The European Fund for Strategic Investment: A Missed Opportunity for the Clean Energy Sector

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Abstract

The European Commission and European Investment Bank have launched the European Fund for Strategic Investment (EFSI) to help recover the European Union economy. EFSI aims to bridge the investment gap and drive private capitals towards key productive sectors, such as energy efficiency and renewables. These fields are supposed to benefit the most from the Fund, given their investment needs and capacity to spur sustainable economic growth. However, limited public contributions, reshuffled capitals, and scarce capacity to improve the policy and regulatory framework characterize EFSI structure. Therefore, experts have cast doubt on the effectiveness of the Fund and its impact on the clean energy sector.

Introduction

The economic and financial crisis has harshly destabilized the European Union (EU) economy. Uncertainty and risk-aversion have spread across the continent, thereby dropping the amount of private capital destined to finance new projects. EU experts estimate that investments have decreased on average by roughly 15%, compared to the pre-crisis scenario.[1]

The clean energy field represents one of the areas hit the hardest by the sudden stop of capital flows.[2] Difficulties faced by the low carbon sector result in dangerous consequences for the Union. Scarce investments in climate- and environmentally-friendly projects could weaken the EU bargaining position internationally, thus hampering Union's ambitions to achieve an effective climate deal at the United Nations Framework Convention on Climate Change 21st Conference of the Parties later this year. Furthermore, lack of funds in clean energy projects might prevent the achievement of EU energy and climate goals.[3]

Therefore, the European Commission (EC) and European Investment Bank (EIB) have decided to launch the European Fund for Strategic Investment (EFSI). The Fund is set to be fully operational by September 2015, with an initial investment period lasting no longer than two years. Designed to drive private capital towards strategic productive fields, EFSI includes clean energy among its main sectors of interest.[4]

This reflection aims to examine which concrete opportunities EFSI creates for the clean energy sector and to critically evaluate its potential in driving investments towards renewables and energy efficiency projects.

About EFSI

The raison d'être of EFSI consists of achieving three targets. Firstly, the Fund yearns for removing financial and non-financial barriers that discourage investment flows towards the EU. Increasing the visibility of profitable opportunities across the continent represents the second priority of the Fund. Thirdly, and most importantly, EFSI aims to mobilise funds able to sustain projects with high-risk profiles. Public contributions work as first loss protection, thus strongly incentivizing private investors.[5]

Regarding EFSI resources, the EU provides a guarantee fund that amounts to €16 billion, while the EIB has committed €5 billion. Notwithstanding a financial guarantee that does not exceed 6.7%, the Fund is supposed to gather at least €315 billion over the period 2015-2017.[6] EU experts consider EFSI able to provide enough risk-bearing capacity to crowd in private investors. According to experts, "€ 1 of protection by the fund generates € 15 of private investment in the real economy that would not have happened otherwise".[7]

Besides the Commission and EIB, member states are also responsible for ensuring the success of EFSI. They can support the Fund either directly or via National Promotional Banks (NPBs). Furthermore, EU countries may contribute through investment platforms, which is often the case with energy-related projects, or by directly co-financing specific activities.[8] To incentivize national public investments, member states' contributions to EFSI are not counted by the Commission when defining fiscal adjustments under the Stability and Growth Pact. Furthermore, EFSI financing is not considered state aid within the meaning of the EU Treaties.[9] Notwithstanding the important role played by member states, the EU Directive 2015/2017 forbids them from appointing EFSI staff.[10]

Articles 5 and 6 of the EU Directive 2015/1017 list some features that candidate projects must possess to be granted EFSI support. Ensuring substantial economic return is denoted as a key characteristic. However, commercial revenue does not represent the only benchmark. EFSI projects must also guarantee social return, while being sufficiently mature and technically viable.

Furthermore, consistency with EU policies and priorities cannot be bypassed. Finally, the Union stresses the importance of the "additionality" clause. EFSI must prioritize additional projects, namely investment opportunities not able to be exploited without the financial support of the Fund.[11]

Decisions about which projects to include under the EFSI's umbrella are delegated to a specific Investment Committee composed of eight independent experts.[12] To guide the Investment Committee throughout its decision-making procedure, the Commission drafted a Scoreboard of Indicators, based on four rating notches. The first pillar tests projects' contribution to EFSI policy targets: it measures economic return and evaluates projects' capacity to promote capabilities and boost employment. Furthermore, it tests sustainability, expressed in environmental and social terms. Finally, the third rating level tests technical and financial capabilities, while the fourth pillar gathers together some remaining complementary indicators.[13]

EFSI and the Clean Energy Field

Realizing a clean energy union remains one of the most ambitious projects ever drafted by the European Union. However, the EU is far from achieving this target. Experts estimate that the energy sector currently faces an investment gap that exceeds €200 billion per year.[14] Overall, the shortage of capital amounts to roughly €1 trillion and is primarily caused by a dramatic fall in private funding.[15] Falling short in backing up new clean energy projects, the EU could face the real risk of missing its 2020 and 2030 climate and energy targets.

Perceived risk and instability have discouraged investment flows targeting the green energy field.[16] Shortages of private capitals available are mainly due to regulatory uncertainty and risk-aversion of private investors. Furthermore, a rolling back in the availability of long-term financial capitals has harshly jeopardized further projects.[17] Finally, public budget constraints have also put renewables and energy efficiency under enormous pressure. The Commission itself signals that about €48 billion are missing to achieve 2020 renewable energy goals.[18] Even worse, €100 billion is required to fulfil energy efficiency targets set by the end of the decade.[19] The market is supposed to provide the bulk of capitals required. However, financial and regulatory barriers can hamper private funds from reaching these fields.[20] Therefore, EFSI represents the proper instrument through which the EU can boost its green energy economy.

Renewables and energy efficiency projects largely accomplish EFSI criteria. Firstly, accessing secure and sustainable sources of energy represents an unavoidable ingredient to boost EU competitiveness.[21] About this, renewable energy and energy efficiency have the proven capacity to leverage private capitals with a substantial return in terms of jobs created. [22] Targeted investments in green energy projects are also compatible with EU policies and priorities.[23] They ensure sustainable growth while contributing to GHG emission reduction.[24] From a socio-economic standpoint, investments in these fields help and reduce energy use[25] and diminish EU import dependence on fossil fuels.[26] Finally, the development of a clean energy union would represent a milestone in the process of deepening the single market.

The EU Commissioner for Energy and Climate Action Miguel Arias Cañete himself declared that "energy projects will be the single largest beneficiary of €315 billion that EFSI will put in the real economy".[27] Although regional or sectorial pre-allocations will not apply, also the EU Directive 2015/1017 lists energy, environment and resource efficiency projects among those fields where to invest EFSI resources first.[28] Consequently, at a first glance, energy and climate projects are destined to become one of the main beneficiaries of the Fund.

A critical view of the EFSI contribution for the clean energy sector

Complementarity between EFSI and clean energy projects emerges clearly on paper. However, much scepticism surrounds the Fund and analysts doubt it can spur massive amount of new private capitals. In light of the investment gap suffered throughout the Union, EFSI is largely considered inadequate in scale.[29] According to Martin Myant, chief economist of the European Trade Union Institute, "a public sector investment programme cannot function without a strong commitment of public resources".[30] They accuse the Fund of not tackling adequately the shortage of public investments in the EU, while shifting the burden towards private investors.[31] Furthermore, public capitals made available by EU and EIB largely consist of reshuffled resources, instead of fresh money.[32] The Union backs up EFSI by reallocating merely €8 billion, almost totally recycled from unspent bids of its budget.[33] Besides €2 billion from existing margins in the EU budget, €3.3 billion and €2.7 billion are obtained by cuts in Connecting Europe Facility and Horizon 2020 programmes. Similarly, the €5 billion committed by the EIB is mainly obtained though recycling existing capital.[34]

Technical criticism targets the Commission's estimate to mobilise €315 billion through the provision of €21 billion first loss guarantee. Despite the high degree of financial risk associated with EFSI projects, the Fund is expected to achieve a financial leverage ratio of 1:15. Several experts consider this scenario rather optimistic, given that similar financial mechanisms have barely accomplished 1:5 to 1:7 multiplier effects.[35]

Apart from general criticism, analysts have also cast doubt on EFSI's capacity to benefit the green energy sector. As described in the previous section, the latter has been harshly damaged by the sudden stop of capital flows. Predictably, multiple interest groups have required the Union to explicitly prioritize investments in clean energy projects. Several MEPs[36] and the Energy Efficiency Financial Institutions Group (EEFIG)[37] also backed this position. However, irrespective of political pressures, the EU has firmly excluded any form of sectorial and geographical earmarking.[38] Instead, the Commission Vice-President Jyrki Katainen has shifted the burden towards private investors. They are portrayed as the only responsible for deciding where to invest EFSI reserves.[39] Nonetheless, this declaration is misleading. Although the Fund relies heavily on private capital, private investors largely perform the role of decision-takers. Instead, the Investment Committee is primarily responsible for selecting projects and dispensing EFSI financial resources.

In this regard, clean energy stakeholders have harshly criticized the Scoreboard, which plays a key role in shaping Investment Committee's decisions. Despite EFSI's targets and ambitions, several misleading criteria hamper capital from reaching the clean energy field. The Scoreboard falls short in capturing value added by single projects to the EU economic recovery path. Furthermore, according to several climate advocacy groups, it shifts sustainability to the background, failing to guarantee sustainable growth in accordance with EU 2020 and 2030 goals.[40] Negative externalities, including GHG emissions, are also not considered when evaluating projects' economic viability.[41] Additionally, even though during the decades the EU has invested massively in Liquefied Natural Gas infrastructures, the Commission does not explicitly exclude carbon- and resource-intensive energy projects. Most importantly, experts from the Commission's Impact Assessment on Energy Infrastructure Priorities for 2020 and beyond estimate that further gas infrastructure investments will be business as usual delivery. [42] Therefore, including carbon- and resource-intensive energy projects under the EFSI umbrella would breach the additionality clause.

This sequence of misleading and missing criteria unequivocally discourages private capital from benefiting renewables and energy efficiency projects. Nevertheless, scarce attention paid to re-establishing a stable investment environment stands out as the key reason why the Fund impacts only marginally the clean energy field. According to the Commission itself, private capital flows do not massively target this sector as long as a predictable and cost-effective policy structures is

guaranteed.[43] Even though EFSI aims to eradicate non-financial barriers that discourage investment inflows in the EU, it barely takes regulatory and policy framework into consideration. Consequently, irrespective of the first loss guarantee provided, private investors are reluctant to meet short- and long- term investments needed by green energy projects.

Conclusion

In his Political Guidelines, Jean-Claude Juncker, president of the European Commission, ranked as first priority the need of strengthening Europe's economy. On 15th July 2014, he announced the launch of an investment package, later named as the European Fund for Strategic Investment, aimed at spurring EU competitiveness and stimulating investments for the purpose of job creation.[44]

Slightly more than one year after, EFSI is ready to become fully operative. Three positive features characterize the Fund. Firstly, it uses public resources as first loss guarantee to crowd in public investors. Secondly, the Fund includes an additionality clause, which aims to canalize financial resources towards underestimated projects able to create sustainable growth, such as those in the clean energy field. Finally, EFSI isolates the Investment Committee from the influence of powerful member states by forbidding the latter from appointing EFSI staff.

Nevertheless, much scepticism surrounds EFSI's ability to spur economic growth, particularly in the clean energy sector. The Fund fails in creating a stable and unique regulatory framework throughout the Union. Furthermore, it falls short in addressing the shortage in public investment that characterize the entire EU. Most importantly, it does not drive investments towards those sectors, such as the clean energy field, capable of ensuring economic growth and jobs creation without obstructing the achievement of 2020 and 2030 EU goals. These shortcomings demonstrate why the Fund is not enough to address short- and long-term investment necessities of the green energy sector and the EU in general. The Union must focus on solving those structural weaknesses behind its economic structure and, in particular, behind the structure of the clean energy field. In order to do so, besides fresh and targeted public investments, a unique and stable regulatory framework throughout Europe is urgently needed to revamp renewables and energy efficiency projects. Through this strategy, the EU could boost the economic recovery of the Union and its green energy sector. Additionally, driving funds towards this field could help the Union fulfil its 2020 and 2030 goals, while reinforcing its commitment for achieving international climate and clean energy deals.

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