

OPEX MEMORANDUM N° 193/2015

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TO: OPEX DATE: 12/04/2015

SUBJECT: DIGITAL SINGLE MARKET, SMEs AND THE JUNCKER INVESTMENT PLAN.

Panel: European Union

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Where does the money come from?

A few months ago (25/11/2014), the European Commission disclosed the mechanism for its much-heralded €315 billion investment plan, revealing how a scarce €21 billion of initial public money is intended to lift fifteen times as much in capital. In March 2015, EU finance ministers agreed upon delivering on the commitment they took at the European Councils in October and December 2014, to wind-off Juncker's flagship investment plan. The idea was to create a new European Fund for Strategic Investments (EFSI), with €5 billion coming from the European Investment Bank and an €8 billion guarantee from existing EU funds designed to secure a further contribution of 16 billion Euro from the institutions. The €8 billion guarantee will come over a three-year period from the Connecting Europe Facility (€3.3 billion); Europe's research programme Horizon 2020 (€2.7 billion) and so-called "budget margin", or unused funds, worth €2 billion.

On the one hand, the EFSI plans to generate investments into the European economy of about €315 billion, by providing guarantees for higher-risk projects which aim at developing telecommunications and transport infrastructure, energy efficiency projects, research, education and innovation activities to finally generating about 240 billion in long-term investments, showing a timid responsiveness for the claims against austerity over the past years. On the other hand, the alternative purpose of the Fund is to provide financing to SMEs to enhance the viability of new venture capital injections, loan guarantees, securitisations and seed financing designed to offer micro-loans to SMEs, to fund start-ups or offer mid-cap companies venture capital, projected to generate €75 billion for those SMEs and mid-cap firms over the period 2015-2017.

In addition, the Commission aims to attract private investors to the Fund. Nevertheless, private investors seem sceptical about investing and assuming greater risks when the returns are not guaranteed. In fact, the basis for most long-term infrastructure or energy efficiency projects will most likely remain public funding -his is especially true of the newer EU member states, where the private sector is not strong enough-. In fact, the EU executive believes that more financing can be provided by individual member states. Two ways are being discussed: Capital contributions, which are not limited to the respective Member State and may entail voting rights and a claim on the fund's return (if any); and that participation in investment platforms that can be restricted to the Member State itself. As an incentive, this amount will be then discounted from the calculations of their deficits within the European Semester. There is a rising concern between Member States that the new fund will turn into a parallel EU budget -where voting rights could be purchased- not subject to enough democratic control, since this is fund is expected to be managed by Commission and the EIB and.

In order to prevent such situation, the Commission has announced that the fund will not consider to make investments on the basis of geographical distribution, but rather based on quality and viability. This may convince member states who fear the introduction of a parallel budget, but it might also raise problems of transparency and for those countries who wish to contribute voluntarily to the EFSI.

Several alternatives to the current functioning of the EFSI -that still need to pass the European Parliament filter- has been tabled: e.g. the possibility that the EFSI regulation could establish mandatory national contributions in order to increase the credibility of the ratio 1:15; also, transforming the fund into a permanent financing system with legal personality, so it could access financial markets for funding; and that but not least, turning the EIB's contribution to EFSI into a regularly one rather

a one-off, as it has been agreed so far. In any case -often accused of relying on leverage private investment unrealistic projections, lacking ambition, means and clear goals- this Juncker's investment plan goes along with several batteries of measures seeking to facilitate a boost in business activity, removing the obstacles hampering private investment in Europe.

Does Smart and better regulation necessarily means deregulation?

In line with the European Business Associations, Juncker told the European Parliament -as he unveiled the commission's top goals for 2015 are growth and jobs, and competitiveness- that a host of regulatory barriers to growth needed to be tweaked or removed in order for the plan to work. Juncker's commission aims to boost the economy and win back an increasingly sceptical public allegedly alienated by Brussels bureaucracy. Accordingly, the Commission will withdraw or change "stagnated" laws on, inter-alia, waste recycling and clean air, and key policies for the future of the 2020 targets.

Juncker stated that the commission would only bring in 23 new planned laws in the coming year, largely focused on a huge tentatively-315-billion-Euro investment plan to kick-start Europe's flagging economy. In parallel, Juncker's right-hand man, and EU commission vice-president Frans Timmermans, faced cries of "shame" in the European Parliament as he revealed that the commission was dropping plans on energy tax and recycling, while a law on emissions would be changed. Firstly, fighting against the EU 2020 targets themselves; and secondly, by endangering the EU leadership on international, global strategies and commitments towards sustainable development. Brussels NGOs understand this movement as a *de-facto* facilitation to EC negotiators to circumvent EU opposition against the Transatlantic Trade and Investment Partnership trade agreement, getting closer to US standards, in prevision of TTIP's landing in Europe.

Therefore, it can be easily ascertained that deregulation has become an end in itself for the current EC cabinet, even over the need to tackle climate change or ensure energy security, or even the fulfilment of democratically decided policies. Hence, fear of a rapid unravelling of EU environmental policies is fed further by Juncker's appointment of a Vice President charged with "keeping the competitiveness dimension prominently at the heart of the Commission's policy work", and even more important, of Mr Timmermans First Vice President for "Better Regulation" whose role includes an exclusive veto right over any proposal – including legislative initiatives – coming from any of the Commission department. For the record, the annual savings on all devices covered by the Eco Design Directive by 2020 could be equivalent to more than 12% of the EU's electricity consumption in 2009.

Public opinion has also partly understood Timmermans' role as being designed to satisfy David Cameron's demands, in the context of his party's Euroscepticism, tackling his promise to deliver an in-out referendum on the UK's EU membership, and his attempts to urge Brussels to cut back on EU regulation to help him persuade Britons not to vote to quit the EU, as previously mentioned, including less red tape for small businesses, the removal of outdated legislation and more authority for national governments. Even, despite telling MEPs that better regulation is not deregulation, it is not ideologically driven, that it is about reducing unnecessary 'red tape', especially for SMEs, the EPP – the political grouping that nominated Juncker – has praised the creation of Timmermans' role as a "portfolio for better regulation and deregulation". Deregulation is therefore proven an obvious part of the agenda.

As Dutch Foreign Minister, Timmermans was a key player in the Dutch Government's 2013 'subsidiarity review' that recommended, inter-alia, that the Soil Framework Directive should be scrapped, the maternity leave directive permanently binned, mandatory proposals on energy efficiency avoided, and that safety, health and welfare legislation be replaced with greater self-regulation, and like the Commission's red tape reduction agenda, they were formed hand in hand with big business, based in part on consultation with Shell, ING group, and Dow Chemical Company. Undoubtedly, raising concerns on public-interest laws and regulations that protect health, employment, the European Environment.

The Digital Single Market (DSM) Risk and opportunities in uncharted territory.

Although still in an early stage yet, another proposal is expected to be delivered in May 2015. The European Commission sees the promotion of online trading across the EU as a useful way to revive growth in stagnating EU economies. Thus, deepening into the mentioned deregulation agenda, in the words of the European Commission: "too many barriers still block the free flow of online services and entertainment across national borders. The Digital Agenda will update EU Single Market rules for the digital era. The aims are to boost the music download business, establish a single area for online payments, and further protect EU consumers in cyberspace". Creating a Digital single market is predicted to generate up to 250 billion Euros of additional growth in Europe in the course of the mandate of the new Commission (2014-2019), and thereby creating hundreds of thousands of new jobs, notably for young job-seekers.

The fact that only 15 percent of EU citizens buy online from other member states is only partly due to issues of culture and language, the EU executive believes, and points towards high cross-border delivery costs, and legal hurdles to making purchases as the main cause for not seizing this potential. Some larger online retailers automatically route customers to local sites, which may charge higher prices than in other EU countries. The Commission said it is considering ways to bolster public trust through making the main social media service providers, as Google or Facebook, more transparent in the ways they route users through the Web and accelerating their removal of illegal content. The Commission's proposals also includes improving data protection while favouring the benefits to be reaped from big data accumulations and cloud computing. In the word of the EU Commission , the data protection reform is geared towards stimulating economic growth by cutting costs and red tape for European business, especially for small and medium enterprises (SMEs). First, by having one rule instead of 28 the EU's data protection reform will help SMEs break into new markets. Second, by proposing to exempt SMEs from several provisions of the Data Protection Regulation – whereas today's 1995 Data Protection Directive applies to all European companies, regardless of their size.

The digital single market agenda would tackle the aforementioned practice known as geo-blocking, as previously stated, harmonizing contract rules and make parcel-delivery more affordable. Nevertheless, Its flagship proposal, the disappear of roaming tariffs through a pan-European approach to managing the radio frequencies needed for mobile telephony, has turn out to be a sonorous failure due to the recent EU Ministers decision to **keep roaming charges until at least 2018**, provoking widespread outrage amongst MEP and consumers association. Governments have been proven loath to cede control of airwaves from which they earn big revenues. This movement -that favours big Telecom companies, whilst

holding up the 4G technology needed to fully develop Commission Digital Agenda- has forced the EC to express its intention to coordinate alternative action across the EU.

On the EU copyright system, a recent report on behalf MEP Julia Reda has shown that the provisions of 2001's copyright directive have not been able to hold step with the increase of cross-border cultural exchange facilitated by the Internet. There is broad agreement on that the current copyright regime hinders the exchange of knowledge and culture across borders. To meet current challenges, the legislation needs to be updated to current practices and further harmonised. She proposed a solution to the fragmentation of EU copyright: The introduction of a single European title, like the European patent and the European trademark (but replacing national titles). A long-term goal that would benefit both right-holders and users: While the former would have a more unified basis of protection, the latter would gain more legal certainty in their cross-border uses without minimizing in protection for both consumers and SMEs. Although not confirmed yet, it is expected that the upcoming EC proposal, will be shaped in this direction.

On the tax side, proposals to simplify cross-border VAT sales taxes for small businesses which disadvantages small companies and sole traders [has also been discussed](#). In fact, the change in VAT regulations which came into effect in January 2015, is being broadly considered as being **a significant (or indeed the most significant) inhibitor to cross-border activities. This seems to be a more long-term objective of SMEs and start-ups. It may need more than a couple of months to find widespread agreement, even when the current momentum due to the DSM clearly points that it is the legitimate way forward.**

What is at the stake for Entrepreneurs, Startups and Small and Medium Enterprises?

It is expected that all this pro-innovation based policy design would help digital SMEs and startups to flourish in Europe. It is considered that within Europe, over 60% of the economic growth between 1995 and 2007 is calculated to have been due to innovation – which is unsurprisingly **disproportionately driven by young, technology-intensive startups, small and medium sized companies.**

It is worth mentioning that, compared to already established SMEs which often don't have similar growth prospects as their primary objective, start-ups are being considered **main drivers of net job creation** across Europe. It's not that SMEs on a broader level are not key players in the EU economy, it's that start-ups, if successful, -and most specifically technological ones- demonstrably create more new jobs and drive economic growth more intensively. This impact is the main reason why policy-makers would take an strategic advantage if able to distinguish between start-ups and 'regular' SMEs. To create and support policies that favour those high-growth potential companies in particular, would be of an enormous benefit to the ignition of the EU economic engine. EU actors has to make an effort to understand that start-ups need to be protected since they are the seed for a sustainable economic fabric based on SMEs, and has to understand that failure is part of life for many an entrepreneur seeking to build a businesses, and a way of living. A good first step, would be that to accommodate failure, and that its potential impact, in new regulation, legislation and strategies used to shape the regulatory environment on entrepreneurship and innovation.

This strategy should become extensive to other domains in which SMEs and start-ups would need additional support. One core demand from several European platforms on how the DSM should develop **a light-weight corporate structure** which would follow the harmonised requirements in all EU Member States, be straightforward to establish, and have a common name to attract foreign investors. It should also allow for all formalities to be conducted online; permit information to be submitted to the authorities only once (instead of resending the same information many times to different authorities); and include start-up-friendly insolvency rules which would not punish innovation, but rather would facilitate 'rescue restructuring' and give a second chance for honest, bankrupt entrepreneurs. This sort of measures should become extensive in order to enhance the EU industrial system based in competitiveness, equity and fairness.

Also, another major obstacle to be removed, or at least harmonised, in the quest for a genuine balanced and sustainable EU -digital and analogical- single market, is to create a common entrepreneurship fees system. The multiplicity of frameworks is significantly troubling the success prospects of the Juncker's investment plan for several reasons. After the European employment crisis, SMEs and freelance workers have tended to play a more important social role in less developed regions. Most large companies and corporations based in the richer EU regions and economic developments over the past couple of years demonstrated that big corporations have been, in most cases, capable of resist the storm. However, due to the power shifts on the employment relations many workers has been forced to move towards self-employment, making their sources of income more precarious for them, their families and by extension for the inner demand itself. The fact that in more economically resilient countries, as in the UK or The Netherlands, becoming a freelance worker is cheaper, simpler and more straight forward (with costs of around 100€ per trimester) than in countries as Spain or Portugal (275/per month, VAT excluded) significantly presenting an obstacle to sustain an evenly and well-distributed growth within the European single market. It may be clearly understood as an unfair competition situation within the EU that only deepens into the economic and social desertification that the peripheral south is suffering.

The previous mentioned sort of measures, paired with a genuine and well managed smart and better regulation strategy, should stimulate economic growth, especially for small and medium enterprises (SMEs). Some proposals are quite reasonable, and as previously stated, they should be extensive to other fields where SMEs and start-ups deploy their activities.

For instance, the data protection new regulation will establish a single, pan-European law for data protection, replacing the current inconsistent patchwork of national laws. The European Commission foresees that dealing with one law, not 28, will produce €2.3 billion per year. Also, the Regulation will establish a 'one-stop-shop' for businesses: companies will only have to deal with one single supervisory authority, not 28, making it simpler and cheaper for companies to do business in the EU; and easier, swifter and more efficient for citizens to have their personal data protected.

It is also expected to set a more fair competition rules set. The same rules for all companies – regardless of their establishment: Today European companies have to adhere to stricter standards than companies established outside the EU but also doing business on our Single Market. With the reform, companies based outside of Europe will have to apply the same rules. Creating a spill-over effect on the global playing field in terms of citizens and consumer data protection. **Further, it has been stated on behalf the European Commission that the**

establishment of a single European regulator equipped with stronger enforcement powers will be able to fine companies who do not comply with EU rules with up to 2% of their global annual turnover. The European Parliament has even proposed to raise the possible sanctions to 5%. Privacy-friendly European companies will have a competitive advantage on a global scale at a time when the issue is becoming increasingly sensitive.

However, when taking a closer look to this reforms, it may disprotect the consumers, as for example, regarding the obligations of data controllers and processors being calibrated to the size of the business and to the nature of the data being processed. For example, SMEs will not be fined for a first and non-intentional breach of the rules. Nevertheless, taking into account the current digital scenario, the size of the company does not affect to the amount of data it is able to manage, significant breaches to data protection may harm consumers rights. Even, if this sort of aid to SMEs and startups facilitating economic activities should be welcome, special emphasis should be put in not neglecting consumer, nor environmental, protection rules and rights. This is exactly what sustainable development means, and what the ultimate target of the European Union, and it uncountable international commitments, regardless the eventual ideology of the EU current executive.

Conclusion

This plan, fostered by lobbyist as “Friends of the European Commission”, seeks to support ‘A New Boost For Jobs, Growth And Investment’ strategy, which once again puts considerable emphasis on cutting red tape and getting rid of unnecessary regulatory barriers. It is undeniably true that the EU economy needs public investment and that differences in national regulatory schemes for SMEs should be tackled and reformed, in order to complete fair and sustainable European single market that would produce fair rewards and quality employment. However, arguing that innovation and competitiveness should not be stifled with too prescriptive and too detailed regulations, emphasising SMEs in particular, pledging to step up Barroso’s work reducing red tape and regulatory burdens Juncker and its commission are using SMEs as excuse to move forward their ideological agenda with the goal of slashing regulations that raise costs for business – and protect the environment, workers and consumers.

Despite the fact that the regulatory bottle neck is not at EU but at national level, the structure of Juncker’s Commission, its origins, in addition to the appointment of a Vice-President for Better Regulation – a new god of red tape, that can smite down any proposed law that burdens business – are cause for serious concern. Thus, inappropriately defying EU legislation that mostly affect big businesses, rather than harmonising divergent national legislation will prove to be completely ineffective in terms of solving the current EU problems. The EU’s Eco Design Directive, which had the support of a majority of member states and of the European Parliament is a good example of regulation that should be protected against eventual ideological excesses.

EU public funds that will go into EFSI, ie the €8 billion, is not new money, but money shifted from other parts of the EU budget. And, although not clearly stipulated in Juncker’s plan, but probable, the same holds for the €5 billion from the EIB. This introduces an 'opportunity cost' component to the calculations, i.e. what the social returns from the additional investment will be above what would have come from their original spending allocation. Thus, the procedure for project

evaluation is a cause of concern. The fact that a six person committee will decide upon investments via simple majority rules is the most troubling of all. Considering that the EU is dealing with a vital instrument for the development of its economies, it should be good to think of more equitable approval procedures. The EU has been criticised for its lack of transparency - the investment plan under these circumstances lacks both legitimacy and vision.

There is much scepticism if the 1:15 multiplier is realistic, particularly as private funding needs to be 'additional'. Expertise and independence of the project selection committee will be key in order to provide additional guarantee to the funded projects. Project selection should also focus on projects that meet both the additionality criteria and which have the highest social rates of return. After all, what matters is not just how much private investment can be leveraged, but how much growth and employment can be created from these investments. All this underlines the need for high quality independent governance of the ESFI, and a monitoring and evaluation strategy specified from the start, if the plan has any serious chance of reaching the 1:15 multiplier and making a meaningful impact on growth and jobs for the EU economy.

The number of kilometres of high-speed railway required in a certain area could act as a criterion for selecting for an infrastructure project. Another example would be the unemployment rate in a region. These criteria could enable investments in areas where they are most needed and prevent further discrepancies in terms of development between Europe's regions. However, and irrespective of the reasons why some peripheral regions, especially newer ones, are poor performers (lack of administrative capacity, corruption, quality of projects, lack of banking commitment with risk projects) the probability that these issues can be addressed in time for them to benefit from the fund is low, since the Commission wants the fund to be up and running by mid-2015. The Commission should also look to specific quantitative and qualitative criteria that will bring real added value to the economies of the areas concerned.

The European Commission should work closely with governments to find public financing to add to projects that need additional key public funding to the EFSI guarantee to become economically viable and therefore attractive to private investors. The Commission should make sure that the EU funds used as guarantee will have at least the same positive impact upon the real economy, SMEs, and start-ups, in areas for which they were initially foreseen, as they would have had if these were spent as grants.

On the Digital Single Market, there is general optimism that the *principle* of the DSM would be beneficial for Europe, however, this is coupled with widespread pessimism that *execution* of the DSM would entail unfair competition between small and large firms, particularly if further efforts are not made to consult and incorporate start-ups and small businesses proposals, rather than hearing European multinationals. Also there is also a rising shadow that the so called European technological revolution will end up in a watery incoherent deregulation reform. This fear, that undermines trusts across non speculative investors, highlights the necessity of a pan-european reform on self-employment, SMEs and Start-ups. As previously stated, ring-fencing the subset of young firms with high growth potential, if at all there should be any ring-fencing. These firms, that typically offer much riskier innovative projects, lacking resources and reputation find harder to access finance, especially in the current European financial market situation of a low appetite for risk funding.

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