The Investment Plan for Europe and European Fund for Strategic Investments (EFSI): New project management challenges.

Emīls Pūlmanis

Abstract

During the Latvian presidency of the EU council, The European Commission approved a € 315 billion Investment Plan to get Europe growing again and get more people back to work. The Plan is built on three main strands:

- the creation of a new European Fund for Strategic Investments (EFSI), guaranteed with public money, to mobilize at least € 315 billion of additional investment over the next three years (2015 - 2017);
- the establishment of a credible project pipeline coupled with an assistance program to channel investments where they are most needed;
- an ambitious roadmap to make Europe more attractive for investment and remove regulatory bottlenecks.

According to European Commission estimates, taken as a whole, the proposed measures could add € 330 - € 410 billion to EU GDP over the next three years and create up to 1.3 million new jobs. Member States are already providing the joint Commission-EIB Task Force established in September 2014 with lists of projects selected according to three key criteria:

- EU value-added projects in support of EU objectives
- Economic viability and value – prioritizing projects with high socio-economic returns
- Projects that can start at latest within the next three years, i.e. a reasonable expectation for capital expenditure in the 2015-17 period.

In addition, listed projects should have the potential to leverage other sources of funding. They should also be of reasonable size and scalability (differentiating by sector/sub-sector). Member States present several types of economies but effects are not limitless, diseconomies might arise. During a Supreme Audit institution Contact Committee meeting in Rīga, Latvia that was held on June 18-19, 2015, discussion of new EU Investment plan and maintenance of good governance in this plan implementation was raised.

This paper analyzes the new EU Investment plan and shows different opinions and problems that might arise during its implementation. Author provides overall view on the investment plan showing also problem aspects such as administrative and institutional framework and project management direction.

Key words: *project management, EU, investment plan, EU Fund for Strategic Investments, EFSI*

Introduction

The €315 billion "Juncker fund", also known as the European Fund for Strategic Investments (EFSI), is being contested by MEPs who don't want that part of the €16 billion EU contribution to the fund taken from the EU's infrastructure and research programs.

Under the new rules, Member States are required to draw up and implement strategic plans with investment priorities covering these five ESI Funds. These "Partnership Agreements" (PAs) are negotiated between the European Commission and national authorities, following their consultation of various levels of governance, representatives from interest groups, civil society and local and regional representatives. The starting point for these Partnership Agreements was position papers produced by the Commission services in 2012 for each Member State setting out how EU investments should support smart, sustainable and inclusive growth by focusing on key advantages and important growth sectors in regions and Member States. In spite of hard discussions, criticisms and defined problems, the so called "Juncker's Investment Plan" was approved during Latvian presidency of the EU council this first half-year of 2015.

The Investment Plan focuses on removing obstacles to investment, providing visibility and technical assistance to investment projects and making smarter use of new and existing financial resources. To achieve these goals, the plan is active in three areas:

- mobilizing investments of at least €315 billion in three years
- supporting investment in the real economy
- creating an investment friendly environment.

.

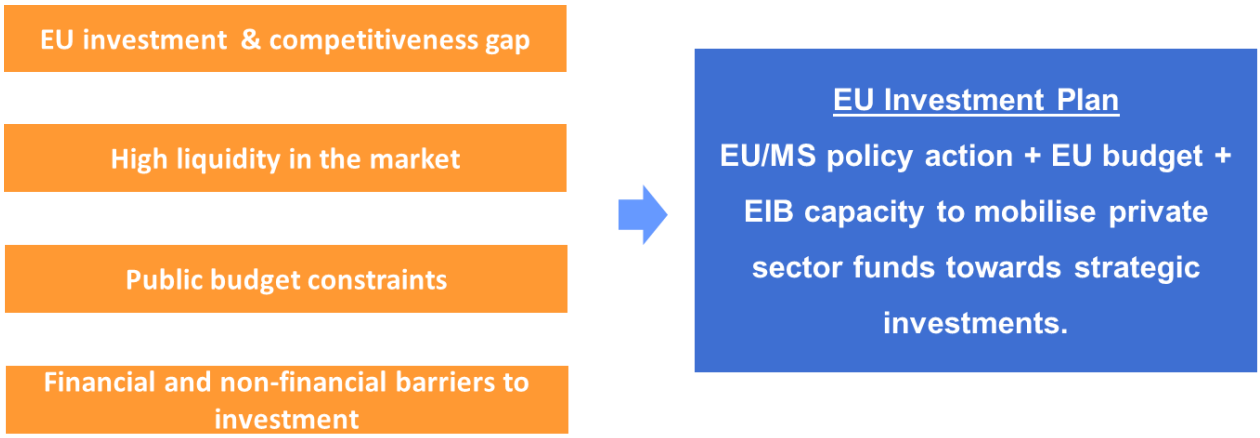

Fig.1. EU Investment Plan: rationale

Investment plan – problems, solutions and project impact factors in the frame of EU policy

The gains from benefitting from a loss guarantee in a world where there is no risk aversion can be simply written as:

$$1 + r^* = (1 + r_i)(1 - \pi_i) + (1 + r_i)\, \pi_i\, (1 - \tau_i)$$

where r^* is the risk free interest rate (the yield on German 10-year bund, currently at 0.7%), r_i is the return of the newly planned investment project, π_i is the probability of default of project i, τ_i is the expected percentage that will be lost on investment in project i in case of default. This equation holds because investors should be indifferent from holding a safe asset or a risky asset with a higher interest rate compensating for the risk.

In the case in which there is a guarantee covering partly potential losses, the equation becomes:

$$1 + r^* = (1 + r_i^g)(1 - \pi_i) + (1 + r_i^g)\, \pi_i\, (1 - max(\tau_i - g, 0))$$

where g is the reduction of the loss because of the guarantee and r_i^g is the interest of the investment project when a guarantee is given. Solving the two equations for r_i respectively r_i^g and taking the differences between the two implied interest rates gives us the reduction of the return rate asked by investors if there exists a guarantee:

$$r_i - r_i^g = (1 + r^*) / (1 - \pi_i \tau_i) - (1 + r^*) / (1 - \pi_i \,.\, max\, (\tau_i - g, 0))$$

For instance if a project has a default probability of 10% and an expected loss of 60% in case of default, the guarantee is equivalent to a reduction of 75 basis points in the return rate demanded by investors to participate to this risky project instead of investing in safe assets. The chart below depicts the gains in terms of interest rates for all possible values of τ_i and π_i. Basically, it shows that the more risky the projects are (with high values of τ_i and π_i) the more the guarantee will reduce the additional return an investor demands to invest in it instead of investing in the safe asset.

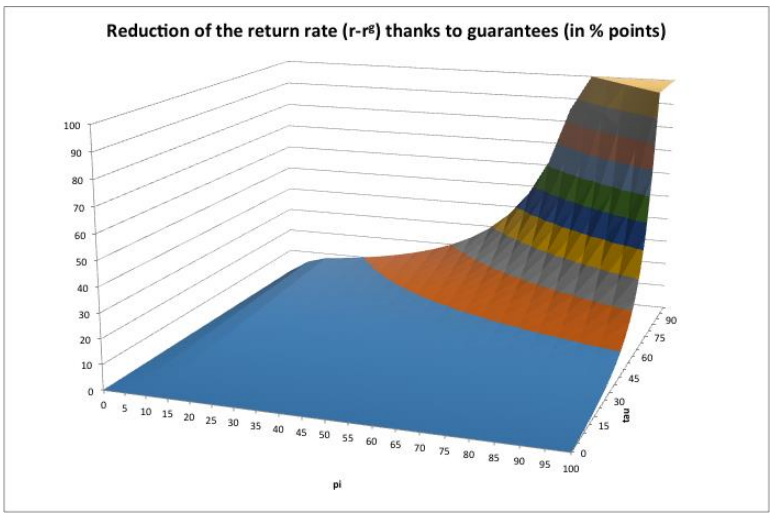

Fig.2. Reduction of return rate thanks to guarantees

How many new investments can be triggered by this scheme depends therefore on the ability of the selection committee to identify new projects that would not have happened without the subsidy. Analysis (by Grégory Claeys, André Sapir and Guntram B. Wolff , 2014) suggests that the EFSI should in fact target very risky projects because they are probably the ones that are not financed at the moment but also because they are the ones on which a guarantee should have a larger effect.

A risk with the scheme is that it may not increase the total amount of private investment in the EU but rather simply provide a windfall gain to those already planning to invest. The governance of the EFSI is therefore of central importance. How can one ensure that new projects get selected instead of seeing a crowding out of existing private projects? The key will be that the selection committee is able to identify projects that add to existing investment. This is a big challenge for economic policy making and experience shows that such publicly run committees often select politically motivated projects rather than projects that add to existing ones. One criterion that could be used is the fact that a project is risky and therefore there is no private appetite to do it.

More fundamentally, there is the question as regards the political economy of project selection. The more projects are of a private sector nature, the more questionable it becomes whether the public sector can select the right projects and how the subsidies would represent competitive distortions. Conversely, for pure public good investment, countries with fiscal space could use their ability to borrow to invest in public infrastructure. This should generate also some private investment to the extent that public investment is productive.

In addition, the public sector can relatively easily generate private investment by offering the right regulatory framework and other framework conditions. For example, it is not difficult to find private investors to fund useful highways when the process of getting the necessary permits is facilitated and the right to collect road tolls granted. Initiatives to harmonize regulation and create a single market for services should also provide for substantial incentives for new investment.

The EC plans to invest in two types of projects at the moment. First, it intends to invest in SME's and mid cap companies through loans but also through equity and venture capital. Second, the EC wants to target "strategic" long-term investment with a particular focus on energy, transport, broadband, R&D and education. The fact that most of these strategic investments are at least partly public infrastructures that are either profitable because they will generate their own revenue streams in the future or that may not have revenue stream but that will raise European potential growth also raises some important questions.

If these projects are really profitable, given the current low interest rates, it would be legitimate to have proper public investment financed by debt that will pay for itself in the long run.

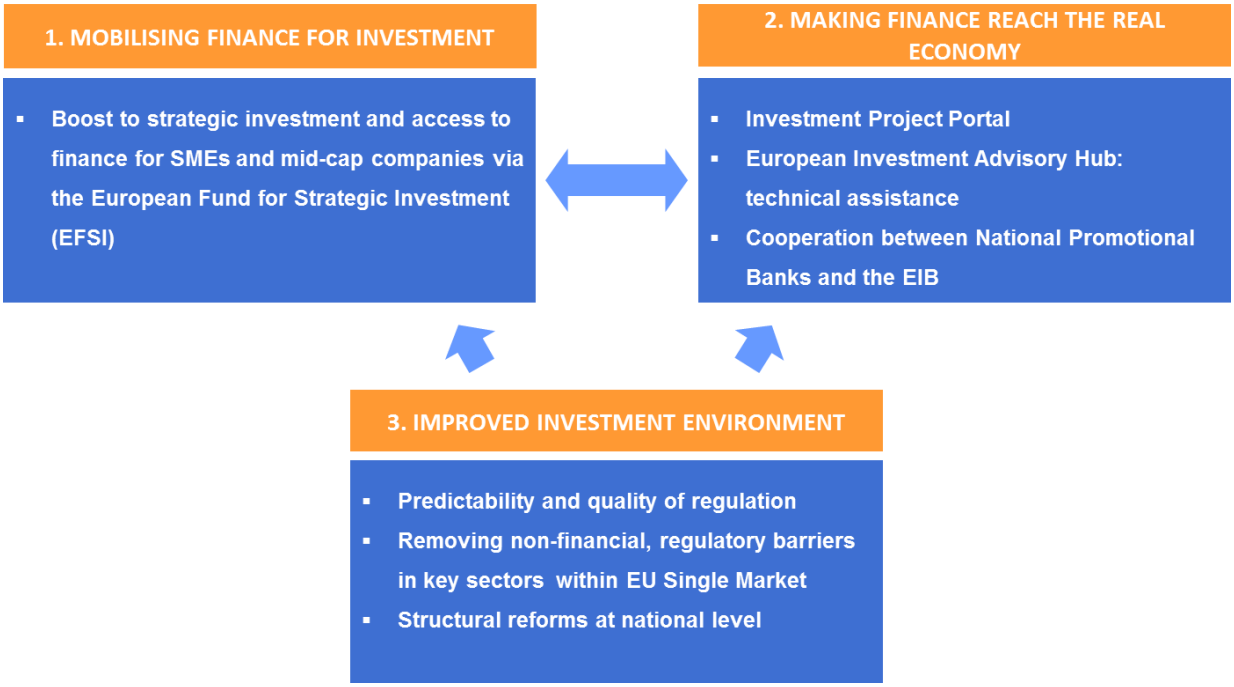

Fig.3. EU Investment Plan: 3 pillars

In order to approve any new projects officials should evaluate and define which projects are eligible for financing. From operational documents and policy planning documents as well as based on expert opinions such projects:

- Must have high societal and economic value contributing to EU policy objective
- Must attract private capital by addressing market failures.
- Must come on top of existing EIB and EU financing possibilities.
- Must be economically and technically viable.
- Must be consistent with EU state aid rules.
- Some examples of key growth-enhancing areas being targeted by the EFSI are:
    - Infrastructure (transport, energy, digital, environment, urban and social sectors)
    - Education and training, health, R&D, ICT, innovation
    - Renewable energy and energy efficiency
    - Support to SMEs and mid-cap companies.

But still there are several more problems on Agenda regarding project implementation in the frame of new investment plan – administrative and legal framework. EU commission and Member States should take all actions to implement better and more predictable regulation at all levels. Some ongoing activities would be Capital Markets Union - Making most of the Single Market:

- Energy Union
- Digital Single Market
- Services Market

New regulation includes such elements as:

- **Structural reforms** in the Member States (Country specific recommendations);
- **Openness** to international trade and investment;
- **Making finance reach the real economy;**
- **Building a dynamic pipeline of viable projects:**

✓ *European Investment Project Portal*

- Bridge between EU's investment opportunities and potential investors;
- A web portal enables EU-based project promoters (public authorities, private, PPP) to share their investment proposals seeking external financing, in a transparent way ;
- Investors can search for opportunities across Europe (size, sector, geography);
- Effective form of presenting new project ideas to the market (G20/ OECD experience);
- Matching investment opportunities proposed by project sponsors with investors' interest.

✓ *Strengthening advisory services*

- European Investment Advisory Hub
- Technical assistance
- Pooling resources & expertise
- A single access point to a wide range of advisory services

Strengthened advisory support throughout the project cycle: project identification, preparation and implementation incl. the use of financial instruments, advice on structuring and implementing public-private partnerships and facilitation of access to finance. The Hub (see Fig.4.) would be as a gateway to:

- Targeted advisory support for project development
- Technical capacity building
- Expert guidance from experienced financial & technical professionals

The Hub seeks to improve project quality and be the reference point for project advisory support in Europe

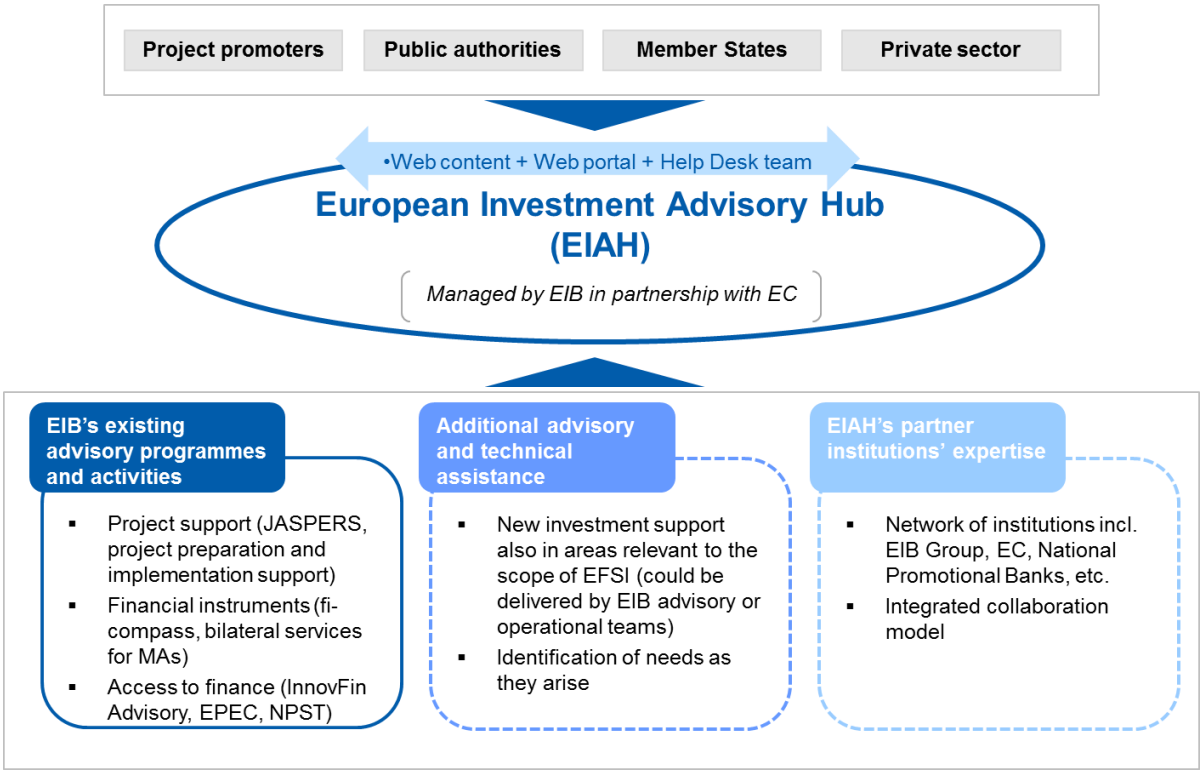

Fig.4. European Investment Advisory Hub

- EUR 16 billion in guarantees from the EU budget
- EUR 5 billion from the EIB

Sources in EU budget:

- Redeployment of EUR 5 bn, of which EUR 2.8 bn from CEF and EUR 2.2 bn from Horizon 2020 – basic research untouched
- Unused budgetary margins: EUR 3 bn over the period 2016-2020. EUR 543 million and EUR 457 million, from the global margin for commitments for the 2014 and 2015 budgets respectively
- Payments until 2022 to provision the EFSI guarantee fund; gradually reaches EUR 8 bn (i.e. 50% of total EU guarantee obligations)

Financial framework of new Investment plan

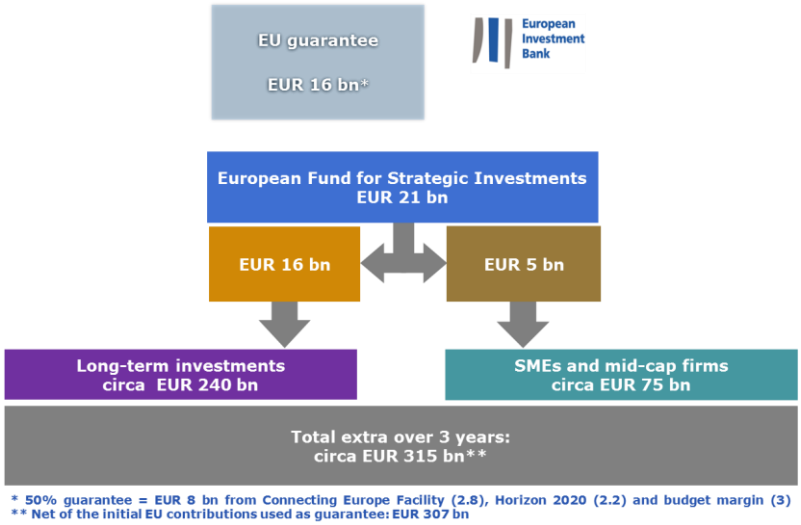

Fig.5. Overview of EU new investment plan

According to EU commission «Juncker Investment Plan» aimed to focus on investments in real economy:

- Market-driven, no political interference
- No geographic or sector pre-allocation
- Measurable results on growth and jobs
- Support to EU policies
- Leverage / crowd-in private sector and third parties
- Economic and technical viability
- Additionally vs existing instruments
- Higher risk-taking than EIB normal activity

✓ *Size of investments*
- EIB uses min EUR 25 mill. for individual loans
- Smaller schemes can be grouped into framework loans
- No restriction for operations via fin. Intermediaries (eg. for SMEs)

✓ *Cross-border projects possible*
- Investments between a partner in MS and extending to countries in Pre-accession and Neighborhood can be covered by EFSI

✓ Projects
- Co-financing / Risk-sharing with EIB/EIF

✓ Investment Platforms
- Pooling of projects with thematic or geographic focus
- Agreement or Fund
- Can benefit from EU Guarantee via EIB
- Cooperation with EU National Promotional Banks

The idea behind the European Commission's plan is to use public money as a buffer to absorb some of the potential losses of the projects. This way, some investment previously considered not lucrative enough and too risky might become profitable to private investors. The first and undecided issue is whether the public resources will really serve as a first loss guarantee or whether they are only part of the risk sharing.

Investment plan implementation and project management environment in Latvia

For 2014-2020, Latvia has been allocated around € 4.51 billion in total Cohesion Policy funding:

- € 3.04 billion for less developed regions (the entire country is classified as a less developed region)
- € 1.35 billion through the Cohesion Fund
- € 93.6 million for European Territorial Cooperation
- € 29 million for the Youth Employment Initiative

Of this, the ESF will represent a minimum of € 629 million. The actual share will be set in light of the specific challenges the country needs to address in the areas covered by the ESF.

Based on Ernst and Young's European Attractiveness Survey, 2014 saw the Baltic States complete 9 percent more investment projects, and create 31 percent more jobs in comparison to 2013 as a result of Foreign Direct Investment (FDI). Furthermore, 10 percent more investment projects were completed in 2014 in comparison to the previous year.

However, investors mostly focused on Western Europe as 52 percent of FDI projects were completed in the United Kingdom, Germany and France - Central and Eastern Europe fall behind in this aspect. The biggest levels of FDI come from European countries. The United States accounts for a quarter of the total FDI projects in Europe, while BRIC investors (Brazil, Russia, India and China) account for a total of 5 percent.

Investment in Latvia has been quite volatile in recent years, declining considerably during the crisis in 2008-2009, and then rebounding sharply in 2011-2012. Investment dropped again in 2013 and is forecast to recover marginally by 0.5% in 2014 as business sentiment is affected by geopolitical tensions. A more substantial recovery is expected in 2015-2016 but there are still significant risks due to the country's exposure to current geopolitical tensions. Investment (excluding inventory) accounted for 23.3% of GDP in 2013 as compared to 19.3% in the EU.

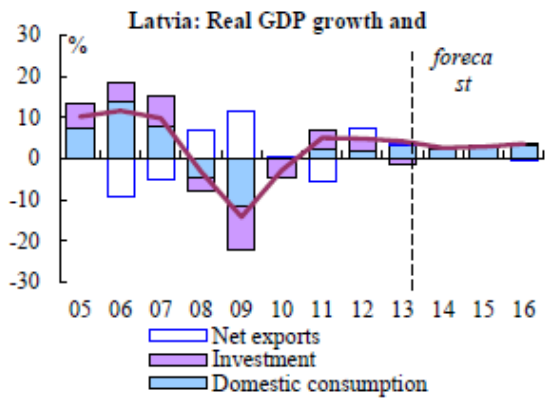

Fig.6. Real GDP growth and forecasts
Source: European commission, autumn 2014

The main challenge relates to low public investment in sectors where there are insufficient private incentives. On the one hand, the government is committed to maintaining a low-tax environment to support private investment and, on the other hand, significant needs for spending on social protection, healthcare and education restrain government resources from investing in infrastructure and R&D, which lag behind EU standards. Facing external security risks, the government recently committed to increase its defense budget, further limiting its capacity to boost investment in other sectors.

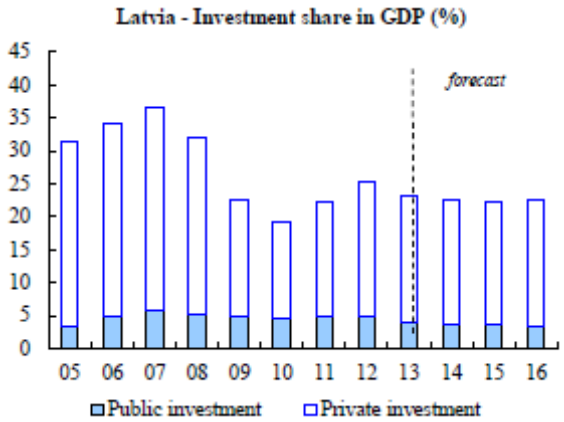

Fig.7. Investment share in GDP (%), case of Latvia
Source: European commission, autumn 2014

In the Country Specific Recommendations for Latvia, the European Union recommended:

- Preserve a sound fiscal position and strengthen the budgetary strategy
- Step up implementation of the higher education reform
- Take steps for a more integrated and comprehensive research system also by concentrating financing towards internationally competitive research institutions
- Reform social assistance
- Accelerate the development of gas and electricity interconnections to neighboring Member States to diversify energy sources and promote competition through improved integration of the Baltic energy markets
- Complete judicial and public administration reforms

About the institutional capacity overall the European Commission agrees with Latvia's self-assessment regarding fulfilment of the relevant ex-ante conditionality's related to institutional capacity, except for the following elements. Regarding the criterion on a quality management system, commitment to timing of the informative report should be included in the action plan. Regarding the criterion on development of skills at all levels, self-assessment is not coherent (considered fulfilled but proposing action plan). The action plan for judiciary is acceptable. With regard to overall public administration, commitment on timing of the informative report should be made for the action plan to be acceptable.

The Latvian authorities should be reminded that the revised directives on public procurement provide for a gradual transition to mandatory e-procurement starting in 2016. Thus, the Latvian authorities are urged to prepare a national strategy for timely and efficient transition to end-to-end e-procurement, setting out the specific objectives to be achieved, the process to be followed, the milestones and indicators.

The PA contains commitment to ensure a smooth transition between the programming periods and reference to the joint human resource development plan to be elaborated. However, it is suggested to include a specific section in the mentioned HR plan that would identify risks and challenges of keeping the experienced and knowledgeable staff and know-how retention throughout the changes of the implementation system.

While a good progress in the elaboration of the Latvian Smart Specialization Strategy framework is achieved, important further steps need to be made to address a number of important remaining issues. These include a robust and reliable monitoring and evaluation system, an effective and dynamic stakeholder's involvement and a focused priority setting by concentrating on fewer innovation- and knowledge-based development priorities. In addition, the composition of the Latvian Smart Specialization Strategy framework should be clarified and coherent linkages between the presented documents and strategies established.

The intervention logic has been improved, however there are still cases when development needs are omitted or not substantiated in the analysis, or proposed actions are not complete or justified by analysis. Also, prioritization within each TO should be evident. These relate mainly to the areas of ICT, entrepreneurship, urban and territorial development, environment, transport and education. All results should demonstrate a qualitative change; be specific and concise about this change, including in relation to the target group; and be possible to achieve solely with ESIF contribution.

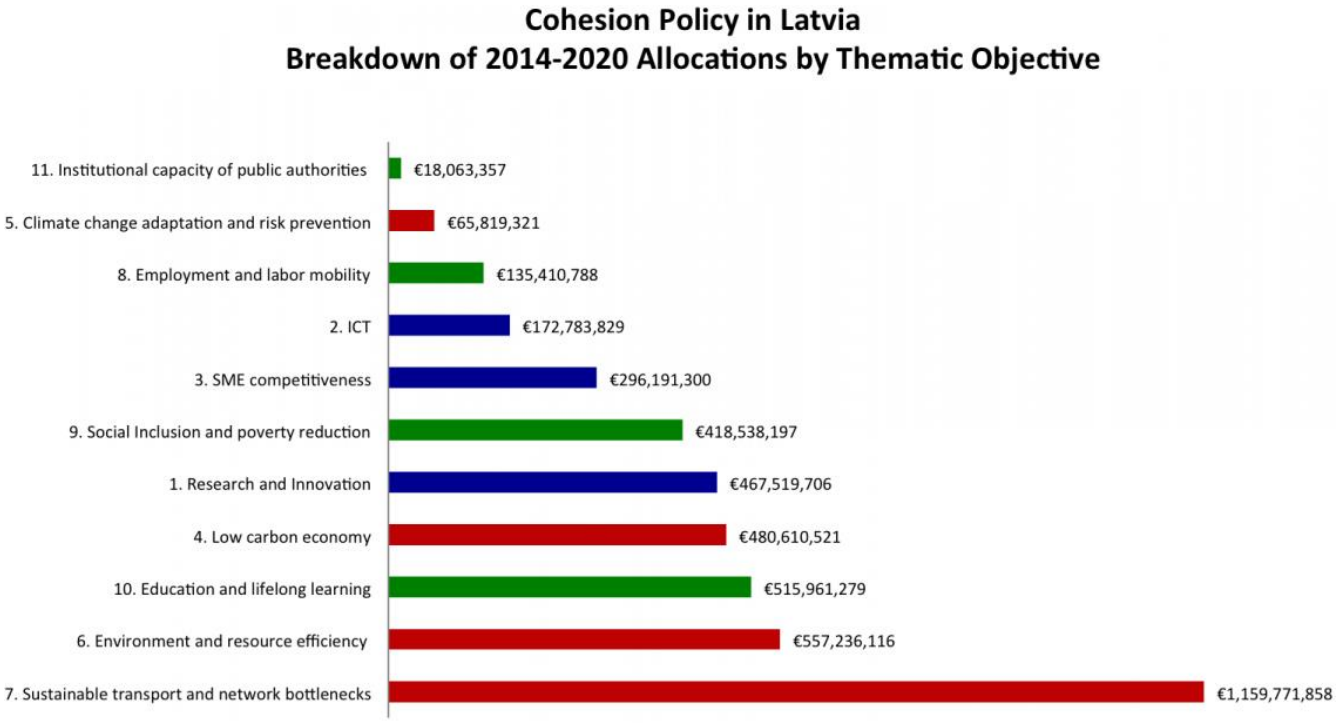

Fig.8. Cohesion policy and support areas for 2014-2020 planning period

In the programming period of 2014–2020 it is planned to involve partners in an extensive and targeted way in rendering services for the attainment of industry objectives related, for instance, to social inclusion, employment, enhancement of business environment, environmental protection, education, etc. based on NGO expertise, thus ensuring the use of intellectual potential of the social partners within the respective industries.

According to the provisions of Articles 41 and 42 of the Proposal for a Regulation, as well as in further implementing of good practices of the CP funds in the programming period of 2007-2013, the primary form for the involvement of partners used by the managing authorities upon approval of planning documents of the ESI Funds will be the SC of the CP funds, EAFRD SC and EMFF SC by involving representatives both of public administration institutions and planning regions and of social partners and NGOs. All SCs of the ESI Funds will mainly be focused on ensuring implementation and supervision of the ESI Funds by involving representatives from a wide range of partners.

The Managing Authority of the CP funds will form a consultative working group for thematic assessment of the CP funds aimed at arranging assessments regarding the priority lines, thematic objectives and investment priorities of the operational program for the PA and CP funds in order to determine efficiency of implementation in a specific time period. In the ESI Funds assessment process the partnership principle will be implemented by involving in the working group those partners who participate in planning, implementation and supervision of the CP funds. The working group will involve representatives of the managing group of the EAFRD and EMFF and, if

necessary, respective experts in order to ensure complementarily and synergy of the ESI Funds.

In the programming period of 2014-2020 of the CP Funds the managing authorities will further employ the practice applied with regard to the EU funds in the programming period of 2007-2013 and in preparing annual reports on the implementation of the operational programs of the EC and ESI Funds the process of endorsement with the partners will be organized through the SC.
The Managing Authority of the CP funds will also inform participants of the SC about the periodical progress reports to the Government.

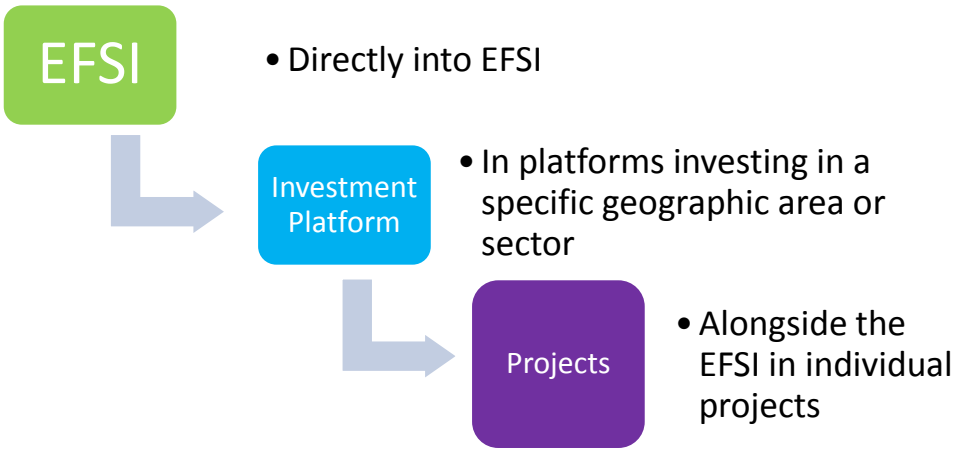

Fig.9. Latvia as well as other EU member states can participate in EFSI operations at three levels

National contributions to EFSI-supported projects have been announced by:

- Italy, France, Germany, Poland (each EUR 8bn)
- Spain (EUR 1.5bn)
- Luxemburg (EUR 80 million)
- Slovakia (EUR 400 million)

All contributions via National Promotional Banks!

Meanwhile, an opinion published by the EU Court of Auditors cast doubt on the safety of the fund's guarantees for taxpayers. The guardian of EU finances said the European Commission did not provide enough information on how to secure the €16 billion the EU will put into the fund. The commission did not "explicitly exclude contingent liabilities for the EU budget beyond the committed funds," wrote the auditors, pointing to the risk that the plan could cost more to the EU budget if projects prove to be too risky for private investors.

The court also asked to be more involved in the plan, saying it should carry out the external audit of the fund. The commission reacted cautiously to the court's non-binding report. EU court of auditors have evaluate new investment plan and they are mindful of the tripartite agreement between the commission, the European investment bank and the court of auditors based to a 2003 agreement by which the court can carry out audits

on the European Investment Bank (EIB), which is to finance investments under the EU guarantee. New rules obliged EIB/EIF to report on financing and investment operations:

- semi-annually to Commission
- annually to Parliament and Council

Project selection should also focus on projects that meet both the additionally 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.

This is especially the case because the EU public funds that will go into EFSI, i.e. 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. The case has to made that the shifted money is spent better in the new Juncker plan compared to the original allocation, but the Juncker plan is silent on this. How sizeable these opportunity costs are will depend on the specifics of where the money is coming from. According to the Juncker plan, the €8 billion will come from the Connecting Europe Facility (€3.3 billion), Horizon 2020 (€2.7 billion) and budget margin (€2 billion).

It is particularly concerning that the money is being taken from the parts of the EU budget that probably have the greatest potential for multiplier effects similar to what ESFI aspires. For example, public investment in basic science projects like those funded through the European Research Council, have been shown to be able to generate substantial social rates of return. In fact, the text of Juncker's plan notes that the 1:15 multiplier "is a prudent average, based on historical experience from EU program's and the EIB." Where is this historical evidence from if not research spending and projects such as the Connecting Europe Facility?! Nevertheless I would like to stresses out that we still can't forget about human resources and professionals who will implement new EU investment plan and who will benefit from it.

During Contact Committee meeting of Supreme Audit institutions in Riga, Latvia this June, discussion on good governance and responsibility of officials were raised. Meanwhile author stress that each investment plan should be implement in professional way. As its planned many of activities will be implemented in the form of projects and it's essential that every project would be planed and implemented precise and according to good sound of project management tools and methods ensuring efficiency and achieving goals stated in the plan.

To be effective, strategic HR planning must occur within the context of the EU overall investment plan. Investment strategies and objectives – both short- and long-term – will dictate what human resources will be needed, in what areas, with what job responsibilities and performing at what level. These strategies and objectives will shape

HR decisions on organizational design, selection, retention, training and development, performance management and rewards.

Further, proactive organizations will be looking at fresh ways in the following years to elicit optimal performance from employees, integrate new technology to streamline the HR function, to support HR and organizational goals, control benefit costs – and, of course, communicate effectively with employees and society about these and other changes. EU funds in recent years have spent a lot in so-called *soft-projects*, like trainings, seminars, camps and etc.

An extremely low investment in measurement and evaluation exists. Most organizations spend about one percent of their direct training and performance improvement budget on measurement and evaluation processes. Investments significantly lower than this amount may indicate a need for greater accountability.

References

1. Ernst and Young's European Attractiveness Survey, 2014

2. European Fund for Strategic Investments (EFSI), Burkhard SCHMIDT, European Commission, Riga, 18 June 2015

3. Partnership of EC and EIB to establish the European Fund for Strategic Investments (EFSI), Nicholas Jennett, European Investment Bank, Riga, June 2015

4. Grégory Claeys, André Sapir and Guntram B. Wolff , Juncker's investment plan: No risk – no return, Bruegel, 2014

5. Cohesion Policy and Latvia, European Commission, March 2014

6. The European Commission-Latvia Partnership Agreement for the use of European Structural and Investment (ESI) Funds for 2014-2020, Ministry of Finance of the Republic of Latvia, 2014

7. Working papers of Contact Committee in Riga, Latvia June 18-19, 2015 in the frame of Latvian presidency in the EU council.

About the Author

Emīls Pūlmanis

Riga, Latvia

Emīls Pūlmanis is a member of the board of the Professional Association of Project Managers in Latvia and development project manager at State Audit Office of the Republic of Latvia. He has gained a BSc. in engineer economics, a professional master's degree in project management (MSc.proj.mgmt) and currently is a PhD candidate with a specialization in project management. He has elaborated and directed a number of domestic and foreign financial instruments co-financed projects. He was a National coordinator for a European Commission-funded program – the European Union's financial instruments PHARE program in Latvia. Over the past 8 years he has worked in the public administration project control and monitoring field. He was a financial instrument expert for the Ministry of Welfare and the European Economic Area and Norwegian Financial Mechanism implementation authority as well as an expert for the Swiss – Latvian cooperation program as a NGO grant scheme project evaluation expert. He has gained international and professional project management experience in Germany, United States and Taiwan. In addition to his professional work, he is also a lecturer at the University of Latvia for the professional master study program in Project management. He has authored more than 30 scientific publications and is actively involved in social activities as a member of various NGO's.

Emīls can be contacted at emils.pulmanis@gmail.com.

To view other works by Emīls Pūlmanis, visit his author showcase in the PM World Library at http://pmworldlibrary.net/authors/emils-pulmanis/