The €315 billion Investment Plan for Europe

The economic and financial crisis led to a 14% reduction in investment in the EU from the pre-crisis peak of 2007 (€2 606 billion in 2013, compared to €3 039 billion in 2007, in 2013 prices), despite a pressing need for more investment. The European Commission believes that this is due to uncertainty regarding potential growth leading to excessive risk aversion among many investors. It sees the solution in using public funds to encourage the private sector to invest more.

The Investment Plan for Europe

To encourage such a 'catalyst' effect, in its 26 November 'Investment Plan for Europe' communication, the Commission stated, among other things, its ambition to mobilise at least €315 billion in additional public and private investment into infrastructure projects and SMEs over the next three years. This sum, €315 billion, is a significant amount – in comparison, the total budget of the EU for 2014 was €142.6 billion – and looks even bigger if we take into account that the expected contribution at EU level will be €21 billion, with no additional impact on the EU budget. Two questions come to mind: where will this sum come from and how does the Commission intend to reach this level of investment with a comparatively low initial amount?

Where will the money come from?

According to the communication, the amount will be used by the Commission to set up a European Fund for Strategic Investments (EFSI), in partnership with the European Investment Bank (EIB). Of the €21 billion, €5 billion will be committed by the EIB and the remaining €16 billion will come in the form of a guarantee created under the EU budget, backed up to 50% by EU funds from the existing margins of the EU budget (€2 billion), the Connecting Europe Facility (€3.3 billion) and the Horizon 2020 programme (€2.7 billion).

From €21 billion to €315 billion – the multiplier effect

The term 'multiplier effect' is used by the Commission to describe how a low initial amount of EU money can generate a much bigger financial volume of projects. As can be seen in figure 1, the Commission estimates that the multiplier effect will occur in two phases and eventually reach a ratio of 1:15.

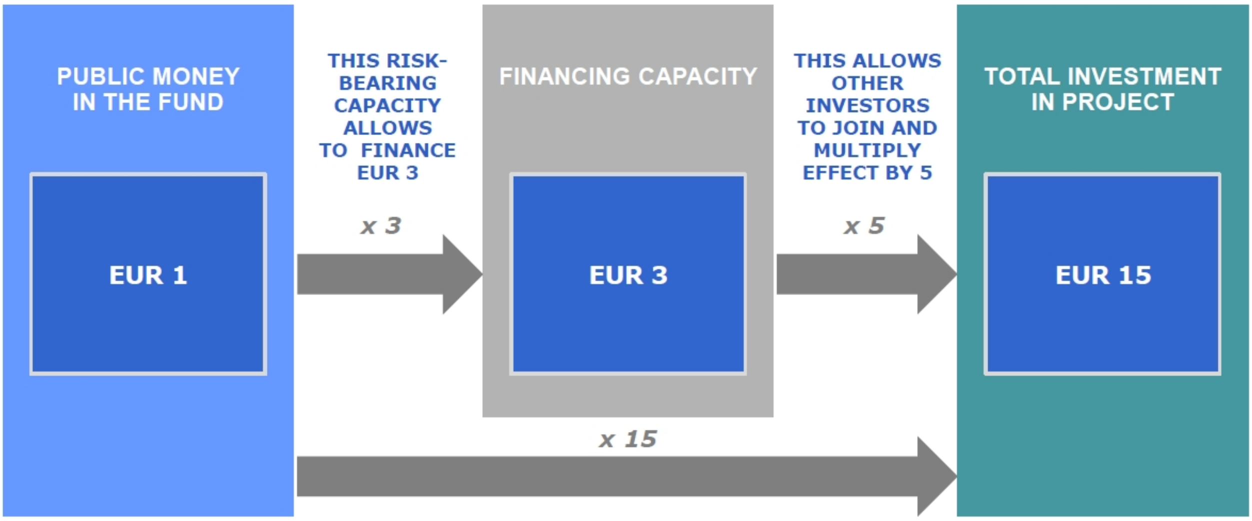

Figure 1: The multiplier effect, as presented in the Commission document 'The investment plan in graphs'.

EPRS | European Parliamentary Research Service
Author: Angelos Delivorias, **Members' Research Service**
PE 545.698

Some information on project financing

Private investors help the EIB to mobilise investment in two ways: by buying debt (see below – phase 1) and by joining its projects (see below – phase 2). The funding provided by private investors – senior debt – forms the largest source of funding for a project. The rest of the financing is provided by the project sponsors in the form of equity or junior (or 'subordinated') debt.

Senior and junior debt have different returns and risks. For example, in the event a project leads to losses, these are (normally) absorbed first by the junior debt holders and only then by the senior debt holders. As a consequence, the greater the protection offered to private investors (the more losses are 'absorbed' before they are asked to contribute) the more likely they are to invest in a project. The Investment Plan for Europe follows this logic.

The '€1 becomes €3' stage – EFSI investment as protection for the EIB
The initial investment of the EFSI will provide partial risk protection (a 'first loss guarantee') to the EIB and the European Investment Fund (EIF), which should enable them to finance three times this amount (€63 billion), by issuing bonds. The EIB would then use cash from these bonds to co-finance projects worth €315 billion, by investing in the projects' riskier subordinated debt. The separate structure of the EFSI will allow the EIB and the EIF to invest in the projects' – riskier – subordinated debt, while still protecting their AAA credit rating from the increased risk.

The '€3 becomes €15' stage – EIB/EIF investment attracts private investors
Indeed, according to the EIB and the European Commission, 'experience indicates that €1 of subordinated debt catalyses (...) on top of that €4 in senior debt'. In other words, the EIB investment of €63 billion in subordinated debt should help to improve investor confidence and encourage private investors to invest four times that amount (or €252 billion) in senior debt in the projects (to reach, in total, €315 billion). The Commission notes that this multiplier is a prudent estimate, based on historical experience from EU programmes and the EIB. It provides as reference the 2013 capital increase of the EIB, which had an estimated effect of 1:18.

Reactions

The plan was presented to the European Parliament on 26 November by Commission President Jean-Claude Juncker, Vice-President Jyrki Katainen and EIB President Werner Hoyer. It obtained the support of MEPs from across much of the chamber, in particular from the EPP, S&D, ALDE and the Greens/EFA political groups. On the other hand, the GUE/NGL and EFDD expressed their lack of belief in the feasibility of the plan, while the ECR called for additional information to enable them to adopt a final position.

Nonetheless, the plan has also drawn its fair share of criticism: researchers from the Brueghel think-tank, wonder whether a 6.7% (i.e. 1/15) first loss guarantee on a project will be enough of an incentive to attract fresh investors, whether the right projects will be selected, and whether those projects would not have been undertaken anyway without the EU guarantee.

A paper from Société Générale bank reckons that the expected leverage ratio of 1:15 is too high, given that the multiplier effect in a similar initiative (the Project Bonds Initiative) was only 1:5 to 1:7. Leading industry stakeholders expressed their concerns about the Investment Plan in a conference in Paris, reproaching the European Commission for its focus on investment levels, when what is needed instead is a clear vision of the industry areas in which investment should be concentrated.

The European Trade Union Confederation fears that the size of the investment plan is insufficient to meet investment needs in the EU. For its part, the League of European Research Universities regretted that 'money from Horizon 2020, the EU's successful research and innovation programme, will be diverted (...) for a vague and highly uncertain project'.