Talking point

Brexit and the EU investment plan: Where do we go from here?

August 2, 2016

Is Brexit going to impact on the EU investment plan? The short answer is „yes“. But the more interesting question is how it is going to play out both on the day-to-day operations, progress with the plan and the future of the European Fund for Strategic Investments (EFSI) in particular.

Let’s start by taking stock: With respect to macroeconomic developments, pre-Brexit baseline expectations for the EU suggested a continuation of the moderate recovery for 2016. Investment had picked up in the winter half, with the investment plan being one of the factors supporting this trend. By mid-June, about a third of EFSI’s key target – trigger EUR 315 bn in investment in three years – had been reached according to estimates by the institutions and the political discussion about continuing EFSI beyond its initial time horizon had already begun.*

As for the UK in particular, the country had been supporting the investment plan for instance by pledging GBP 6 bn in co-financing as well as benefitting from EFSI funds. By mid 2016, seven infrastructure and innovation projects were envisaged, amounting to EUR 1.9 bn in EFSI financing, expected to trigger EUR 8.2 bn in investment and create a substantial amount of jobs over a multi-year period. Via the European Investment Fund’s (EIF) EFSI activities to support SME’s, 10 financing agreements with intermediaries had been approved. The Commission expected this to trigger EUR 3.6 bn in investment and benefit about more than 1,000 firms.** Together, EFSI-related activity in the UK amounted to about 11% of total expected investment volumes.*** In addition, there are several projects planned to involve multiple countries also including the UK.

Both the EIB and the EIF were quick to emphasize that at present the Brexit vote would not imply changes to project operations. This also reflects that until Art. 50 gets triggered and during the two-year period of negotiating exit, the UK would remain a member with „full rights and obligations“. However, it is worthwhile to keep in mind that EFSI does not work by allocating funds based on geographic quotas. It relies on projects being put forward for financing – both by private and public actors – and building up cooperation with intermediaries in member states. Even if the Brexit vote would imply little changes to operations already under way****, it is likely to reduce the enthusiasm for new UK projects being put forward while the country is negotiating its way out and might make the EIB and EIF more cautious, too given uncertainties with respect to the future development of UK-EU relationships.

What about effects on the EU27-UK? On the one hand, the Brexit vote meant a shock and raised uncertainty. It lowered the Union’s growth outlook and increased sensitivity to political risks – altogether no good news for investment. Hence, the main objective of generating a substantial amount of additional investment arguably becomes harder to reach as a result of the Brexit vote. On the other, the plan itself may in fact be more important than before. In an upside scenario, the Brexit shock could even provide an impetus to the plan’s lagging 3rd pillar, i.e. reforms to improve the investment environment in member states and help to push progress on flagship initiatives like the digital single market. At the project level, getting EFSI support could be seen as a „seal of approval“, and serve as a confidence-building signal that is now particularly valuable to get things off the ground. Last but not least, Brexit is going to impact on the discussion about EFSI’s future beyond 2018. Much suggests that it rather strengthens the case for continuation due to higher uncertainty, a more moderate mid-term outlook and the willingness to instil investor confidence as well as demonstrating Europe’s value added via concrete projects against this backdrop.

Yet, how to provide the means for a future EFSI is somewhat complicated by the Brexit vote. EFSI’s capacity is based on a guarantee from the EU budget (EUR 16 bn) and a EUR 5 bn allocation of the EIB’s own capital. The EIB also provides additional financing for EFSI projects. A Brexit would likely mean fewer overall budgetary resources and potentially lower financing capacity for the EIB itself as the bank could lose one of its largest shareholders.

In turn, how to proceed with EFSI (financing) is also connected to the overarching question about the UK's participation in the EIB as well as the future engagement of the bank in the UK. The stakes are considerable for both sides: The UK accounts for about 16 % of the EIB's capital but currently only EU member states can be shareholders. The EIF, which is part of the EIB group and focused on SME-financing, is partly owned by the EIB but also has participations by financial institutions of which two are based in the UK. However, the current list of the EIF's corporate shareholders, altogether accounting for a minority stake of 12% in the fund, also include institutions from non-member states. At the same time, the EIB has substantial financing activities in the UK. For example, EIB lending for projects there amounted to EUR 48 bn in 2015, i.e. the fifth largest share among EU countries.***** For comparison, total loans granted for projects in all EFTA countries accounted for about EUR 1.5 bn. Also, the EIF provided a non-negligible source of funding for UK Private Equity and Venture Capital funds,****** strengthening London's role as Europe's main VC hub and helping to connect it to other funds and firms across Europe or beyond.

At this point, it is too early to tell what future arrangements concerning the EIB group and the UK are going to look like. The timing and baseline conditions for a withdrawal settlement need to be clarified somewhat before being able to assess the impact on projects and Europe's public investment landscape more precisely. What is becoming increasingly clear though is that untying relationships after decades is going to involve a substantial amount of work including – but certainly not limited to – questions such as future UK participation in „common infrastructure" like the European Project Portal established as part of the investment plan, the need to agree on transition periods or grandfathering arrangements for projects in the UK or with UK participation once the country will have left, to potential possibilities for future cooperation with the UK no longer being an EU member but potentially still a partner.

* For an overview see Wruuck (2016): Promoting investment in Europe - Where do we stand with the Juncker Plan? Research Briefing, Deutsche Bank Research.

** See European Commission, Investment Plan for Europe State of Play for the UK (June 2016).

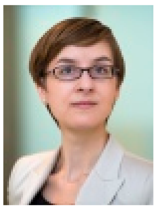
*** Based on total volumes for expected investment as of june 2016.

**** For example, on the first Board meeting after the Brexit vote, one new project in the UK and one involving UK participation were approved. See EIB project database (as of July 20th 2016).

***** Outstanding volumes, end of 2015. Aggregate loans include dispersed and undispersed portion. See EIB financial report 2015.

****** See for example statement by the British venture capital association and and Kraemer-Eis, Signore and Prencipe (2016): The European venture capital landscape: An EIF perspective. EIF Working paper 34/2016.

For further assessment of the EU Investment plan also see here



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