Infrastructures, institutions and new equity funds in the Euro-Mediterranean area

Dr. Francescalberto De Bari

SUMMARY.

1. Introduction .

This contribution is prompted by the current situation regarding European infrastructure financing. The undeniable difficulties resulting from the States' (fiscal) crisis, have evidenced a number of factors that can favour the birth of new parties and institutions devoted to for long-term investments, encouraging, at the same time, international economic cooperation; the "*Marguerite*" is a fund that can be assumed as a prototype for the mentioned scenario. The opportunities this tool provides are put to the test in the Mediterranean dimension where the recently established "*InfraMed*" Fund can play a fundamental role at regional level and, in particular, in Egypt and Morocco.

2.The scenario: European infrastructures at a time of crisis.

Two considerations emerge in the current scenario and shall be taken into account dealing with the Euro-Mediterranean dimension:

a. The international economic crisis affected the various States (and regions) in the Mediterranean basin in a profoundly different way;

b. the “States' fiscal crisis” i.e. the incapacity of public finance to meet the structural and short-term needs, has got worse in the more developed countries, particularly those in the Euro Area. Just think of the increase in the relationship between public debt and GDP which reached 102% for the G-22 economies in 2009 and could get to 122% in 2014 (IMF, The State of Public Finances; Cross Country Fiscal Monitor). On the contrary, the countries on the southern bank of the Mediterranean have “wealthy” public funds**,** in terms of primary advance**.** It can't be denied that in many cases positive cash-flows of these countries are the result of the availability of energy resources; nevertheless it would be over-simplistic not to consider other “structural” factors, especially demographic ones, that characterize the south Mediterranean in a completely opposite way compared to “old Europe”.

As a consequence, Euro Area States have witnessed a major levelling out towards the top of public debt stock in relation to the GDP and some countries have lost the title of “first of the class” in maintaining public finances**.**

From an economic point-of-view, the investments in infrastructures, particularly in the transport sector, assure a long-term effect on potential growth and, at the same time, are a tool to overcome the crisis in the short-term. In this sense we see that:

1. In terms of potential growth, Community policies on infrastructural development, in particular the “TEN-T” Transeuropean Transport Network, have already absorbed (and will continue to absorb) substantial resources; the World Bank estimates a figure of 40 billion a year will be necessary for new infrastructures and a 60 billion per year for maintaining and replacing existing ones. The European Commission estimates that the total cost of “TEN-T” projects will be 900 billion euros.
2. In terms of “anti-crisis”, we should bear in mind that America and China's initiatives to counter the crises are heavily concentrated on investments in major infrastructural projects. Likewise, the economic recovery in Europe

could take place though the investments in “new european public assets”

The biggest obstacle to the strategic importance of developing infrastructures is the difficulty of attaining a suitable level of funding.

As a result a kind of “vicious circle” seems to take place: the crisis hits the funds of the European Union and its Member States finances, thereafter limiting the resources that could finance infrastructures; and in turn, the anti-cris policies need to focus on infrastructural financing. Moreover, the fact that, to this very day, the Treaties exclude the possibility for the European Union to “emit debt” and innate inadequacy of Community funding to provide suitable anti-crisis solutions, as maximum spending allowances are pre-determined way in advance and therefore make the Union incapable to face the crisis challenge.

3. The opportunities: international financial system, long-term investors and infrastructures

Despite the scenario described above, this does not necessarily mean that Europe will have to renounce building large infrastructures as a result of the States’ new fiscal crisis. The basic idea is that we will have to (and will be able to...) turn to private European and Non-European public capitals coming from outside the EU.

Two underlying trends lead to (moderate) optimism:

a) There are Countries with strong monetary and financial surpluses who intend to diversify their reserves.

b) We are witnessing a change in “investors’ risk profiles”, more and more tending towards low-risk, long-term investments, something which, without doubt, favours satisfying the “demand for infrastructures”.

Turning such an opportunity into a success lies in the hands of the so-called long-term investors (in particular “sovereign wealth funds**”** and insurances). Naturally, the role these people will play in guaranteeing economic and financial stability is related to the hypothesis that will come into effect a reform of the international financial system, especially when long-term investments are concerned. Above all, the key points to be monitored constantly are: the regulation of financial markets, international accounting rules, intermediary organization, vigilance of supranational authorities, fiscal policies, company governance rules.

The opportunities emerging from the afore-mentioned factors can be taken by the European Economic system though the European Union acquiring "financial activities" Here it should be stressed that this acquisition is allowed by the European rules in force (i.e. statistics and accounting) and therefore are not based on hypotheses, up to now vary vague, of Treaty reforms.

The model to be followed could be provided by the experience gained in the various Member States that are familiar with financial institutions that don't coincide with the States and don't have their administrative complexities, but are in someway or another "owned" by them. These institutions are sufficiently large in operational and financial terms and their purpose is, on the basis of the law and/or statute, to finance long-term investments. Frome this point of view, in Italy *Cassa Depositi e Prestiti* is an example and the model could be copied in order to create an European "super-fund".

These Member State institutions, as well as being a model to follow, can also be the direct protagonists in setting up a European "super-fund" able to catalyse private capitals and public capitals outside the EU towards infrastructural investments. Investors specialized in infrastructures should use two main tools:

a. Public – Private Partnership - "PPP". A PPP is created when a public administration entrusts a private operator to carry out a project for building public infrastructures or public utility infrastructures and with managing them. 'Carrying out the project' can consist of one or more of the following activities: project-designing, funding, building and renovating, management, and maintenance. The PPP operation is characterized by: i) long-term collaboration between public and private partners; ii) guaranteed funding by

b. *Project Financing* – "PF". PF is when an investment project is presented as an autonomous entity in relation those promoting it. It is judged on the basis of its capacity to generate sufficient cash-flows to reimburse the debts incurred for financing the construction phase and repaying the risk capital . The PF is characterized by: i) the project's "financial independence" ii) considerable financial requirements ; iii)) the division of risks between the various partners involved

For our purposes it's sufficient to stress that the "risk" is somehow the corner-stone of PPP and PF. They should be considered not as simple alternatives to the more traditional sources of funding and contract modalities, but rather as methodologies for allocating "risk" between the "various" parties involved (*risk sharing*) among various partners (public, private, institutional investors, "sovereign wealth funds"…), according to the golden rule that each kind of risk should be allocated to the public or private partner most capable of dealing with it or, in other words, of minimizing its negative effects.

Turning to PPP and PF is also dictated by the role that "risks" play in determining whether or not investment spending should be accounted for in budgets of European Union, Member States ad public bodies (i.e., investments have *on-balance* or *off-balance* nature). In fact, on the basis of a suitable risk allocation in relation to European statistical and accounting rules, PPP and PF allow the investment to be accounted for as *off-balance.*

The result is that, in the face of the limitations imposed on public funding by the current situation, turning to PPP and PF is in many cases the investment's *conditio sine qua non*

4. The "Marguerite" prototype .

As a reconfirmation of the consistency of the trend described above, in November 2009, an initiative called the "*2020 European Fund for Energy, Climate Change and Infrastructure (Marguerite)*" was launched. This fund is presented, explicitly and ambitiously, as the prototype of a "*Family of Sectorial Equity Funds*" to support the "market" in financing the objectives of the Lisbon Agenda.

Marguerite was launched after the Nice informal ECOFIN Council held in September 2008, when Italy suggested that "funds for strategic European infrastructures" should be set up in order to overcome the growing restrictiveness and rigidity of the EU finances. It shall be recognized that allocating risks to "non-public" parties (although not even "private" ones) allows, under certain conditions, the investment to be considered *off-balance* and, from this point of view, it was certainly not by chance that this proposal came from Italy, a county with large public debt. However, to consider the proposal a mere "accounting expedient" would be to over-simplify the matter. On the contrary, it should be seen as an important factor in the *European Economic Recovery Plan* (EERP), set up in December 2008.

Marguerite is the result of the work done by the "*Marguerite Network*". Its characteristic is that its promoters are not the Member States as such, the reason why, strictly-speaking, we can't talk about a "reinforced cooperation". Instead, the promoters are "long-term investors" whose common characteristics, apart from the different juridical configurations, are the fact that they are owned by States (totally or partially, directly or indirectly) and operate in a way that "conforms to the market rules"

In particular, the following institutions take part in it:

1. European Commission;
2. European Investment Bank (EIB).
3. Cassa Depositi e Prestiti (CdP);

4. Caisse des Dépôts et Consignations (CDC);
5. Kreditanstalt für Wiederaufbau Bankengruppe (KfW);
6. Instituto de Crédito Oficial (ICO);
7. Powszechna Kasa Oszczędności Bank Polski (PKO);

Marguerite aims at a 1.5 billion euro equity capital, with additional debt facilities of up to 5 billion euros. Furthermore it is presented as "pan-european" equity fund, dedicated to investments in Energy, Climate Change and Infrastructure.

Marguerite's strategic and operational characteristics can be summarized as follows:

- Specialization in financing long-term projects;
- Using tools that "conform to the market", like project bonds and guarantee schemes (along the lines of the guarantees offered by the EIB), shares in other equity funds (e.g. "*InfraMed*");
- Strong public and institutional endorsement, thanks also to the European Commission's participation, resulting in a *reputation premium* that improves the credit rating of project bonds;
- Non-speculative profit rates;
- "Multiplier Effect", that allows private capitals to be drawn in, by virtue of a suitable combination of length of time, risks and profits.

5. The Euro-Mediterranean perspective beyond the crisis: "InfraMed".

A very promising objective emerges if we broaden our horizons to the Euro-Mediterranean area. Aside from general considerations on the geopolitical, strategic and economic importance of the Euro-Mediterranean "region", it shall be noted the positive moment for "Mediterranean" infrastructure development (i.e. financing), both on the south bank and the "Community" one. Naturally, this prospective is linked to the clarity of objectives, and the coherence and energy the European Union and the States will be capable of demonstrating towards the Mediterranean Union.

However, it is also determined by the effectiveness of the solutions and "technical" tools the Euro-Mediterranean area will be able to provide itself with.

On the 26th May 2010 an agreement was signed in Paris for setting up the "*InfraMed Infrastructure Fund*" (*InfraMed*), defined as "the Union's first Mediterranean funding tool". It is certainly not by chance that after starting up *Marguerite* , the "*Marguerite Network*" launched *"InfraMed";* rather, it is the result of a precise strategy. The items described above, (the EU States' fiscal crisis, reorganization of international finances, divergences between States in basic macro-economic trends etc.) converge in the direction of tools capable of uniting "market conformity" and the ability to be axes in transmitting strategic objectives shared by public decision-makers. Naturally it is too soon to judge the importance of the *InfraMed* initiative; it is, however, worth summarizing its characteristics.

InfraMed's promoters are:

InfraMed's Promoters			**Initial capital granted (euro)**
1.	Cassa Depositi e Prestiti (CDP)	Italy	150 million
2.	Caisse des Dépôts et Consignations (CDC)	France	150 million
3.	Caisse de Dépôt et de Gestion (CdG)	Morocco	20 million
4.	EFG - Hermes	Egypt	15 million
5.	European Investment Bank (EIB)	EU	50 million

Inframed's investor board elected Franco Bassanini, president of the *Cassa Depositi e Prestiti (CDP)* as its chairman. His two assistant chairmen will be Augustin de Romanet, Director General of the *Caisse des Dépôts et Consignations* (France), and

Anass Houir Alami, Director General of the *Caisse de Dépôt et de Gestion* (Morocco). Rachid Mohammed Rachid, Minister of Trade and Industry of the Arab Republic of Egypt, will lead the strategic board. He will be responsible for providing advice and guidelines on the Fund's entire activity. Frederic Ottavy has been elected as the Managing Director of the *InfraMed Management* team. Finally, an investment committee, with a majority of independent members, will have the task of approving the investments

The Fund is open to other subscribers. It has a maximum equity capital of 1.2 billion euros by November 2011, with additional debt facilities of up to 3 billion euros.

InfraMed is devised for funding "Mediterranean" and "sustainable" infrastructures in the transport, energy and urban sector, with a preference for *Greenfield* projects requiring long-term investments

The operational area includes Algeria, Egypt, Israel, Jordan, Lebanon, Libya, Mauritania, Palestinian Territories, Syria, Tunisia and Turkey. It is interesting to note the presence of Israel in the *InfraMed* geographical operational area.

We are therefore talking about a "regional scale fund", from an operational point-of-view. To this day the fund is regional also in terms of those who have granted capital, even if the intention is to open the doors to financial institutions "outside the Mediterranean", like sovereign wealth funds and development banks in China, Russia or from the Gulf area.

The role of the protagonists Egypt and Morocco, apart from granting initial capital, is very strongly evident from the expected partnership with Egypt's EFG-Hermes and Morocco's *Caisse de Dépôt et de Gestion.* These institutions will promote, in their own countries, local infrastructural investment funds that will support *InfraMed.* Furthermore, it's forecasted that at least 20% of the *InfraMed* investments will take place in Egypt and Morocco.

6. Open problems.

As mentioned above, *InfraMed* is designed as a tool to boost mediterranean cooperation and is part of the Union's framework for the Mediterranean. We shall conclude by mentioning a few problematic aspects; first of all the coherence between the *Union for the Mediterranean*'s members and tools and those of *InfraMed*. Like *Margherite* fund, *InfraMed*'s promoters aren't the States as such, or their administrative networks, but entities like the *Cassa Depositi e Prestiti* or Financial Institutions "of public interest" that, independently from their juridical configuration, have a strong public institutional endorsement.

The picture is enriched by the participation of European institutions like the *European Investment Bank* that is likely to become the protagonist of *InfraMed*. In addition, there is the possibility that the *Margherite* fund, as such, will support or finance *InfraMed*. In doing so the European Commission's presence will, albeit indirectly, come to light and, likewise, it will confirm that European Community Institutions have "a lot to say" on the Mediterranean front, while Member States are not destined to be the sole *dominus* of Euro-Mediterranean relations

To this day its not possible to forecast the outcomes of the initiative. What is certain is that the success of *InfraMed* could give strong support to "major federate projects" , as a moment of economic and civil growth as a sign of visibility and legitimization of the process among the populations.

In the face of these ambitions the fundamental question remains, concerning the effective capacity of "prototypes" like *Margherite* and *InfraMed* to attract long-term investors, be successful and determine the birth of a new family of financial tools to be used for growth and stability.

In reality, the only way of attracting long-term investors, or perhaps, more precisely, to revive long-term investments, is to be able to map out a long-term future. This is what the credibility of the European Union depends on.