The New European Investment Plan

A Critical Analysis of Financial Instruments and Large Infrastructure Financing

Counter Balance
Challenging Public Investment Banks

Credits

Authors Georgi Medarov, Jana Tsoneva
Editors Desislava Stoyanova, Xavier Sol
Copy editor Irina Samokovska
Graphic design Georgi Sharov

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In November 2014 the European Commission announced a new Investment Plan that is to “unlock” investment in the “real economy” of over 300 billion euro from 2015 to 2017. Despite the fact that the plan was promoted as a paradigm shift and as a plan that is needed to lead Europe out of the current crisis, there are some serious concerns regarding this particular proposal.

This report explores these concerns by focusing on a few elements that may undermine the promises of unlocking huge investment in the real economy. Among the questions that need to be answered are:

Is the plan providing provide enough fresh money?

Will it be used to further the development of unsustainable infrastructural projects (such as in natural gas infrastructure)? Is the project selection going to be transparent and open to public scrutiny?

What about the danger of socializing high risks of private investments while privatizing profits?

Lastly, do the financial mechanisms that are to be deployed, such as Project Bonds, imply a risk of imposing financial markets as a mediator between public investment and the real economy, thereby rendering investment highly insecure?

I. Why the "Investment Offensive" Does Not Signal a "Paradigm Shift" in Public Investment Policy

The EU is still struggling with low growth rates and high unemployment. Investments are direly needed to escape from the crisis but high deficits have pushed governments to opt for deepening austerity. Currently, both public and private investment levels are lower compared to the levels before the recession, especially in the European periphery. The three-year European Investment Plan, proposed in November 2014 by the EC President Jean-Claude Juncker, is the major instrument that is supposed to break the current deadlock. The plan was an important part of Juncker's campaign for the EC presidency. In the 2014 European Parliament elections Jean-Claude Juncker was the candidate proposed by the center-right European People's Party (EPP). In fact the 2014 EP elections were the first in which European political parties proposed candidates for the Presidency of the EC. The gist of the campaign of the center-left was to attack fiscal discipline. The Investment Plan, proposed by Juncker, enabled him to draw support from the social democrats, who saw Juncker as "a man of compromise".[1] Juncker's Investment Plan is also a response to the ongoing criticism towards the conservative investment strategy of the European Invest-

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1 http://www.euractiv.com/sections/eu-elections-2014/centre-left-backs-juncker-man-compromise-303072

ment Bank (EIB). The EIB was often seen as “too protective” due to its failure to use its 2012 capital increase effectively. The aversion to risk and the attempts to protect high credit ratings were seen as a major factor influencing the inability of the EIB to stimulate investment.[2] The plan envisions enabling the EIB to support riskier projects without compromising the bank’s AAA credit rating, at least according to the EIB Vice-President Jonathan Taylor.

The new European Investment Plan provides for the establishment of a new European Fund for Strategic Investment (EFSI), jointly created by the European Investment Bank (EIB) and the Commission. The EFSI will function as a public guarantee by hedging the risk of mostly private investments. Other measures include various forms of assistance and deregulations that are to stimulate investors.

Overoptimistic expectations and lack of fresh money

The Commission expects a “conservative” multiplier effect of 1:15. This means that for each euro the EFSI spends on guarantees, 15 euros need to be mobilized as private investment in the real economy.[3] 16 billion euro will be provided by the EU

2 http://www.euractiv.com/sections/euro-finance/eib-will-administer-juncker-investment-plan-through-new-fund-310191

3 http://ec.europa.eu/priorities/jobs-growth-investment/plan/docs/fact-

budget and the EIB will commit 5 billion euro. The idea is that the EFSI will serve as credit protection for investments. Even though private investors will be able to join the fund, it will be financed mostly with public money. Member States will be able to join in and contribute further to the Fund, to which the Commission "will take favorable position".[4] In order to achieve such a high multiplier effect and reach the promised 315 billion euro, "innovative" financial instruments are to be applied and investment is to be directed towards projects entailing higher risk which therefore have the necessary potential for high monetary returns. Considerations on the projects' social and environmental use-values may be ignored, and, at same time, risk can be socialized and profits privatized (see more in III. Innovative Financial Instruments).

The projected multiplier effect was called "overly optimistic" by some financial experts,[5] but even if the 315 billion were reached, that would hardly be sufficient to fill in the investment gap. In an article for the Guardian, Mariana Mazzucato, an economics professor at the University of Sussex, reminds that after the crisis, the US "government invested 4% of GDP ($787bn in the American Recovery and Reinvestment Act of 2009, which also directed investments to green areas via agencies like ARPA-E)" and "even if Juncker manages to raise €315bn that

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sheet2-where-from_en.pdf, pp. 2–3

4 http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=COM:2014:903:FIN

5 https://www.societegenerale.com/en/content/look-headlines-0

is still not enough."[6] According to The European Trade Union Confederation (ETUC) secretary-general Bernadette Ségol, "[r] aising €315 bn would be quite a feat, but would fill less than 40% of the annual investment shortfall since the crisis".[7]

A more serious pitfall of the plan is that it does not provide enough fresh money. For example, out of the budget-provided 16 billion, only 8 will actually be fresh funds used to guarantee the other 8. Furthermore, the EC was accused of relying on "fake money"[8], that is, recycling funds from already existing programs. For instance, the EC tried[9] to take away 2,7 billion euro from the EU's scientific research and innovation program Horizon 2020. This enraged the scientific community and the League of European Research Universities (LERU) protested stating that "Horizon 2020 is not a lemon! Stop squeezing it!".[10] The EP opposed the attempts to transfer funds from Horizon 2020 towards the EFSI, but it still remains unclear whether the resources of other programs will be used.

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6 http://www.theguardian.com/science/political-science/2014/nov/27/junckers-investment-plan-how-to-radically-transform-it

7 http://www.etui.org/News/President-Juncker-s-European-Investment-Plan-has-Christmas-really-come-early

8 http://www.euractiv.com/sections/euro-finance/french-wary-fake-money-eus-eu300bn-investment-plan-308739

9 http://news.sciencemag.org/europe/2014/11/e-u-commission-wants-divert-horizon-2020-money-new-investment-fund

10 http://www.leru.org/index.php/public/news/horizon-2020-is-not-a-lemon-stop-squeezing-it

The Plan documentation states clearly that the public 21 billion euro in the EFSI will only serve to kick-start private investment in riskier spheres, contrary to popular expectations that the Juncker Commission will break with the orthodoxy mandating less state intervention in the real economy. Additionally, the importance of finance as a mediator between the real economy and public investment will increase. Financial markets will be more closely integrated with the real economy via the marginalization of grant financing schemes for industrial development. Furthermore, there will be an introduction of securitization and non-banking intermediation between the EFSI and the end recipients of investment aid for the "real economy". (see more in III. Innovative Financial Instruments).

Paradigm shift, but in what direction?

The "investment offensive" does not break with the logic of austerity. The EFSI's role is "to ensure enhanced risk-bearing capacity and mobilize extra investment, essentially from private sources, but also from public sources, in specific sectors and areas."[11] The aim is to spur investment in industries but without "burdening" state budgets; that is to say, public investment within the framework of austerity. The plan hopes to use public resources in order to unlock and mobilize private capital without running public deficits. For example, as the Commis-

11 http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=COM:2014:903:FIN

sion puts it, one of the aims of the plan is to "reverse downward investment trends and help boost job creation and economic recovery, without weighing on national public finances or creating new debt."[12]

There is a novelty, however, and it relates to what will count as public deficit. Responding to concerns raised by the group of Socialists and Democrats in the European Parliament that the Plan might negatively impact budget deficits, Juncker stated that contributions to the EFSI by individual member states will be deducted from the public deficit and debt under the Stability and Growth Pact.[13]

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12 http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=COM:2014:903:FIN

13 http://www.euractiv.com/sections/eu-priorities-2020/juncker-christmas-has-come-early-here-my-big-plan-310355

Stability and growth pact

The SGP is an agreement between the EU-28 for fiscal and monetary stability in the European Economic and Monetary Union (EMU). The SGP mandates strict limits to budget deficits (3%) and public debt to GDP (60%). It functions as a straitjacket on public spending, along with the euro, in order to prevent inflation, while disabling currency devaluation. Because of the double straitjacket on currency value and state spending, the only adjustment available to states within the SGP is the so-called internal devaluation: suppression of wages and prices.

Later on, the EC confirmed that if the 3% deficit threshold is not respected due to Member State contributions to the EFSI, the Commission will not start an Excessive Deficit Procedure (under the SGP), "provided the deviation is small and expected to be temporary". **The Commission also asserted that when "assessing respect of the debt criterion, contributions to the EFSI will not be taken into account".[14] The upshot is that state provision for public needs still incurs deficits, while Member State contributions to the EFSI and political guarantees against private losses do not.**

14 http://ec.europa.eu/priorities/jobs-growth-investment/plan/docs/efsi_qa_en.pdf

What sustainability for the plan? The risks of financing business–as–usual

The new Investment Plan raises strong concerns about the lack of transparency and democratic deliberation, along with the fact that there are no sufficiently clear measures guaranteeing the environmental and social sustainability of the projects that will be supported.

According to the initial proposal of the European Commission, the "EIB will report (i) semi-annually to the Commission and (ii) annually to the European Parliament". The EFSI, according to the Commission, has to enjoy independence from its public and private contributors, much like a central bank. To this end, its Investment committee will be staffed by "independent professionals" with a "high level of relevant market expertise".[15] This means that the Fund will be governed by market actors amid insufficient guarantees of public transparency, let alone democratic participation in decision making. A Steering Board, to which the Investment committee will be accountable, shall be appointed by the EIB and the EC, in order to formulate the overall orientation, the investment guidelines and the other criteria for project selection.[16]

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15 http://ec.europa.eu/priorities/jobs-growth-investment/plan/docs/efsi_qa_en.pdf, p. 9

16 http://ec.europa.eu/priorities/jobs-growth-investment/plan/docs/efsi_qa_en.pdf, p.13

The allocation of EFSI funds is not determined in advance, according to a peculiar planned use-value the investment projects might have, or according to geographical or sectoral quotas. The selection will be based on the projects' potential return on investment rates. It is claimed that projects need to be "economically viable", to have (undefined) "European added value", and to be in "key growth-enhancing areas", with an emphasis on "projects with a higher risk-return profile than existing EIB and Union instruments".[17] EFSI-supported projects are also supposed to be "consistent with EU priorities" (2030 Climate and energy package, the 2020 Strategy, etc.).[18] Nevertheless, there are no sufficiently concrete democratic mechanisms to ensure the promotion of climate-friendly and sustainable projects by the EFSI. A so-called scoreboard of indicators will be adopted by the end of the summer 2015 in order to prioritize the use of the EU guarantee for operations that display higher scores and added value. The EIB shall calculate the scores and indicators ex-ante and monitor the results at project completion. The Investment Committee shall then receive the scores obtained under the relevant pillars and the value of each indicator. But so far the proposed scoreboard falls short of going beyond the current evaluation system of the European Investment Bank and ensuring higher additionally for the operations of the EFSI.

17 http://europa.eu/rapid/press-release_MEMO-15-3223_en.htm

18 http://ec.europa.eu/priorities/jobs-growth-investment/plan/docs/efsi_qa_en.pdf

A worrying pre–selected list of projects

A Task Force, appointed by both the EC and the EIB, identified over 2000 "investible" projects with "European value-added".[19] The projects identified by the Task Force are solely "a first step towards creating a critical mass of projects for the EFSI.", However, it is by no means definitive, but rather a mapping out of potential projects across Europe that may serve as a stepping stone for the achievement of the comprehensive "Jobs, Growth and Investment package" promoted by the new EC President.[20] These projects are worth over 1.3 trillion euro. The list is based on input prepared independently by the individual Member States. The compilation process has not included wider civil society participation and has failed to ensure democratic participation.

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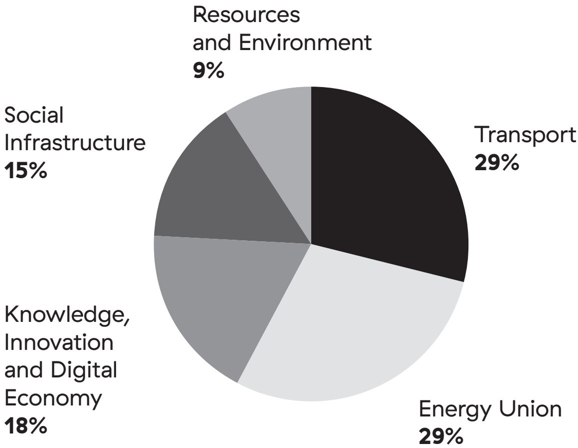
19 http://www.eib.org/infocentre/press/releases/all/2014/2014-277-investment-offensive-for-europe-eu-task-force-identifies-2-000-potential-projects-worth-eur1-3-trillion.htm

20 http://ec.europa.eu/priorities/jobs-growth-investment/plan/docs/special-task-force-report-on-investment-in-the-eu_en.pdf

Distribution of selected projects [21]



The projects proposed by the individual Member States are often rightly seen as a wish list of already existing projects that failed to attract funding before. There is no sign of coordination efforts to match the different proposals and the list is very poorly designed. There is no standard for the kind of projects to be proposed and the individual proposals are often incommensurable. For example, Bulgaria proposed only 18 projects and Croatia proposed 77. There are certain project proposals that stand very far from any reasonable understanding of

21 http://ec.europa.eu/priorities/jobs-growth-investment/plan/docs/special-task-force-report-on-investment-in-the-eu_en.pdf,p. 11

“providing rewarding jobs and a high standard of living”. For instance, Romania included a proposal by the Institute for the Investigation of the Communist Crimes and Memory of the Romanian Exile for a project entitled “Prison of silence”. It is a 6 million-euro project for the restoration of a former Communist prison as a place of “reflection on the criminal nature of Communism”.[22] Perhaps the unconcern of Member States vis-à-vis the list could be attributed to the fact that it will be entirely up to the EFSI to decide which projects are accepted. This means that national democratic institutions will be practically excluded from the decision making process.

All this is not to argue against the need for proper economic recovery planning. But the current ad hoc proposals leave it entirely up to the EFSI to decide. At the same time, the EFSI does not have the necessary empirical knowledge to implement a well-grounded comprehensive and truly long-term plan. In other words, **democratic participation, transparency and in-depth research are not merely formal requirements, but should be at the core of any *efficient* economic planning that is to achieve environmentally and socially sustainable results. Unfortunately, all those are lacking at the current stage of the new EU Investment Plan.**

Moreover, it is yet to be clarified what going beyond risk aversion actually means. Riskier projects could be both using risk sharing mechanisms to boost the old energy model (e.g. natural gas infrastructure) and looking for high-risk high-re-

22 Ibid.

turn projects. On the other hand, it might mean going for projects with high environmental and social use-value in the European periphery that would generate lower monetary gains. Currently, it seems, unfortunately, that the former is more likely to be the case.

Concerns regarding the lack of mechanisms to ensure a transparent selection process and the sustainability of the projects provoked MEPs in April 2015 to push the Commission to adopt key amendments that would secure larger EP participation and provide some instruments for monitoring the selection.[23]

Unsustainable infrastructure and the price of internationalization of energy markets

Despite the lack of transparency and the lack of information about the type of projects that will be supported, the list of identified initiatives betrays a strong bias towards environmentally unsustainable projects. It includes nuclear and coal power plants, along with waste incinerators and mining projects. A significant number of the projects on the list are large infrastructure projects. For example, out of 77 projects proposed by the Croatian government, there are 2 for coal power plants, 10

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23 http://www.counter-balance.org/parliament-presses-for-more-scrutiny-of-eu-investment-plan-but-guts-green-prospects

for motorways, 3 for airports and 5 for gas projects (pipelines, terminals, networks). Gas projects form a significant part of other countries' proposals, too. For instance, Greece proposed 10 natural gas projects and 2 interconnectors out of 55 energy projects. In fact, it seems that extending natural gas infrastructure will be a central part of the plan.

Natural gas is becoming a highly politicized issue with the escalation of the armed conflict in Ukraine. Avoiding dependence on Russian gas imports is a top political priority for the EU. Nevertheless, the EU's strategy mostly boils down to extending the gas infrastructure by building more pipelines and Liquefied Natural Gas terminals. However, creating a more integrated and better connected global gas market, as research shows[24], will lead to price increases and will not solve Europe's gas dependence. Energy prices are a peculiarly difficult issue in Southeast Europe where there are high levels of energy poverty, which leads to high political instability. For example, in Bulgaria in February 2013 mass protests against energy price hikes toppled the government. Additionally, dependence on gas imports may also mean dependence on environmentally unsustainable shale gas imports from the US and/or from other regions with high levels of human rights abuses. It is more sensible and efficient

[24] http://www.counter-balance.org/no-more-gas/#the-price-of-gas-8211-3-times-as-expensive cf. Polder, P. Gilbertson, T., Tricarico, A. (2014) Natural Gas Lock-In. Current Politics in the European Union. http://rosalux-europa.info/publications/books/natural-gas-lock-in

not to focus on useless infrastructure, but on truly sustainable solutions such as energy consumption reduction and investment in smaller-scale renewable energy sources.

The following boxes present three illustrations of what civil society organizations (CSOs) throughout Europe have identified[25] as highly unsustainable projects in the Task Force list. Listed proposals include nuclear and coal power plants, river dams, motorways, waste incinerators and mining projects.

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25 http://bankwatch.org/news-media/blog/juncker-investment-offensive-against-europeans-economy-and-environment

Slatinka water plant (Slovakia)

It is a 114 million-euro project for the construction of a dam on the Slatina river in central Slovakia. The water in the planned 27 million m3 reservoir is to be used by a nuclear power plant. CSOs from Slovakia have insisted that the project will destroy the homeland of local communities, and it will compromise biodiversity in the preserved wetlands and forests in the Slatina valley which are the habitat of endangered species. In 2013 the EC claimed the project contradicts Slovakia's own biodiversity policies. DG Environment in particular asserted that "unique natural habitats will be destroyed which are also subject to the Habitats Directive", stressing that this goes against EC-supported biodiversity polices. CSOs had also emphasized the poor planning of the dam project. For instance, losses from the damage to the biodiversity and the destruction of the property of local citizens had never been included in the calculations.

Lipno–Aschach hydro power plant
(Czech Republic/Austria)

Lipno–Aschach is a 1000 MW pumped–storage hydro power plant project that is to connect the Vltava River with the Danube via a 27 km long and 10.5 m wide tunnel that would go from Lipno (Czech Republic) to Aschach (Austria). Lipno — Aschach s.r.o. (the private company that was established for the project) has a capital of merely 30 500 euro. They have cited the lack of "political support" as a barrier to its implementation. The project itself is expected to cost between 1.5 and 2 billion euro. CEE Bankwatch has argued that such a sum would have sufficed to equip "270 000 or 16% of all homes in the Czech Republic...with photovoltaic generators (including phase shifters and consumption regulators) – providing about half of their annual electricity consumption."

Nuclear Power Plant
(Poland)

The construction of the first nuclear power plant in Poland is also on the list of identified projects. The estimated cost of the plant is 12 billion euro (600 million planned for 2015–2017). The project underestimates environmental and safety risks. One of the two sites for the construction, for example, is currently protected by the Habitat and Bird Directives. The Polish government has not developed a concrete strategy on nuclear waste management. Actual costs have been severely underestimated. For instance, a similar capacity project (the 3200 MW UK Hinkley Point C) is expected to cost 24.5 billion pounds — over twice as much. Construction is scheduled to start in 2019 and the first reactor is to become operational in 2024. However, compared with similar projects, 5 years appears an unrealistic estimate and the highly plausible delays hardly entail "a 'kick-start' for Europe's economy", as Greenpeace nuclear energy expert Jan Haverkamp points out. According to Haverkamp, it would make more sense to invest in "realistic alternatives that are economically, socially and environmentally more beneficial."

The focus on large infrastructure projects and unsustainable energy schemes discernible in the list actually expresses a wider bias in the selection criteria for all public infrastructure investment. A similar trend can also be observed in the Projects of Common Interest (PCIs), which include over 100 projects for natural gas transmission, storage and Liquefied Natural Gas terminals.[26]

The EC has drawn up a list of 248 projects labeled as PCIs. They are supposed to facilitate the integration of the EU energy market. The selected projects "may benefit from accelerated licensing procedures, improved regulatory conditions, and access to financial support totaling €5.85 billion from the Connecting Europe Facility (CEF) between 2014 and 2020". The list is to be updated once every two years (the next update is scheduled for the end of 2015). Most projects involve gas and electricity transport infrastructure, but also gas storage projects and Liquefied Natural Gas terminals.[27] A Bankwatch policy briefing details the poorly designed PCIs related to environmental legislation and the lack of effective environmental assessment procedures for the planned projects.[28]

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26 http://www.counter-balance.org/what-perspectives-for-the-project-bonds-initiative

27 https://ec.europa.eu/energy/en/topics/infrastructure/projects-common-interest

28 http://bankwatch.org/publications/streamlining-environmental-assessment-procedures-projects-common-interest-pcis

There are about twenty projects that have been conclusively confirmed under the EFSI. The first tranche of the Investment Plan was approved on the 22nd of April 2015. The four projects that were approved include "investment in healthcare research in Spain, expansion of a key airport in Croatia, the construction of 14 new healthcare centers across Ireland and backing for industrial innovation in Italy."[29] The EIB claimed that the projects will be supported even in the case of an inapplicable EU guarantee. Xavier Sol of Counter Balance attacks the "additionality" pledge of the Juncker plan[30], stressing that it was meant "to finance only risky projects that add genuine value to Europe". Sol claims that if "EFSI projects would anyway be financed by the EIB, then it means that the fund may further deprive the EU budget of scarce public money so that the EIB can continue business as usual". Markus Trilling[31] of Bankwatch explains that the Italian project can hardly be seen as "innovative" as it is in fact an old "industrial revolution-era factory that was to be closed in the 1950s". "Similarly", Trilling continues, "the Dubrovnik airport project, a relic of a more recent past, will recycle unused funds from the 2007–2013 EU budget". According to Trilling, this "is a very underwhelming start for the fund that is to kick-start Europe's future."

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29 http://www.eib.org/infocentre/press/releases/all/2015/2015-086-eib-group-proposes-first-operations-for-efsi-guarantee-and-rolls-out-the-investment-plan-for-europe.htm

30 http://www.counter-balance.org/europes-back-is-to-the-future

31 http://www.counter-balance.org/europes-back-is-to-the-future

As stated above, there is still no definitive list of all of the projects that will enjoy EFSI support. The EC or the EIB do not have any financing commitments and they do not provide any preferences towards the 2000 projects identified by the Task Force. This list is rather to be used as an example of "typical" projects that "could potentially benefit from financing"[32], but the bias towards the old model of unsustainable huge infrastructural projects is already visible. For example, the only project Bulgaria is likely to get approved is a planned gas interconnector between Bulgaria and Greece (ICGB)[33], which means that more sustainable proposals on the list such as water and rail infrastructure renovation will not be given the green light.

32 http://ec.europa.eu/priorities/jobs-growth-investment/plan/docs/factsheet3-what-in_en.pdf

33 http://www.publics.bg/en/news/12269/Bulgaria_Might_Get_Financing_from_the_Juncker_Plan_Only_for_Gas_Interconnector_with_Greece.html

II. Innovative Financial Instruments: Towards Greater Financialization of the European Economy

As already explained, the plan does not break with austerity (see I. Why the "Investment Offensive" does not signal a "paradigm shift" in public investment policy). Neither does it break with financialization. If anything, it deepens it. According to the Commission, "increased use of financial instruments in the form of loans, equity and guarantees, instead of traditional grants" is to be expected.[34] In other words, if a big break with orthodoxy is underway, it seems to consist in effecting a more definitive movement away from grant financing with the help of financial institutions. This in turn would mean financialization of end recipients of investment (such as SMEs[35]) and burdening them with debts to be repaid as opposed to grants. To this end, the Plan "will assume substantial risk support to encourage promoters to initiate investments and private financiers to join."[36]

34 http://ec.europa.eu/priorities/jobs-growth-investment/plan/docs/factsheet2-where-from_en.pdf, p. 3

35 The idea of SMEs as "the backbone of Europe's economy" animates the justification for the "investment offensive". Despite the strong focus on huge infrastructure projects, as already shown, the Commission argues that SMEs "across Europe should be able to benefit from the first funds from the new European Fund for Strategic Investments (EFSI) before the summer." http://europa.eu/rapid/press-release_IP-15-4441_en.htm

36 http://ec.europa.eu/priorities/jobs-growth-investment/plan/docs/factsheet3-what-in_en.pdf, p. 2

Financialization

The concept of financialization became widespread after the 2008 economic meltdown. It usually means the imposition of short-term and volatile financial markets' interests over the real economy. It may simultaneously mean commodification of common goods. Financialization of nature, for example, usually refers to turning environmental commons into a commodity. A telling example is carbon trading – reducing air pollution to a monetary general equivalent to be speculated with. Currently there are attempts, such as the EU's "No Net Loss Initiative", to introduce similar mechanisms for trading in biodiversity. The idea is that if an investor causes environmental damage in one place, they would be allowed to "compensate" for this damage legally via "offsets". This means reducing incommensurable qualities (say different plant and animal species) to purely fiscal and universally convertible quantities. Nature, however, cannot be easily treated as an "ecosystem service" because, as Friends of the Earth Europe explain,[37] "each part of biodiversity is part of our world heritage, is unique and has an inherent value, which cannot be measured or transformed into economic values in accurate and reliable ways". Financialization generally subjects all concrete social and environmental use-values to maximizing financial gains in the short run, but to instability in the long run.

37 https://www.foeeurope.org/nature-not-for-sale

Socializing risks, privatizing profits, and having your AAA–cake while eating it

The EC hopes to achieve the high multiplier effect by stimulating high-risk investment. Public money is to be used to lower risks for private investments and thus create the necessary favorable business climate by transferring risk from the investor to the EFSI. In other words, the new European Investment Plan introduces a new notion of risk. In the past, risk used to be tightly indexed to categories such as "entrepreneurship" and "investment" but today the Commission is uncoupling these previously inseparable notions and tying risk solely to public money (as opposed to "entrepreneurial daring", as before). Thus, the EFSI will invest in high-risk tranches such as equity and subordinated debt, leaving the safer "senior debt" to private investors. **In the past, entrepreneurship, risk and volatility were depicted in positive light (i.e. as stimulating innovation). Today, the Commission speaks openly against them and disperses risk by socializing it. The expectation is that if risk is transferred to the public, it will be easier to attract private investment. However, this takes away the risk only for the investor and not for the public.** Furthermore, the concrete financial instruments, such as Project Bonds, that are to be deployed, have already proved to be highly problematic in not only socializing risks, but also contributing to the financialization of public-private partnerships and large-scale public infrastructure investments. The rationale behind the development of "innovative" financial instruments should be seen in the light of the EC's Long Term Financing strategy[38] to stimulate banking and non-banking (insurance companies, pension funds, etc.) financial actors to invest in long-term, productive and responsible projects, fostering sustainable and inclusive growth. Nevertheless, solving financialization-related problems, which result from the short-term orientation of investment, by furthering the same model of financialization, seems seriously problematic.

The primary goal of the EFSI guarantee is not to fund projects directly, but, as already mentioned, to function as an instrument to absorb "the riskier tranche of the investment so as to maximise the contribution from private sources of financing by taking risk out of the equation", or what the EC calls "first loss protection".[39] To this end, the EFSI will adopt "innovative" financial instruments, thus guaranteeing more favorable conditions for the private sector (as the Plan aims mostly to mobilize private capital so as not to incur budget deficits, as mandated by the Stability and Growth Pact) for higher-risk investments. These processes of risk absorption will be mediated by financial markets. It is believed that this will restore confidence in investors and will unlock idle private capital: "Since the EFSI will take riskier tranches in investment projects, the private sector will be able to join under more favourable con-

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[38] http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX-:52014DC0168&from=EN

[39] http://ec.europa.eu/priorities/jobs-growth-investment/plan/docs/efsi_qa_en.pdf, p. 12

ditions."[40] This does not mean that individual projects will have the EU's backing but that EIB operations will be supported and then the EIB will finance projects directly. As the Commission puts it, "[t]he role of the guarantee is to provide the EIB with additional risk-bearing capacity so that it can invest in projects with a higher risk profile without losing its triple-A rating."[41]

As the Commission states, "the main idea is to provide greater risk-bearing capacity through public money in order to encourage project promoters and attract private finance to viable investment projects which would not have happened otherwise. This will make the best use of EU public resources." Also,

[f]rom a financial point of view, this multiplier effect is obtained by the combined effect of the EIB issuing additional bonds on the markets in order to finance projects with a higher level of risk, together with the blending of the existing and diversified EIB portfolio. The existence of a €21 billion risk-bearing capacity means that there is a capacity of public funding to absorb significant losses.[42]

For private investors wishing to invest in a certain project, this means that they are reassured that they have a safety net against potential losses ("a first loss-protection")."[43] Simply put,

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[40] http://ec.europa.eu/priorities/jobs-growth-investment/plan/docs/efsi_qa_en.pdf, p. 9-10

[41] Ibid. p. 10

[42] http://europa.eu/rapid/press-release_MEMO-15-3223_en.htm

[43] http://ec.europa.eu/priorities/jobs-growth-investment/plan/docs/efsi_qa_en.pdf

the EFSI envisions public money as a stand-in for socialization of risk and losses. Furthermore, "[t]ypically, the European Fund for Strategic Investments will provide greater risk coverage of the different projects, thus considerably facilitating private investment in safer tranches of the projects."[44] This basically means that EFSI will invest in the more risky, or subordinated debt, so as to leave the more protected, or "senior debt", to private investors.[45]

Investment in the real economy or more financialization?

One of the stated goals of the Plan is investment in the real economy and job creation. But to that end, the securitization[46] of SME loans will be relied on, according to the Commission. The EFSI will be dependent on the European Investment Fund (EIF) for that.[47]

44 http://ec.europa.eu/priorities/jobs-growth-investment/plan/docs/an-investment-plan-for-europe_com_2014_903_en.pdf, p. 9

45 http://ec.europa.eu/priorities/jobs-growth-investment/plan/docs/investment-plan-qa_en.pdf, p. 9

46 Securitization involves the creation and bundling of bonds out of illiquid assets. For example, in housing finance, the pooling of many housing loans together creates a mortgage-backed security which is then sold to investors.

47 The EIF is an EU agency that provides venture capital for SMEs and guarantees for banks issuing loans to SMEs. It does not provide loans and

Investment in the real economy will be thus strongly mediated by the financial and capital markets. Similarly, with regard to SME financing, for each euro of public contribution by the EFSI, the expected multiplier effect in terms of loans, securitization, venture capital and growth finance will be 3, which should in turn attract other investors "on project basis" to debt-finance SMEs, multiplying the effect by 5. As the Commission states, "[t]he extra leverage is generated by the EIB borrowing against the money, rather than the money going directly to the end-recipient. The €21 billion from the EFSI allows the EIB to borrow around three times as much, and then invest/finance the final recipient, rather than the €21 billion being given directly as grants."[48]

As regards financial instruments, "EFSI can for example use debt instruments, guarantees, equity, quasi-equity instruments, credit enhancement tools or venture capital. It will be able to finance projects directly or participate in funds that finance various projects."[49]

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capital directly but through intermediation of financial institutions and instruments. The EIF's shareholders are the European Investment Bank (EIB) (with 63.7%), the European Union, represented by the European Commission (with 24.3%) and private financial institutions from the EU plus Turkey (12.0%). http://europa.eu/about-eu/institutions-bodies/eif/index_en.htm and http://www.eif.org/who_we_are/shareholder/index.htm

48 http://ec.europa.eu/priorities/jobs-growth-investment/plan/docs/efsi_qa_en.pdf, p. 20

49 http://ec.europa.eu/priorities/jobs-growth-investment/plan/docs/efsi_qa_en.pdf, p. 21

There is also the idea that the EFSI needs to have the ability "to finance not only individual projects but also support private fund structures such as the European Long-Term Investment Funds (ELTIFs) set up by private investors and/or national promotion banks", as this is supposedly going to "create an additional multiplier effect and maximise impact on the ground".[50] In addition, the Commission deems certain regulatory reforms in the financial sector necessary. For example, it plans to have the above-mentioned ELTIFs operational in 2015.[51] ELTIFs are vehicles for non-banking and non-speculative financing of long-term projects, usually targeting companies not listed on stock exchanges (although the Task force report states that listed SMEs will be targeted, too[52]). The Commission also hopes to revive post-crisis securitization markets and introduce private placement regimes (that is to say, private and not public/open listings that are normally monitored by regulatory bodies or accompanied with publicly available and transparent infor-

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50 http://ec.europa.eu/priorities/jobs-growth-investment/plan/docs/an-investment-plan-for-europe_com_2014_903_en.pdf

51 http://ec.europa.eu/priorities/jobs-growth-investment/plan/docs/fact-sheet4-environment_en.pdf, p. 4

52 http://ec.europa.eu/priorities/jobs-growth-investment/plan/docs/special-task-force-report-on-investment-in-the-eu_en.pdf, p. 17

mation campaigns) in the investment process.[53] Among the proposed reforms is the reduction of “administrative burdens” that will allegedly make it easier for SME to list.[54]

In other words, the establishment of the EFSI will significantly contribute to the furthering of the financialization of the real economy. As the EC puts it:

> In the context of the Investment Plan, the ambition is to at least double the use of innovative financial instruments in the European Structural and Investment Funds for the period from 2014 to 2020. The increased use of innovative financial instruments, rather than grants, should create additional financial leverage on every euro mobilised. By doubling the amount of innovative instruments and using the leverage effect thus created, at least 20 billion euro in terms of additional investments in the real economy could be mobilised between 2015 and 2017.[55]

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[53] http://ec.europa.eu/priorities/jobs-growth-investment/plan/docs/factsheet4-environment_en.pdf, p. 3

[54] Ibid.

[55] http://ec.europa.eu/priorities/jobs-growth-investment/plan/docs/investment-plan-qa_en.pdf, p.14

Towards a new wave of public–private partnerships

There is no elaborate list of the concrete instruments to be deployed. The EC asserts that the EFSI will remain flexible for each individual project. It is likely that new credit enhancement and risk sharing mechanisms, such as Project Bonds, will be among these "innovative" instruments.

Project Bonds have been instrumental in the wider shift towards a new generation of PPPs (public-private partnerships) that are financializing large European infrastructure projects. PPPs proved (on a global scale) dramatically incapable of providing social use-values in projects of public interest. As a Corner House study has shown, PPPs are not about providing public services, but "about constructing the subsidies, fiscal incentives, capital markets, regulatory regimes and other support systems necessary to transform 'infrastructure' into an asset class that yields above average returns". In sum, *according to* **Corner House, PPPs are "less about financing development", but rather "about developing finance".**[56] Instead of critically examining their negative aspects, the EFSI seems bent on radicalizing the use of PPPs by financial markets mediation. Project Bonds, and other similar credit enhancement instruments, are solely furthering the financialization of PPPs.

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[56] http://www.thecornerhouse.org.uk/resource/PPPs-extraction-wealth-gap

The failure of project bonds: the Castor Project fiasco

The Europe 2020 Project Bond Initiative (PBI), launched in 2012, has been strongly criticized for exploiting taxpayers money to socialize risks. There are already illustrative examples that Project Bonds may lead to large financial losses for the public. The Spanish underground gas storage plant Castor, a pilot project seeking approval under the PBI, ended in a fiasco.[57] The authorities had to close down the project due to poor planning and poor project management, by both the Spanish government and the EIB. Risk assessments had not considered the seismic activity provoked by injecting gas, regardless of the fact that there had been studies showing that danger. Moreover, there was the lack of consultation with local communities. The Castor bonds had been degraded to “junk” status in 2014 by Fitch Ratings and currently the costs are shifted towards the Spanish government. The Spanish Minister for Industry, Energy and Tourism said the government may compensate the residual value of the project – 1.7 billion euro – in order to restore trust in the bonds. Spanish CSOs tried to show that the EIB was also to blame for the poor assessment and the eventual failure of the project. The EIB, however, is not officially part of the Concession agreement, therefore all responsibility is transferred to the national government. Thus, as Counter-Balance

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[57] http://www.counter-balance.org/what-perspectives-for-the-project-bonds-initiative

has argued[58], "the pilot-project of the PBI looks likely to end in a massive government bail-out by an EU Member State, which in the case of Spain's beleaguered tax-payers, could not come at a worse time". This case, alongside a number of similar ones, led Counter-Balance to argue that "the increasing financialisation of infrastructure pushed by the EIB and EC demonstrates that when markets are involved, the public purse risks forking out for initiatives such as the PBI."

The financialization of infrastructure projects is particularly problematic, because it also subjects their use-value for the public to short-term private economic gains. Approved PBI projects also exhibit a bias towards support of the old fossilized, centralized and unsustainable energy model. As it was shown in the previous section, this reflects a wider bias towards unsustainable infrastructure projects, such as natural gas storage, transmission, etc.

The current trend is likely to "lock Europe into further decades of fossil fuel dependence" and it stands in "contradiction to EC's long term objective to reduce dependence on these fuels as part of its 2050 roadmap"[59]. Moreover, this process is concomitant with a lack of transparency and a deficit of citizen participation in decision-making, since whenever the ratio-

58 http://www.counter-balance.org/what-perspectives-for-the-project-bonds-initiative

59 http://www.counter-balance.org/what-perspectives-for-the-project-bonds-initiative

nality of the projects is presented in terms of return on investment, democratic considerations are substituted by market efficiency and the profits-first rationale.

Therefore, Project Bonds and similar "innovative" financial instruments are not a cheap way to kick-start private investment. Neither do they provide any guarantee for climate-friendly economic development. Instead of continuing to use flawed instruments after the establishment of the EFSI, these instruments should be put on hold for further assessment, ensuring that social, environmental and democratic considerations have been taken into account in the future. This is particularly pressing in ordrer to prevent Project Bonds from spilling over into other sectors such as health and education, as the EC has indicated it will do.

III. Conclusions

The EC documentation on the new Investment Plan asserts structural reforms are needed "to resolve barriers to investment in transport infrastructure and systems". This may entail support for the old energy model, that is, reliance on huge environmentally unsustainable fossil energy production and distribution projects (such as those based on natural gas). According to the EC, "some Member States" have resorted to "distorting retail price regulation" on energy markets. This will further limit the possibilities of democratic deliberation over energy price formation. Furthermore, it is difficult not to read Juncker's statement that "we need smarter investment, more focus, less regulation and more flexibility when it comes to the use of public funds" as yet another call for deregulation.[60] In other words, the direction the European Investment Plan is taking makes it difficult to envision solutions that will put democracy, people's needs and nature at the center of economic planning.

Amid mounting fears that the Juncker Plan will kick-start investment in ways that will facilitate capital accumulation and finance large-scale environmentally unsustainable infrastructure projects, it is a ripe moment to revise the rationale behind Europe's attempt to extricate itself from the crisis. It is crucial to assess the EFSI's pitfalls in due time before it is converted

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60 http://ec.europa.eu/priorities/jobs-growth-investment/plan/docs/an-investment-plan-for-europe_com_2014_903_en.pdf, p. 15

into a permanent fund and before the logic of the financialized development of unsustainable infrastructure is irrevocably entrenched within an austerity framework.

It is crucial for CSOs to monitor the projects the EFSI will select and, if needed, to campaign against unsustainable large-scale infrastructure projects with a detrimental social and environmental impact. Furthermore, it is of utmost importance to expose the dangers of the financialization of public investment in general and particularly in infrastructure. Democratization is a key area that needs the intervention of CSOs in order to ensure transparency, environmental sustainability and wider stakeholder involvement in spheres that are important to local residents. **What is of utmost urgency, along with monitoring and campaigning on concrete projects, is to strengthen the public debate[61] on what would be a really efficient public investment policy.** CSOs have to push for a model that puts long-term environmental, social, human rights, democratic and tax considerations at the heart of public investment policies, rather than short-term return on investments. Public finance has to be used to definancialize the economy, not the opposite.

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61 See the joint paper written by Counter Balance and Re: Commons on an elaborated proposition of a potential social, environmental, sustainable and equitable public investment policy. http://www.counter-balance.org/reclaiming-public-banks-2