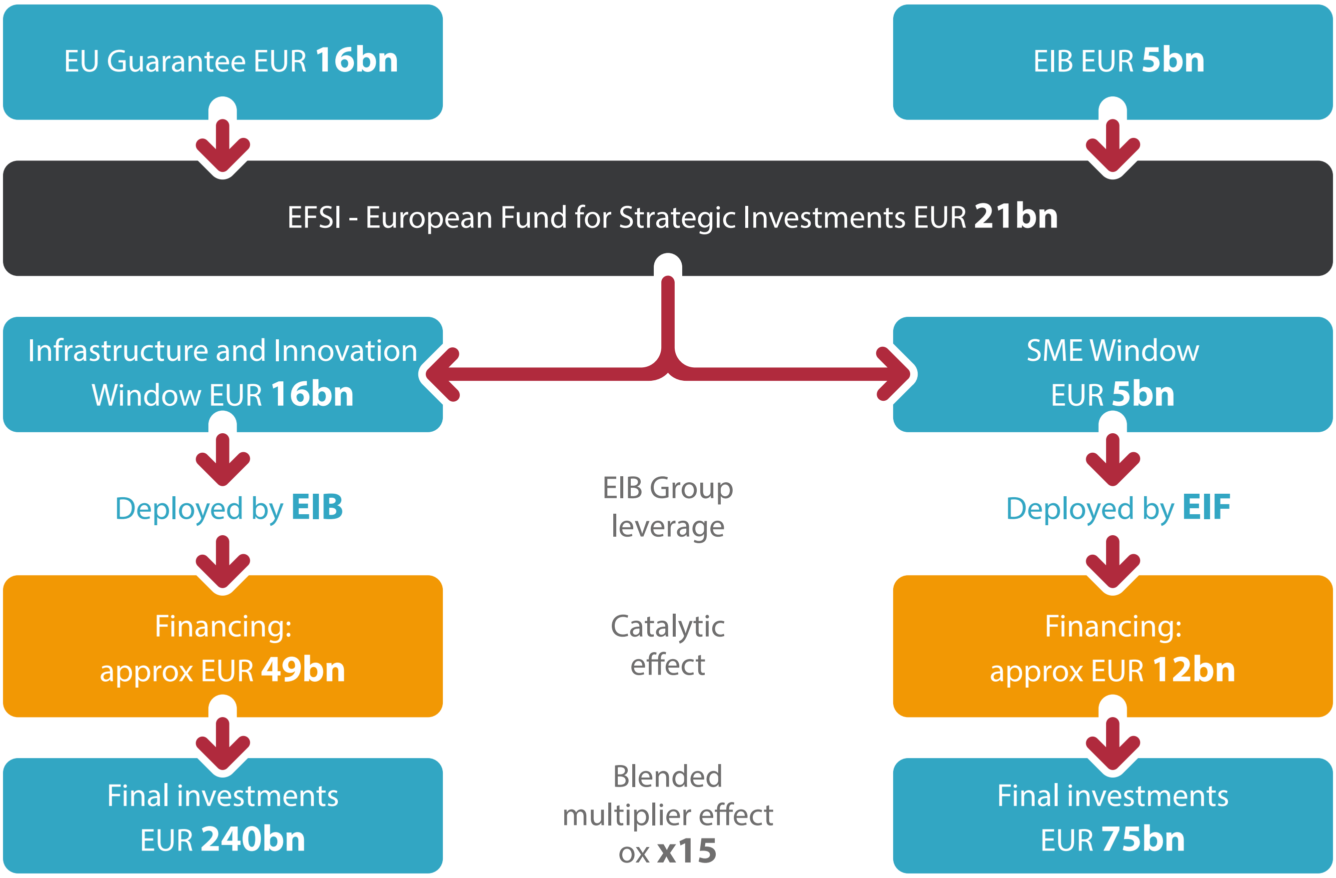
Chapter 1:

The new Investment Plan for Europe and the involvement of regions and cities

1.1 The Investment Plan for Europe and the European Fund for Strategic Investment

In November 2014 the European Commission presented its Communication "An Investment Plan for Europe"[1] and in January 2015, a draft Regulation on the "European Fund for Strategic Investments (EFSI)"[2]. The EFSI will mobilise additional investments in the real economy in areas including infrastructure, SMEs, education, research, innovation, renewable energy and energy efficiency and 1.3 million new jobs could be created as a result, according to European Commission. It is expected that the European Parliament and the Council will agree on the EFSI Regulation by June so that the fund can be operational by mid-2015. The Investment Plan comprises three strands:

- First the mobilisation of EUR 315 billion in additional investments over the period 2015-2017. The European Fund for Strategic Investments (EFSI) endowed with EUR 21 billion (16 from the EU budget and 5 from the EIB), will leverage circa 240 billion for long-term investments and 75 billion for SMEs and mid-cap companies.



(source: EIB)

- The second strand of the Investment Plan includes actions to ensure that the extra investment **meets the needs of the real economy**, for instance by setting up a European Investment Advisory Hub (EIAH) and a transparent pipeline of projects.

- The third strand includes measures to provide **greater regulatory predictability** and to remove barriers to investment, making Europe more attractive and thereby multiplying the impact of the Plan. A first set of actions is set out in the Commission's 2015 Work Programme.

1 COM(2014) 903 final, 26 November 2014
2 COM(2015) 10 final, 13 January 2015

The proposed EFSI Regulation states that the fund should target projects typically with a higher risk profile than normal EIB and EU instruments, which struggle to access finance, ensuring additionality over existing operations. Moreover, projects should be economically viable, sufficiently developed to be adopted and consistent with EU policy priorities such as the 2030 climate and energy package, the Europe 2020 strategy and other long-term EU strategic priorities. Funding could concern:

- development of infrastructure, in areas such as transport, particularly in industrial centres; energy, in particular energy interconnections; and digital infrastructure;
- investment in education, health, research and development, information and communications technology and innovation;
- expansion of renewable energy and energy efficiency;
- infrastructure projects in the environmental, natural resources, urban development and social fields;
- providing financial support for companies which have up to 3000 employees, including financing working capital risk.

In December 2014, a task force composed of the European Commission, the EIB and the Member States presented an initial, indicative longlist of more than 2,000 possible investment projects worth over EUR 1.3 trillion. In the meantime the pre-selection process has started. There will be no country-specific or sector-specific quotas for selecting projects to receive EFSI support. The draft Regulation suggests that, alongside EIB governance, project selection will be governed by a Steering Board composed of the European Commission and the EIB. The latter will decide on the overall orientation, the investment guidelines, the risk profile, strategic policies and asset allocation of the Fund. The EFSI will be open to direct contributions from Member States or their National Promotional Banks. Both could complement the contributions by the EIB and the EU budget, contribute to an investment platform or co-finance certain projects and activities.

Finally, the link between the **EFSI and the European Structural and Investment Funds (ESIF)** will be mainly via co-financing at project level, by using financial instruments or grants or any other funding tools. Between 2014 and 2020, EUR 350 billion from the ESIF will co-finance about 400 national and regional programmes, the majority of which will enhance the competitiveness and cohesion of the less-developed Member States and regions. Between 2007 and 2013, a total of 900 financial instruments, namely loans and guarantee funds, received support from the EU structural funds in the order of EUR 14 billion. A widened scope for such instruments during the period 2014-2020 is expected to increase the impact of financial instruments under the ESIF[3].

Once approved and operational, EFSI will operate as other parts of the EIB Group. All EFSI operations will be implemented within existing EIB Group structures in order to maximise synergies. As financing operations will be on the EIB's balance sheet, they are subject to standard due diligence by EIB staff and approval by EIB governing bodies. EFSI will make a difference by offering to finance projects which ordinarily would attract investment but currently don't due to limited willingness to take even moderate risks. Using money to reduce the risk associated with certain viable projects will crowd-in private investors that are now holding back.

1.2 Regional and local involvement in the Investment Plan

Europe's regional and local authorities are responsible for the **about two thirds of public investment** in the EU. Consequently, the Commission's Communication on the Investment Plan mentions that growth and investment challenges need to be tackled by public authorities at all levels. Regarding the implementation of the investment package subnational authorities need to be sufficiently involved in the Investment Plan for several reasons:

3 More information can be found at: http://www.fi-compass.eu/

- First, a stronger involvement of **national and regional authorities and banks** is necessary in the implementation of the investment package[4]. They can strengthen the level of investment, which will only be achieved if enough stakeholders join in to stimulate demand. Furthermore, to counter the present trends of centralising public budgets triggered by fiscal consolidation efforts, better coordination between the EU, national and local and regional budgets should be aimed for.

- Second, the EFSI regulation foresees the engagement of third parties, which would involve opportunities for local and regional authorities. Regions and cities would be a useful **source of information** when assessing whether the engagement of the EFSI will take place in the locations with the highest need.

- Finally, efficient cooperation between public and private stakeholders, e.g. on public-private partnership projects at regional level, requires appropriate **administrative capacity** of subnational public administrations as well as transparent information flows between the EU, national and local authorities. Experiences at local level with financial instruments co-financed by the EU structural funds should be taken into account in this respect.

1.3 Committee of the Regions' position on the Investment Plan

On 16 April the European Committee of the Regions (CoR) adopted its opinion[5] on the EU regulation of the European Fund for Strategic Investments (EFSI), established by the Investment Plan. The opinion, drafted by the President of the Picardy Region, Claude Gewerc, warns against the **risk of territorial concentration** and calls for greater attention to be given to weaker regions. It pleads for coordination between the Investment Plan and EU structural funds, as well as for a stronger role for Europe's local and regional authorities in identifying and delivering strategic projects.

Regions and cities want EU investment to contribute to achieving economic, social and territorial cohesion in Europe. "**Clear references to the territorial dimension of the Juncker Plan are needed**. We must also consider how to reduce investment gaps and pay more attention to less developed and isolated regions" CoR President Markku Markkula stressed. "Through integrated investment and collaboration at EU level, regions and cities will be able to implement their smart specialisation strategies: these will be key drivers for economic growth, innovation and employment in the future." The CoR also called for clearer rules to ensure the fund complements the EU's existing growth strategy - notably structural and investment funds – without any crowding out or overlapping.

Responding to the concerns of the CoR members the Vice-President of the European Commission, Jyrki Katainen said that "Regions will play a key role in the successful implementation of the European Fund for Strategic Investments. I encourage them to get active and make use of the additional investment potential provided by EFSI. The Commission can provide the framework but the projects will come from the regions. Now there is an excellent opportunity to put forward different projects that originate from regional conditions and needs with a higher risk profile. I very much look forward to our cooperation with the aim to bring much needed private investments to Europe".

The CoR insists on the effectiveness of such a bottom-up approach and considers investment platforms - co-financing mechanisms established at regional, national, cross-border or sectorial level to finance a group of projects - to be the key to ensuring all of Europe's regions are involved. The EFSI regulation should provide a clear definition of platforms' role and function and the participation of Member States, as well as of regional and local authorities, should be encouraged. **The national co-financing of the Juncker Plan should not be curbed by the Growth and Stability Pact**, and the CoR reiterates its call to extend this favourable treatment to the co-financing of all projects supported by EU structural and investment funds.

"For the Plan to succeed the Commission and co-legislators must **avoid a top-down approach** in shaping and implementing the EFSI", argued rapporteur Claude Gewerc. "Regional and local authorities should be structurally involved notably in developing

4 CoR, 'Resolution of the Committee of the Regions on the European Commission's Communication for an Investment Plan for Europe' (December 2014)

5 Committee of the Regions COTER-VI-003 (2015)

Claude Gewerc

the project pipeline – where they can ensure regional scale projects and credit facilities for SMEs are considered – as well as provide advice and strategic support through the European Investment Advisory Hub". The new hub should also count on local and regional development experts to support regions and cities in promoting private investment for growth. Support should be offered free of charge for local and regional authorities.

To ensure local and regional authorities are better informed on the opportunities offered by the ESIF and by existing European Investment Bank (EIB) financing, **the CoR and the EIB are intensifying their cooperation** and will implement common activities to ensure regions and cities make the most efficient use of public spending at the local and regional level.

With regards to the financing of the Plan, the Committee fears strategic tools - such as Horizon 2020 and the Connecting Europe Facility - could be weakened by diverting part of their allocations to fund the EFSI. All flexibility margins existing in the EU budget should be exploited before opting for reducing Horizon 2020 and CEF funds. The European Parliament should then progressively authorise such a reduction after assessing the real absence of alternatives.

Chapter 2:

Regions and cities improving the investment environment in Europe

Improving the regulatory environment has a direct impact on investment, growth and jobs. SMEs in particular – which provide two out of three jobs in the private sector, contribute more than half of the added value created by businesses in the EU, and reinforce the social and economic tissue of their territories by creating stable, local employment – are faced with important **problems linked to administrative burden and regulatory complexity**.

While measures aimed at improving the regulatory framework are largely taken at EU and national level, regional and local authorities have an important role to play in identifying obstacles and undesired effects of EU measures. Furthermore, they can highlight specific good practices and point out opportunities for further administrative and regulatory simplification that have arisen out of the implementation process of EU and national measures.

IIn 2014, the CoR consulted the twelve regions awarded the European Entrepreneurial Region (EER) label on selected measures of the Commission's programme for reducing regulatory burdens (ABRplus initiative[6]). The regions identified the reduction of administrative burden in the area of **financial reporting** requirements for small businesses as particularly important for improving the business environment for SMEs. In addition to the simplification of the reporting method for annual accounts, the number of different financial reports and taxes that micro-companies have to declare each year was also identified as a significant administrative burden. Thus, simplification of reporting procedures concerning VAT etc. could help further improve the regulatory environment for SMEs.

However, an undesired effect of simplifying financial reporting requirements can be identified with regard to **SME access to finance**: credit institutions have less financial information at their disposal and are thus less inclined to lend money to the companies concerned.

In the same consultation, the measure related to the **Public Procurement** Directives emerges as the only one that is unanimously seen as positive by the respondents, both

6 http://ec.europa.eu/smart-regulation/refit/admin_burden/

regarding the importance of the issue addressed and the potential impact of the specific measure on SMEs.

Finally, it should be noted that the **participation of regional authorities and stakeholders** in the implementing process of EU measures aimed at administrative burden reduction emerges as rather uneven across regions. In some cases, cross-border cooperation programmes, European Groupings of Territorial Cooperation (EGTC) and macro-regions have developed efficient approaches to public procurement, investment and other policies, which could serve as an example for other regions.

Local and regional case studies

(more examples can be found on: http://www.fi-compass.eu/conference-download)

Selected good practices include, for example, the **MoorFutures** in Mecklenburg-Vorpommern and Brandenburg – Germany – which is a flexible investment mechanism for the protection of peatlands, which serve as valuable habitats for a number of plant and animal species. The investors (mainly companies) choose a project they wish to invest in and purchase a MoorFutures certificate. All MoorFutures funds are invested in the project region in Germany, located between the two major urban centres of Berlin and Hamburg (Mecklenburg-Vorpommern and Brandenburg). Currently, two long-term projects (Kieve Polder and Rehwiese/ Fließgraben) are open for investment.

When a company decides to purchase MoorFutures, it receives a contract proposal specifying that the agreed amount is earmarked for the selected project in the MoorFund managed by Stiftung für Umwelt- und Naturschutz, a registered not-for-profit environmental organisation and the Flächenagentur Brandenburg GmbH, a nationally recognised agency.

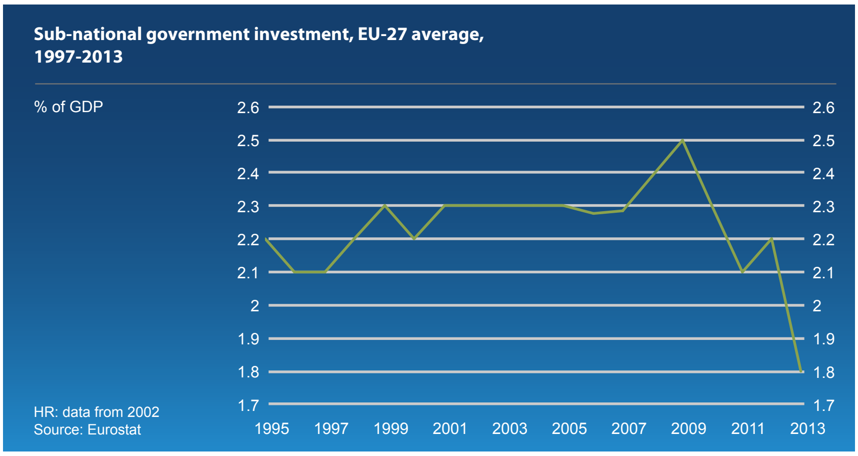
Another example could be the **Local Enterprise Partnership** (LEP) in Liverpool City Region – United Kingdom. The tool used is the Local Enterprise Partnership (LEP), which is also responsible for setting the priorities against which government money is spent and for managing the ERDF programme in partnership with a network of intermediary organisations and agencies (including social enterprises and charities) that are involved in the delivery of enterprise and business start-up support across eligible wards in the Liverpool city region. The Liverpool City Region provides a good case study for: i) a multilevel governance approach to developing social enterprise and entrepreneurship in the poorest and most socially deprived areas of the Liverpool City Region, ii) multilevel engagement with government and other stakeholders, linking social enterprise, community groups and the private sector, iii) developing a strategic governance framework to develop social enterprise and entrepreneurship. This creates employment and entrepreneurial opportunities for the most hard-to-reach communities through public support, especially ERDF.

Yet another example: **StedenbaanPlus** initiative – Soft governance in The Netherlands. The StedenbaanPlus initiative is essentially a partnership arrangement between various public and private parties that operates with very few statutory powers or instruments at its disposal, promoting greater integration between public transport and urban development. The initiative combines two main strategies: 1) the creation of a high-frequency light-rail transport system on the existing railway network; and 2) a regionally coordinated programme of urban development around railway stations. In addition to governmental bodies, the StedenbaanPlus initiative involves non-government actors: the rail infrastructure providers. Being essentially a partnership arrangement with few statutory powers, it is therefore a form of soft governance, which has a primary role in coordination and providing information, both vertically and horizontally: linking municipalities with the regional governance body and, to some extent, with the central government (vertically) while bringing together different sectoral interests concerned with urban development and public transport (horizontally).

Chapter 3:
Investment capacity of regional and local authorities

3.1 Local public investments hit by the crisis

Regional and local authorities play a key role in public investment, as they manage the **majority of public investments**. In 2013, subnational authorities carried out **55% of public investment** (fixed investment and capital transfers). However, the share of subnational authorities in public investment has declined since 2000 in 14 EU Member States, for a large part due to fiscal consolidation measures implemented across the EU as a result of the financial and economic crisis. Especially when the **economic crisis hit in 2009**, public investment was sacrificed: subnational "fixed" public investment fell 20% in the EU between 2009 and 2013 (OECD). There are great variations per country with regard to the drop and countries such as Ireland, Spain, Portugal and Greece were hit particularly hard[7]. Looking in particular at the Southern EU Member States, the collapse of investment



Governance and administration skills essential for investment capacity

The investment capacity of regions and cities largely relies on the **quality of public administration**. Multi-level governance vitally depends on the skills, competence, experiences and knowledge of different levels of government. The institutional/organisational capacities and the challenges are likely to vary across countries with different distributions of competences, legal frameworks and the degree and maturity of decentralisation. They can also vary by type of region and level of development or across sectors. While large regions, particularly established ones with substantial autonomy and significant numbers of staff, can tap into a range of professional skills, capacity challenges can hit small regions and municipalities where decentralisation has outpaced corresponding development of administrative capacity.

Besides organisational aspects related to administrative capacity, **governance skills** play a crucial role in the policy process. The most important governance-related capacity challenges for regions and cities concern strategic planning. Regional and local authorities often lack the capacity to develop a strategy based on an assessment of regional (or local) characteristics and specific competitiveness factors, to which the investment mix should be tailored and linked. Such a mix would also need to be result-oriented, with the elaboration of clear goals and targets in order to get the benefits of policy complementarities and conflicts among sectoral investments. Strengthening strategic planning skills at regional level would also enable regions to effectively involve other stakeholders and play their role as an actor of multi-level governance. Enhanced administrative capacity requires several kinds of abilities, such as prioritisation, cross-sectorial coordination to address policy complementarities, cross-jurisdictional coordination to enhance synergies with neighbouring policies, multi-year budgeting, competitive public procurement, and well-designed monitoring systems. This is even more apparent when it comes to public investments with coordination challenges across levels of government (gaps in terms of policy coordination, fiscal relations, information asymmetries, accountability). The organisational and governance capacity challenges vary significantly across countries and regions, creating potential bottlenecks for effective public investment.

7 European Commission, 'Investment for jobs and growth: Promoting development and good governance in EU regions and cities' Sixth Report on economic, social and territorial cohesion (July 2014). Access: http://ec.europa.eu/regional_policy/sources/docoffic/official/reports/cohesion6/6cr_en.pdf

is the main factor that explains the contraction of the economy. The economic crisis has wiped out one decade of economic convergence in the region, with a sharp increase in the disparities in macroeconomic imbalances that existed before the crisis.

3.2 Recommendations for improving the investment climate

Recent consultative work by the European Committee of the Regions has listed some recommendations to improve the investment capacity of regional and local authorities. Two specific recommendations in the CoR **Athens Declaration** (2014[8]) focus on the investment capacity of regions and cities:

- Funding for long-term investment should be mobilised, ensuring better spending. To "do more with less", effective horizontal and vertical coordination of public budgets should be ensured, also involving private resources;

- Administrative capacity and innovation in the public sector should be strengthened through benchmarking, exchange of experiences, peer reviews and mutual learning between regions and cities.

In its **"Blueprint for a revised Europe 2020 strategy"**[9] the Steering Committee of the CoR Europe 2020 Monitoring Platform gave a list of concrete proposals and recommendations to make the Athens Declaration a reality. The Blueprint mentions, among other things, better multilevel coordination in the National Reform Programmes, the establishment of an EU investment helpdesk, a new Commission flagship initiative on administrative capacity and more knowledge transfer among regional and local authorities.

In its opinion "Promoting quality of public spending in matters subject to EU action"[10], the CoR points to the risk that a persistent low level of quality public investment would **further deepen the dividing lines in terms of cohesion** and convergence. The CoR requests that the European Commission include a chapter on the quality of public investment, including at subnational level, in every annual report on Economic and Monetary Union (EMU) public finances and calls for a review of the methodology for **calculating the "structural deficit"**. This should take account of the intrinsic characteristics of national economies and of the structural differences in public expenditure.

Related to multilevel coordination and subnational capacities for investment, in 2014 the **OECD** adopted an official instrument (Recommendation) on Effective Public Investment Across Levels of Government[11]. It is based on three types of challenges involved in multi-level governance, namely **co-ordination challenges, capacity challenges and challenges in framework conditions** (more details in the OECD annex chapter).

8 http://cor.europa.eu/en/news/Pages/regions-cities-athens-declaration.aspx
9 http://portal.cor.europa.eu/europe2020/SiteCollectionDocuments/2459-brochure-BlueprintEU2020.pdf
10 Committee of the Regions, BUDG-V-009 CdR 4885/2014
11 http://www.oecd.org/gov/regional-policy/recommendation-effective-public-investment-across-levels-of-government.htm; OECD, 'OECD Regional Outlook: Regions and Cities: Where policies and people meet' (2014)
Access: http://www.keepeek.com/Digital-Asset-Management/oecd/urban-rural-and-regional-development/oecd-regional-outlook-2014_9789264201415-en#page1

Chapter 4:
Local and regional politicians and experts discussing the Juncker Plan

Looking back at the conference "An Investment Plan for Europe", organised by the European Committee of the Regions, on 15 April 2015 in Brussels.

You can read the full reports of all conference sessions on www.cor.europa.eu/investment.

"There is a need for a thorough discussion on the topic of releasing the investment capacity of local and regional authorities, which were responsible for 55% of overall public investment."

Karl-Heinz Lambertz, First Vice-President of the European Committee of the Regions

"The lack of investment is not necessarily due to a lack of liquidity, but to accessibility issues and to a lack of confidence in the economic environment brought about by regulatory uncertainties."

Wilhelm Molterer, Vice-President for Cohesion at the European Investment Bank

"The essential elements of the plan are inclusion, ownership and cooperation. The European Parliament supports improving the status of local and regional stakeholders as well as regional platforms, which are to play an active role in the Juncker Plan."

Roberto Gualtieri, Chair of the European Parliamentary Committee for Economic and Monetary Affairs

Panel debate Opening Session: An Investment Plan for Europe: Brussels' cosmetics or a response to local and regional needs?

Rudolf Niessler, Director for Policy, DG for Regional and Urban Policy, European Commission; **Anne Bucher**, Director for structural reform and competitiveness, DG Economic and Financial Affairs, European Commission; **Raffaele Cattaneo**, President of the Regional Council of Lombardy, Italy, and Chair of the CoR Commission for Territorial Cohesion Policy and EU Budget; **Chris Burns**, moderator; **James Watson**, Director for Economic Affairs, BUSINESSEUROPE; **Luiz de Mello**, Deputy Director of the Public Governance and Territorial Development Directorate, OECD.

Workshop panel: Local involvement in EU investment management

Alessandro Laterza, Vice-President for Southern Italy and regional policies, Confindustria; **Graça Fonseca**, Deputy-Mayor for Economy, Innovation, Modernisation and Decentralisation, Lisbon City Council, Portugal; **Jérôme Hamilius**, Director European Cooperation and Strategy, Council of Europe Development Bank (CEB); **Bas Verkerk**, Mayor of Delft, the Netherlands, and a member of the European Committee of the Regions; **Werner Schmidt**, member of the Task Force for the Investment Plan, European Investment Bank; **Dominique de Crayencour**, Secretary-General, European Association of Long-Term Investors.

Workshop panel: The Investment capacity of regions and cities

Brian Field, Senior Advisor, European Investment Bank; **Ken Bishop**, Head of Partnerships and Investment, Northern Ireland Local Government Association, UK; **Marc-Etienne Pinauldt**, Director for Territorial Capacity Building, General Commissariat for Territorial Cohesion (CGET), France; **Wim van de Donk**, Governor Chair of the Council of the Province of Noord-Brabant and a member of the CoR; **Joan Carles Rovira**, General Director, Catalan Institute of Finances, Spain; **Marcel Roy**, Secretary-General, European Association of Public Banks.

Workshop panel: Local and regional authorities improving the EU investment environment

Jorge Núñez Ferrer, Associate Research Fellow, represented the Centre for European Policy Studies; **Cristina Mazas Pérez Oleaga**, Regional Minister for Economy and Budget, Cantabria, Spain and Member of the CoR; **Claude Gewerc**, President of the Picardy Regional Council, France and CoR rapporteur on the Investment Plan and the European Fund for Strategic Investments (EFSI); **Lambert van Nistelrooij**, Member of the European Parliament (EP) and rapporteur on the REGI committee opinion on the EFSI; **Konstantin Pashev**, Head of Unit at DG for Internal Market, Enterprise, Competitiveness, Industry and Growth Policies, European Commission.

Workshop panel: Guaranteeing innovation and quality in local public finances and investment

OECD, **Paul-Emile Mottard**, Provincial Deputy of Liège, Belgium and Chairman of the European Confederation of Local Intermediate Authorities; **Simon Barnes**, Director Advisory Services/fi-compass, European Investment Bank; **Manuela Geleng**, Head of Unit ESF Policy and Legislation, DG Employment, Social Affairs and Inclusion, European Commission; **Bogdan Nawrocki**, Deputy Director of the Debt and Financial Policy Department, City of Warsaw, Poland.

Panel debate Closing Session: Future prospects for a multilevel alliance

Miguel Gil-Tertre, member of the Cabinet of Commission Vice-President Katainen; **Brian Ager**, Secretary-General of the European Round Table of Industrialists; **Markku Markkula**, President of the Committee of the Regions; **Claude Gewerc**, CoR Rapporteur on the Investment Plan and the EFSI.

"Regions and cities are responsible for creating the appropriate financial and political environment. They bring together political and institutional stakeholders, industrial players and citizens and combine their strengths to create jobs and welfare."

Claude Gewerc, CoR Rapporteur on the Investment Plan and the EFSI

"We need to be more closely involved in the roll-out of the Investment Plan, particularly in the process of identifying and preparing projects. The CoR offers the Commission full support in its efforts to create a genuine dialogue on the investment strategy with local and regional partners"

Markku Markkula, President of the European Committee of the Regions

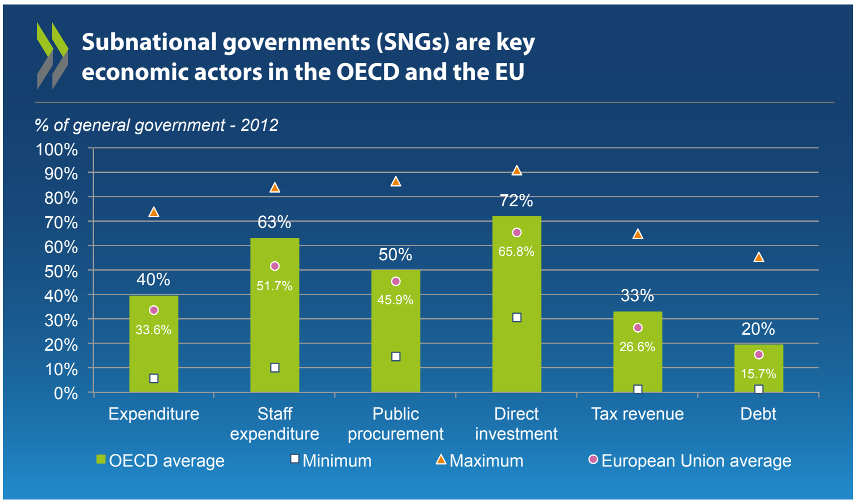
Chapter 5:

Local and regional governments driving the economy in the European Union

(Summary of a contribution by Dorothée Allain-Dupré, Isabelle Chatry and Joaquim Oliveira Martins, OECD, Regional Development Policy Division, Public Governance and Territorial Development.)

Subnational governments are key economic actors in the OECD and the EU. This is reflected by their spending which represented 39.9% of all public expenditures and 17.2% of GDP in 2012 in the OECD (Graph 1). They typically represent a higher share of public spending and GDP in federal countries – over 45% of expenditures in all federations and quasi-federal countries (except Austria) and over 17% of GDP (except Mexico) because they represent a combination of expenditure by the federated states and from local governments.

Graph 1



Source: Authors' elaboration from OECD Regional Outlook 2014

It is important to note, however, that this indicator of spending does not always reflect the real degree of choice that subnational governments have in terms of expenditure. Spending autonomy can be restricted as expenditures can be mandated, earmarked or passed through from a central government.

In the EU, the top two budget items – each representing 20% of subnational expenditure – are education and social services (infrastructure and social benefits such as sickness, disability, old age, survivors, family, youth, unemployment, housing and exclusion).

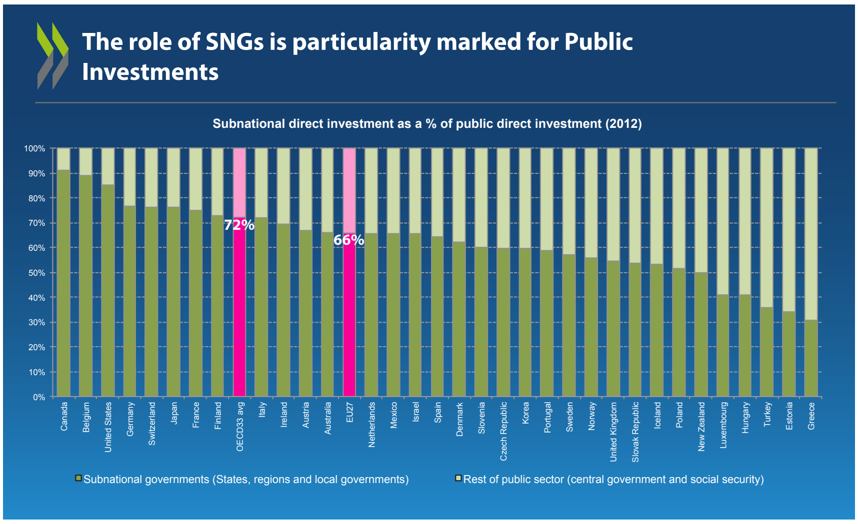
The allocation of spending responsibilities across levels of governments is not set in stone. Since the crisis it has been under discussion in a number of countries which have introduced or plan to introduce reforms to reallocate competencies, in particular in the health and social sectors, often with the aim of generating savings.

This importance of subnational governments in the economy is also reflected by their role as employers i.e. the number of staff they employ. It appears that the lion's share of public sector workers is at the subnational level overall, with 63.3% of government personnel expenditure undertaken by subnational governments in the OECD (51.7% in the EU). Again, this average masks different situations between countries: high figures may result from the fact that subnational governments are responsible, by delegation from the central government, for the payment of teachers' salaries or for social and health workers.

Subnational governments are also a major economic actor through public procurement. Through their spending on goods and services (intermediate consumption) and on construction and public works, they play a key role on local public markets. On average, they are responsible for 50% of public procurement in the OECD area (and 45.9% in the EU), a figure varying from 14.6% in Greece to 86.7% in Canada.

If we focus on capital expenditure, the leading role of subnational governments in public investment appears even clearer. In 2012, OECD countries spent about USD 1.2 trillion in public investment in infrastructure and equipment and 72.2% of this investment was carried out by subnational governments, which represented 1.9% of its GDP. In the EU, subnational direct investment[12] represented 65.8% of public investment and 1.5% of GDP (Graph 2).

Graph 2



Source: Elaboration from OECD (2013) Subnational Governments in OECD countries: Key data.

When used wisely, this represents one of the most growth-enhancing forms of public expenditure. Most of the subnational public investment goes to areas of critical importance for future economic growth, sustainable development and citizens' well-being. In terms of total investment by subnational governments across the OECD, 37% is allocated to economic affairs and transport. Approximately 26% of subnational public investment is used for education, which helps determine the quality of the future labour force. A further 11% is dedicated to housing and community amenities. Health care and environmental protection are also major areas of investment for subnational governments (OECD 2013, Regions at a Glance).

Finally, when looking at other fiscal indicators, it appears that subnational governments collected over one third of all public tax revenue in the OECD in 2012 (33.2%, but more than 50% in Spain, Canada and Switzerland and 26.6% in the EU on average) and accounted for around one fifth of public debt[13] (19.6%).

12 It is defined as gross capital formation and acquisitions less disposals of non-financial non-produced assets.

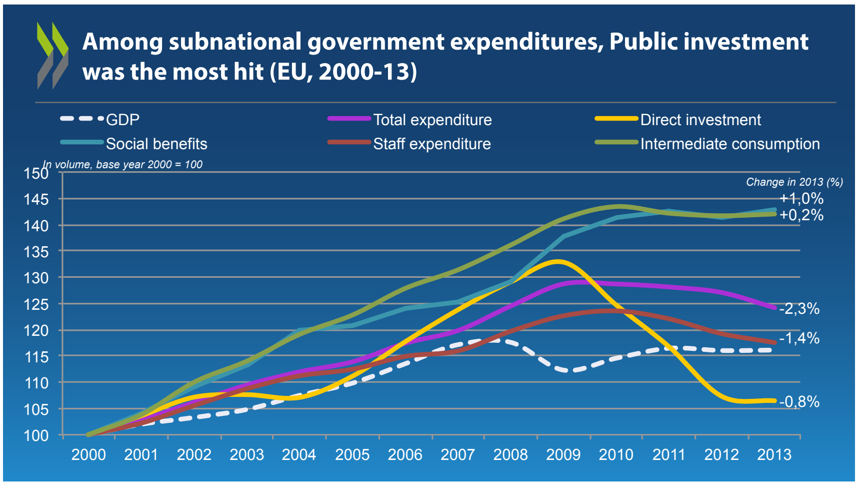
13 According to the SNA definition of debt which differs from the one applied under the Maastricht Protocol. The definition used by the OECD is broader, including insurance technical reserves and other accounts payable. The debt according to the Maastricht definition is valued at nominal prices and not at market prices.

Public investment is sacrificed as subnational budgets continue to be under constraints

In a great number of countries, direct investment by subnational governments was particularly robust in the early years of the global financial crisis due to the involvement of regions and municipalities in stimulus plans and strong support from national governments. However, the deepening of the social and economic crisis as well as the adoption from 2010 onwards of national and local budget consolidation measures in response to the public finance crisis put severe strain on subnational governments' finance.

Faced with limited scope for controlling other forms of spending, in particular current spending on welfare, health and education, subnational governments treated investment as an adjustment variable. They cut investment, which contracted by 13% between 2009 and 2012 in the OECD in real terms. The decline in subnational public investment was even bigger in the EU between 2009 and 2013: the drop reached 20% over the 4 years, i.e. 5% per year in real terms. Some countries were particularly hit, such as Ireland, Spain, Portugal, Italy and Greece. Over 2013 only, the drop in direct investment seems to have stabilised in the EU on average, decreasing by 0.8% in real terms between 2012 and 2013, but this hides great variations. The situation looks as if fiscal constraints will remain for a while.

Graph 3



Source: OECD calculations based on Eurostat National Accounts.

That means that it is more important than ever for governments to learn to do better with less, i.e. by spending smarter. The challenges are much broader than just financing investment. Even when investment funding is available, different levels of government may lack the appropriate governance tools to make the best use of investment funds. That is why the OECD has developed an instrument which aims to help governments to increase the investment efficiency.

The OECD Recommendation for Effective Public Investment across Levels of Government, approved in March 2014 by the OECD Council, has identified three systemic challenges that all governments face in co-ordination across levels of government or sectors; key public management capacities throughout the investment cycle and framework governance conditions for public investment such as procurement or fiscal framework.

Since the adoption of the instrument, which was endorsed by the European Committee of the Regions, the OECD has developed an Implementation Toolkit. It contains guidance for each of the Principles, examples of good practices, data and indicators as well as self-assessment tools (http://www.oecd.org/effective-public-investment-toolkit/). The OECD is also conducting case studies on the implementation of the Principles.

Institutional and territorial reforms have accelerated in recent years in the OECD and the EU

It is clear now that the crisis has multiple impacts, which are not confined to financial issues or with short-term effects but are much deeper and more diverse. Bringing about structural changes in the long term, the crisis is also a catalyst for changes in territorial and institutional organisation.

The pace of institutional and territorial reforms at the level of subnational governments has accelerated in recent years, in part motivated by a need to achieve greater cost savings, but also as a means to reallocate responsibilities across levels of governments.

There are almost 141,000 general-purpose subnational governments in OECD countries (90,125 in the EU), comprising around 136,350 municipalities, 526 regional level governments and around 4,000 intermediate governments in countries which have three government layers below that of the central government.

Because the crisis puts pressure on governments to figure out how to increase efficiency through economy of scales, many governments encourage the reduction of municipal fragmentation. The objective is also to find the right scale for delivering public services with appropriate financial and human capacities. In fact, many current subnational political and administrative boundaries are based on historical settlement patterns which now appear to be disconnected from today's realities. There is a need to diminish the mismatch between administrative and functional areas through re-scaling policies.

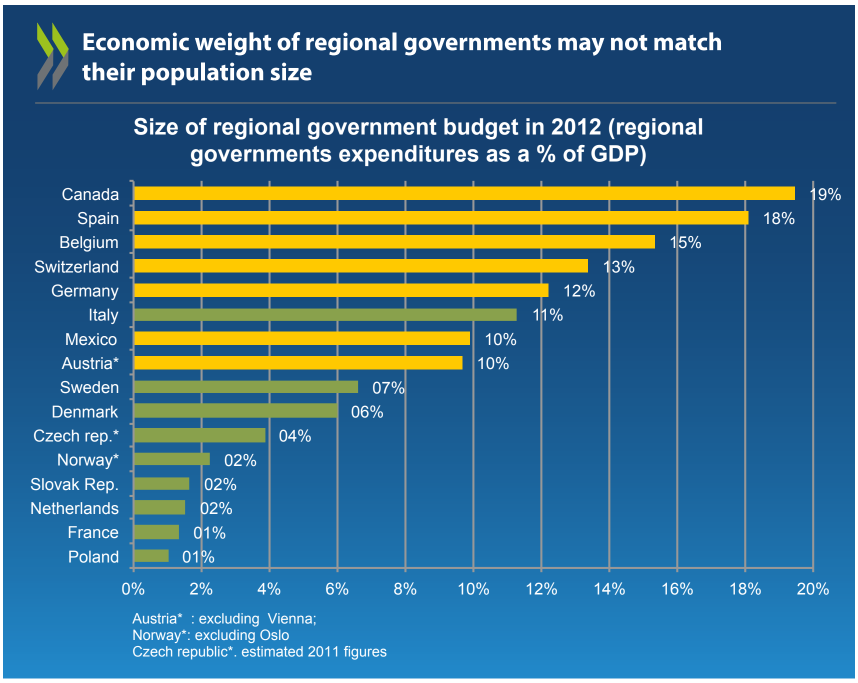
Since 2010 a number of countries have undertaken such re-scaling reforms (OECD Regional Outlook 2014): Finland, Greece, the Netherlands, Ireland, Estonia, Hungary, Luxembourg, etc.

They also include policies favouring inter-municipal cooperation, e.g. improving the governance of metropolitan areas has become a hot topic in many countries as a tool for improving national economic, environmental and social performance. Financing and political systems at the local level often provide disincentives for metropolitan-wide engagement, therefore national reforms are often used to provide better incentives such as in France, Italy or the United Kingdom. Among the 275 functional urban areas with 500 000 or more inhabitants defined in the OECD, there were at least 49 metropolitan entities created in the 2000s and already at least 15 in the first three years of this decade.

Beyond the municipal reforms, reforms of intermediate and regional levels have a more diverse set of rationales. In countries with three subnational tiers, intermediary-level authorities are, in most cases, the subject of continuous debate on their role between the municipalities, the regions and, increasingly, inter-municipal cooperation (metropolitan) entities. In Italy, a law was adopted in abolishing provincial administrations where metropolitan city areas are created. Many reforms at regional level are focused on some form of greater decentralisation, and devolution of new responsibilities to the regions. Sometimes these reforms seek also to reduce the number of regions so as to reach a greater critical geographic and demographic size, starting with experimental regions to test the waters.

But when looking closer at the regions in the OECD, it appears that there is no strong correlation between size and successful performance, in terms of GDP for example. The challenge today is more to define administrative boundaries in line with the social and

Graph 4



Source: OECD calculations based on data from national statistical offices economic functional areas (commuting patterns, urbanisation, water management, sustainability, land use, economic development, etc.) than defining an ideal regional size in terms of area or population. One additional challenge is to provide regional governments with sufficient competencies and financial and human capacities so that they can improve their performance and competitiveness on the local, national and international scales.

Chapter 6:

EU economic governance and fiscal decentralisation: The state of subnational public finances

(Contribution by Angel Catalina Rubianes, European Commission DG for Regional and Urban Policy, and Rocco Bubbico, European Investment Bank)

The financial and economic crisis had a dramatic impact on public finance all over the European Union. The debt-to-GDP ratio in the EU increased from 58.8% in 2007 to 87.1% in 2013. That is a rise of almost 30 percentage points in six years, which is a trend not observed since the Second World War. The deterioration of public finances was nevertheless much more severe in some Member States than in others: public debt increased more than 100 pp in Ireland, around 70 pp in Greece and more than 60 pp in Spain and Portugal. While the reduction of economic activity was detrimental for the tax base and public revenue, the main explanatory factor underlying the high public deficits during the crisis has been the significant increase of public expenditure (expressed as a share of GDP). It attained on average 51% of GDP in 2010 and then started declining slowly with the implementation of fiscal consolidation plans. In 2013, however, public expenditure was still well above pre-crisis levels (49.1%).

Fiscal consolidation has affected public investment more than current expenditure. The budgetary policies carried out to achieve the fiscal targets have generally been characterised by major cuts in public investment, especially in the Member States hit the most by the economic crisis. Public investment in nominal terms was still 70% lower than the pre-crisis level in Spain in 2013, more than 60% lower in Greece and Ireland and around one half in Greece. The reduction of public investment has been significantly higher than other items corresponding to current expenditure such as staff costs, social benefits or maintenance of the infrastructure for the functioning of the public administrations. Thus, fiscal consolidation has mostly been carried out at the expense of public investment, which contrary to other crises did not play any counter-cyclical role in cushioning the effects of the crisis on growth and employment. As a result, public investment reached the lowest levels in decades in many Member States.

The increase in the debt of subnational governments has been limited. Central governments account for most of the increase in public debt observed during the crisis. Subnational governments, instead, have witnessed much lower rises, in some cases because they are not authorised to incur new debt. While they are responsible on average for around one third of the total public expenditure, just 15% of the total public debt in the EU is owed to subnational governments. This share has even slightly decreased during the crisis, reflecting the fact that the bulk of the new debt is owed to central governments. The share of subnational expenditure in total general government spending has increased in most EU countries over the past few decades, but varies considerably between countries. In general, this percentage tends to reflect differences in the institutional setting, the degree of decentralisation and the assignment of expenditure functions. Regions and local authorities are responsible for around 66% of total public expenditure in Denmark and for almost 50% in Sweden and in Spain. In Spain, this is due to highly-decentralised educational and health systems, while in Denmark this is due to the decentralisation of social protection as well as education. In Greece, Cyprus and Malta, subnational authorities are responsible for less than 6% of total public expenditure. Overall in the EU-27, subnational authorities account for around one third of the total public expenditure.

Public expenditure by regional and local authorities stopped increasing and a trend towards centralisation of expenditure is observed in some Member States. From 2000 until 2009, public expenditure at the subnational level in the EU fluctuated around an average of just under 16% of GDP. In 2009, it increased by 3.4%, partly as a result of the fiscal stimulus package as well as the additional demands on social services. Then it started declining as a consequence of tight fiscal consolidation strategies implemented from 2010 onwards. Since then, expenditure by subnational governments has followed, in relative terms, a similar pattern as the central governments, i.e. public expenditure starts gradually declining but remains slightly over pre-crisis levels. In 2013, local and regional government spending accounted for 16.2% of GDP. An interesting feature is that during the crisis there has been a slight centralisation trend in terms of public expenditure in some Member States such as Estonia, Ireland, Hungary and the United Kingdom and also, to a lesser extent, Latvia and Lithuania. On the opposite side, local government has significantly increased its share in total public expenditure in Bulgaria.

The revenue of subnational levels has been affected as well. As for the revenue side, resources of subnational governments accounted for 16% of GDP in 2013, which is around 35% of the total financial resources of the general governments. While between 2000 and 2009 subnational revenues increased at a rate of 2.5% a year on average, during the crisis between 2009 and 2013 they have decreased by 0.1% a year. As a share of GDP, like in the case of central governments, revenues have been rather stable during the crisis, fluctuating between 15.7% and 16.3%. The only exception is the year 2009, when these resources were higher because of the implementation of some actions related to the economic recovery packages. However, the average masks some major differences in the trends; subnational authorities have enjoyed a significant increase of their revenues in Denmark, Finland and France while they have witnessed a decline in Ireland, Italy, Latvia, Lithuania and Poland. The causes of these changes differ between countries, depending on the sources of revenues, the assignment of revenue sources and on fiscal management across levels of government. In many Member States, the main sources of subnational revenues are internal transfers.

The net transfers from central to local levels of government were drastically reduced between 2009 and 2013, especially in the countries hit the most by the crisis. This is particularly the case for Spain, Ireland, Cyprus and Italy. In countries where the recession was limited in time or intensity, such as Germany, Sweden and Luxembourg, net transfers increased considerably in the same time span.

Subnational governments are as responsible as central governments for the significant decline in public investment. Subnational governments are responsible for a large share of public investment (around two thirds) and growth-enhancing expenditure (around 45% of the total expenditure in education, healthcare, environmental protection, transport, R&D and energy). The effects of the economic crisis on public finances have placed further stress on regional and local authorities which had to face significant pressure generated by the reduction of the tax base and increased social needs, calling for additional expenditure in social protection while also facing a deterioration of borrowing conditions. The capacity of subnational authorities to contribute to public investment in particular has been affected by the fiscal consolidation strategies implemented across the EU. There is a higher decline in public investment than in other items of expenditure, but not dramatically. The decline of public investment at subnational level is overwhelmingly explained by Spain and, to a lesser extent, Italy, Ireland, Portugal and the United Kingdom. Subnational public investment declined dramatically in Spain and was almost 70% lower in 2013 at subnational level compared to 2008. A similar decline is found in Ireland. It is particularly in the countries mentioned that the adjustment of expenditure at subnational level has been carried out at the expense of public investment. In the rest of the EU the adjustment is overall more evenly shared by the various items of expenditure.

Structural Funds, in this context, have ensured vital resources. From 2010 to 2013, Structural Funds and national co-financing have represented around 14% of expenditure on public capital investment and around 21% of total fixed capital investment. In some countries, such as Slovakia, Hungary, Bulgaria and Lithuania, resources linked to EU regional policy amounted to more than 75% of public investment.

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