EU infrastructure policy

Key considerations for investors

Navigating global politics, business and policymaking

Introduction

A key challenge for the European Union's 2019-2024 policy cycle will be to secure a larger share of the economic opportunities offered by new technologies, in a more explicit race with the United States and China. Hopes in the previous cycle that this could be secured by a new generation of start-ups and by establishing the EU as a global regulator are being replaced by a renewed emphasis on building from existing industrial strengths. This will become most obvious during the German Presidency in the second half of 2020, but is already informing the policy agenda and power balance of the incoming European Commission and European Parliament, as well as driving domestic policy decisions in member states.

The first components of this pivot towards interventionism have been a set of competing proposals, including from France and Germany, on how to regulate and support the integration of specific technologies, such as artificial intelligence, batteries for electric vehicles and the internet of things.

Global Counsel's team of policy advisers anticipate, however, that this eventually will be complemented by a focus on the enabling infrastructure for this modernisation. Given the importance of infrastructure in investment portfolios and in corporate planning, the economic impact of these choices will be even greater than the explicit industrial policy agenda.

Most obviously, this will require the delivery of superfast internet connectivity, on which the adoption and application of new technologies will depend, but also on the rules that drive adoption of process innovations such as the re-use of waste. Decisions in these areas also take place alongside more urgent pressures for common standards for zero emission transport options and for a clear pathway towards decarbonisation of the energy mix.

In this publication, we assess some of the choices that policymakers face or will face in these areas, and the consequences for business and investors that stand to win or lose from a changing regulatory and funding landscape.

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A dual-track approach to European TMT policy

The experience of European telecoms policy in recent decades has been one of a tension between the prioritisation by policymakers of the consumer interest and fiscal revenue raising, and arguments from the telecoms industry that long-term regulatory certainty is required to invest in the maintenance, upgrading and development of telecoms networks. There are signs that the approach of policymakers is shifting closer towards industry sentiment as they grapple with the need to encourage private sector investment in 5G and fibre networks. But the tension remains, and how it is resolved is key for firms and investors.

This tension has played out at both EU and national levels. In Brussels, it has manifested itself as policies designed to appeal directly to European consumers. The most prominent examples have been successive regulatory interventions to first cap and then abolish mobile roaming charges within the EU, where the telecoms sector was perceived as over-charging consumers. This agenda has found new life with the recent introduction of caps on calls between different European countries.

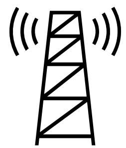
This prioritisation of the consumer interest has also been prominent in the approach of Competition Commissioner, Margrethe Vestager. Over the past five years, Vestager has opposed mergers between mobile providers — blocking O2-Three in the UK while overseeing the withdrawal of the Teliasonera-Telenor merger — and has only approved mergers between fixed-line providers where the emergence of a new competitor has been assured. The telecoms sector has argued that this has led to fierce price competition in national markets, coming against a backdrop of average revenue per user (ARPU) for telecoms operators over the past years.

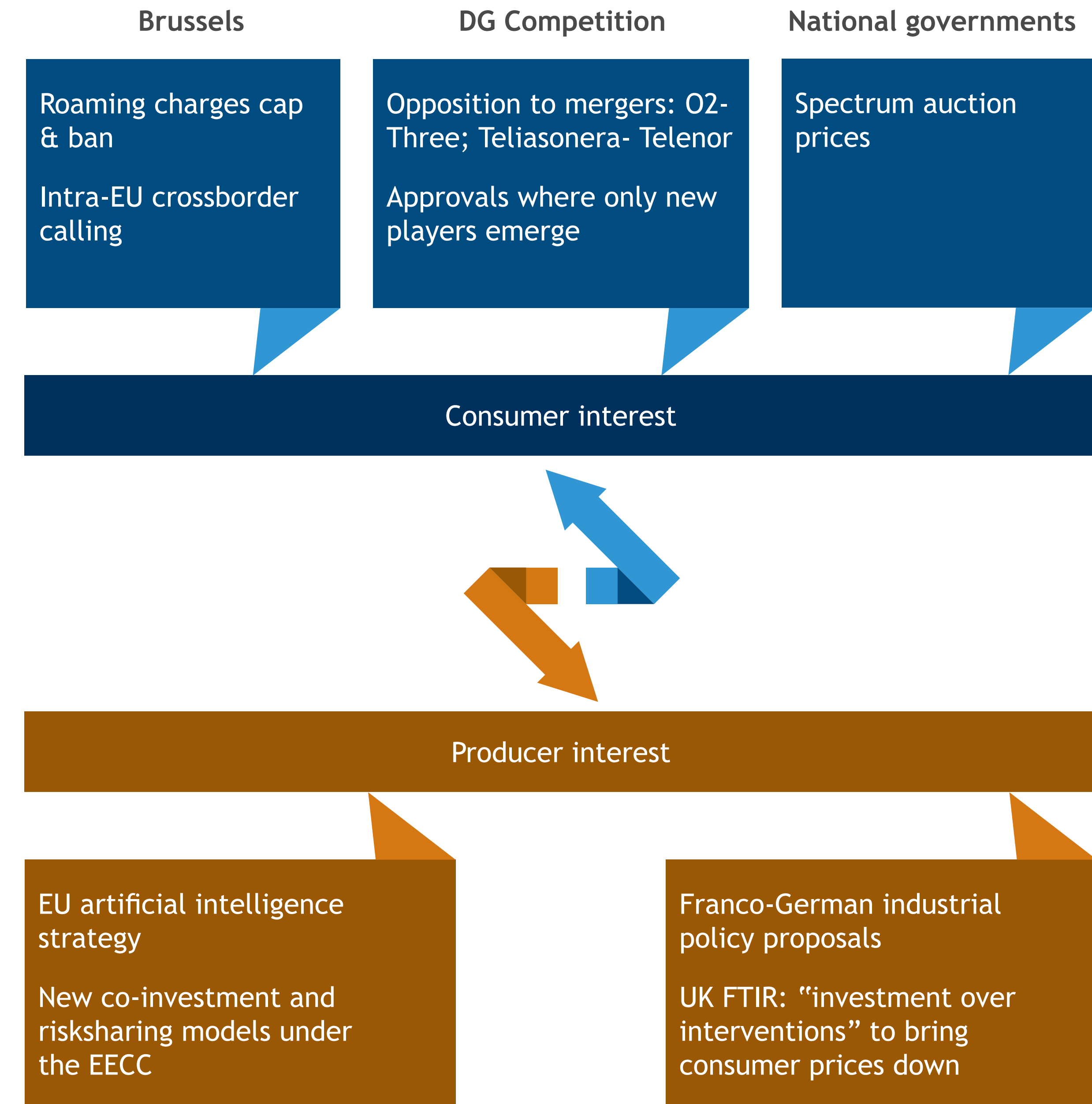
At a national level, policy tensions have primarily emerged over fiscal policy, particularly with regard to spectrum auctions. For national policymakers under budgetary pressure, spectrum auctions are a relatively painless way of raising revenues, compared to tax increases. Prices at recent auctions for 5G bands, most notably in Italy, have in turn prompted a backlash from telecoms operators who have complained that short-term fiscal considerations are being prioritised above the long-term sustainability of 5G investment.

There have, however, been some indications that policymakers are beginning to edge closer to the position of industry. This has been prompted by concerns over Europe's competitiveness in artificial intelligence, big data and the internet of things, which will all be underpinned by 5G and fibre infrastructure. The European Electronic Communications Code, for example, included incentives for co-investment arrangements such as long-term risk sharing models to deploy new fibre networks and fibre-based backhauls. On competition policy, Berlin and Paris have argued that the Commission needs to allow greater leeway for mergers and acquisitions which create European global champions. Some governments, such as the UK, have been even more explicit. In its Future Telecoms Infrastructure Review, it argued that "promoting investment should be prioritised over interventions to further reduce retail prices".

The extent to which this causes a fundamental review of the investment environment will, however, be shaped by the EU institutions' reaction to the challenge of a sense of disillusion with the EU in many EU member states and the sense in the institutions that this needs to be combatted with 'retail' policies. Roaming is considered a major achievement in Brussels and the quintessential popular EU policy. A new round of MEPs and Commissioners will see further intervention in the sector, e.g. through further caps on intra-EU calls, as a tempting target.

The earliest signal for telecoms investors will come from the appointment of the next Competition Commissioner and the way they are briefed for hearings with the EP. Their power and independence on mergers and acquisition cases will determine the course of consolidation within the sector for the next five years. Hearings in the autumn will give initial indications of whether they will follow the Vestager blueprint - prioritising price competition in consumer markets - or oversee a more accommodating approach to telecoms mergers favoured by Berlin and Paris, and the telecoms sector.





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Addressing the waste gap

The last few years have seen a dramatic change in the focus on waste and what to do about it - especially plastic waste. This has been driven in part through high-profile advocacy like that of David Attenborough, but also a growing awareness across the political spectrum that Europe's 'waste' may actually be a valuable resource - particularly as certain resources grow increasingly scarce. This has focused policymakers on circular economy approaches in which resources are reutilised and thereby waste is reduced. In order to make this a reality, a series of legislative changes related to waste management and product design have been proposed over the last years and in 2018, the EU passed changes to four major directives under the umbrella title of the Circular Economy Package (CEP). The directives outline new targets and fees in order to prioritise waste prevention and recycling. The question now is how Europe will meet higher targets with significant gaps in infrastructure for recycling and recovery. This is a potential area of investment opportunity and risk.

As Europe is ramping up its own ambitious plans to tackle waste, China and many other Asian countries which have historically accepted low-grade sorted materials (e.g. paper, plastics, metals) have been cracking down and closing their borders. This has created increasing urgency for many European countries to determine how to rapidly scale domestic recycling and recovery capacity. Until recently, however, waste management and particularly recycling have not been popular sectors to invest in, due in part to perverse policy incentives - which make recycling less lucrative. It is also a sector that has long been plagued by inefficiencies, local politics, and a considerable amount of waste crime. Perverse incentives, such as the low cost of waste exports, have provided little drive to develop infrastructure internally, whilst the financial risk of nascent waste management solutions has been too great for many investors. The EU has put the wheels in motion to address these barriers, and is set to put its weight behind the transition in the next policy cycle to plug market gaps and mobilise private investment. While the CEP is straightforward in setting out targets, it allows for considerable interpretation by member states in how those targets are achieved.

Member states are looking to drive this transition through a combination of: i) market participation incentives (e.g. deposit return schemes); ii) charging for externalities (e.g. carbon tax); and iii) educating the finance sector on how circular business models work (e.g. solvency, breakeven point, customer loyalty). Each of these measures presents implications for producers of waste (e.g. retailers, manufacturers, etc.) and investors in waste processing, where there will be clear winners and losers depending on member state interpretation on how to achieve CEP targets. Variability across member states means that multinationals will be impacted differently depending on which markets they are engaged in, which could lead to shifting production/manufacturing, but also a potential push to the highest common denominator whereby companies are forced to comply with the most stringent interpretation to ensure compliance across all member states.

Arguably the largest impact on funding for waste infrastructure will come from reform of Extended Producer Responsibility (EPR) obligations, where member states are obliged to implement national legislation which makes producers of packaging responsible for the full cost of management, with a preliminary deadline of 80% of costs covered by 2023. New legislation will force producers to pay the full net cost of packaging recovery. This represents a considerable increase in funding, with producers currently covering from 10–30% of the cost of packaging recovery. The deadline for revising EPR legislation at member state level is July 2020, which means the costs imposed and how funds are directed towards infrastructure face considerable change.

Further incentives could stem from the simultaneous work that the EU is conducting on sustainable finance including a 'green' taxonomy which identifies what type of investment can qualify as green – of which recycling is on the list, but energy from waste is not - and therefore access earmarked funds. This will not be decided until the next Parliament is in place and the Council comes to its own agreement on how far to go in drawing the line on where to steer money. Inter-institutional negotiations on the taxonomy are underway, and with a surge in Green MEPs within the Parliament, it can be expected that ambition here will only be ramped up.

Gross investment in tangible waste infrastructure (% GDP)

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Source: Eurostat

Solving the electric vehicle policy puzzle

The European Union has committed to developing safe, clean and connected transport networks. But the future of modern mobility hinges on a jigsaw puzzle of evolving national and sub-national policy and funding frameworks. Policymakers at all levels are racing to catch up with rapid advancements in transportation technology and its effect on the forms of and demand for transportation infrastructure across the region.

This is particularly acute in Europe's urban areas, where 70% of the population lives and 80% of GDP is generated, and where political and social pressure has led to a growing awareness of the public health impacts of poor air quality caused by polluting vehicles and congestion. Policymakers are therefore focussed on ensuring cities' mobility systems are efficient, promote economic growth and minimise harmful pollution – three policy challenges which do not necessarily complement each other.

The European Commission in its Europe on the Move action plan has identified what it believes is a viable next step towards urban mobility, in the form of smart roads, cleaner electric vehicles and associated infrastructure. The framework is designed to promote clean and sustainable mobility, focus on improving citizen health and the environmental impacts of transportation, whilst also providing opportunities for the European economy. It is in these opportunities that lie the possibility for private investment to capitalise on a clear and unified EU-wide policy initiative.

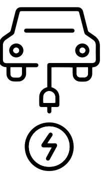
The Commission's commitment to Europe on the Move is definitive. The EU's announcement of further CO_2 emissions reductions targets from cars and - for the first time - heavy duty vehicles will be instrumental in stimulating the uptake of electric and more fuel-efficient vehicles. The monitoring and reporting of emissions will increase transparency and may affect consumer and producer decisions as markets strive to achieve the ambitious target levels set for 2030.

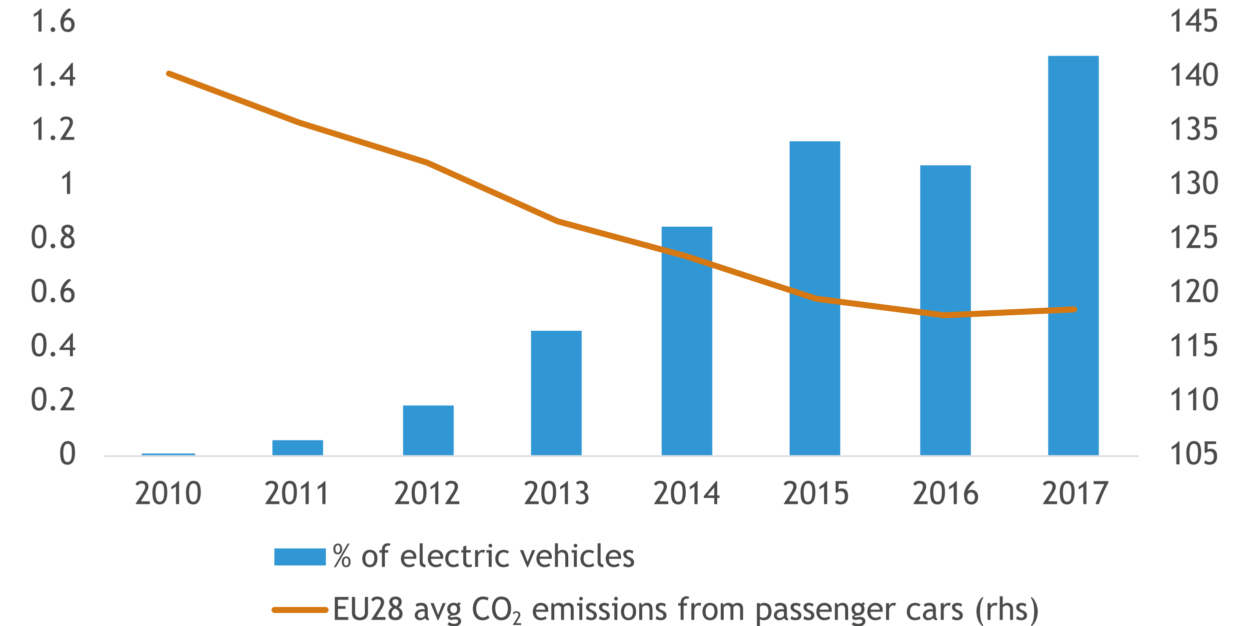
Naturally, this growth trajectory will trigger a requirement for convenient and efficient charging infrastructure, which the Commission is actively encouraging through legislation and investment - it aims to have spurred the development of over 1,200 alternative fuelling points by 2020 through funding mechanisms such as the Connecting Europe Facility.

Political obstacles remain an issue. National legislators will struggle to generate popular support in banning traditional combustion vehicles from the roads, and discouraging ownership of private vehicles to promote the use of shared electric transport will mean disrupting deep-rooted attitudes towards independent mobility. Electric vehicle prices are dropping sharply, but at current figures, the majority of people are still priced out of access.

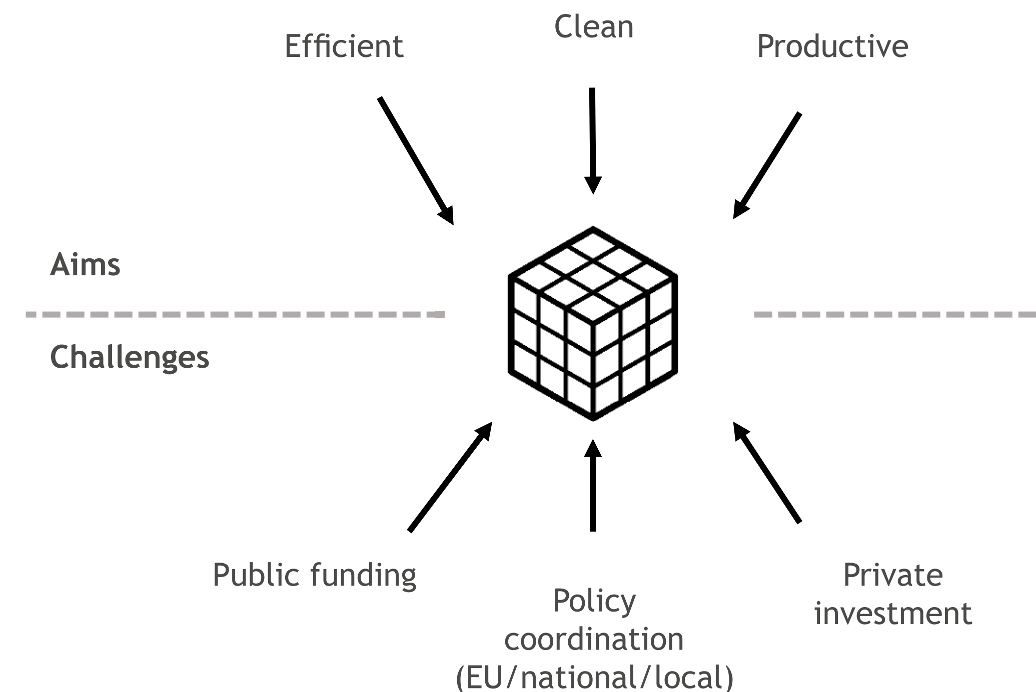
However, the trickiest sticking point will likely be encouraging EU member states and local authorities to proactively develop their own bespoke plans of action suitable for their own geography, demography, economy and governance. In some cities like Bremen or Oslo, regulatory encouragement has combined with economic factors to drive investment into sustainable urban mobility development. In other cities in Europe, factors as diverse as parking rules, local government boundaries and lack of the necessary charging structure has prohibited the adoption of such solutions. The interests of producers across member states will also play a role; the move to electric and shared mobility options will challenge internal combustion engine manufacturing supply chains from Eastern Europe through to Germany.

Breaking this deadlock requires leadership from national and local government, coupled with a private sector willing to actively engage government to drive and co-fund change. As national policy agendas develop, those seeking opportunities in urban mobility infrastructure will be monitoring whether the Commission decides to take greater leadership in the field, harnessing their Europe on the Move strategy to facilitate the next wave of mobility development and subsequent investment opportunities.





Source: European Environment Agency



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The future of low-carbon gas

One of the first major EU policy decisions under the next Commission will be whether to adopt a 2050 target of net-zero greenhouse gas (GHG) emissions; that is an EU that absorbs as much GHG as it emits. The adoption of net-zero would set into policy a commitment to the transformation of the European energy system. For energy infrastructure with lifespans measuring in the decades, this presents significant risks and opportunities that will be heavily shaped by the next Commission.

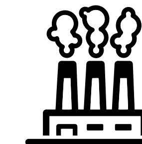
So how likely is it to be adopted? From a current target of an 80-95% emissions reduction by 2050, an increase to net-zero is a major upgrade in ambition. But the proposal has gathered significant political momentum in recent months. At the national level the UK, France, Germany, the Netherlands and others have signalled their support for a net-zero target. And while they are likely to meet opposition from certain central and eastern European member states, the proposal was also backed by all the major political groups during a European Parliament election that saw an unexpectedly strong result for the Greens.

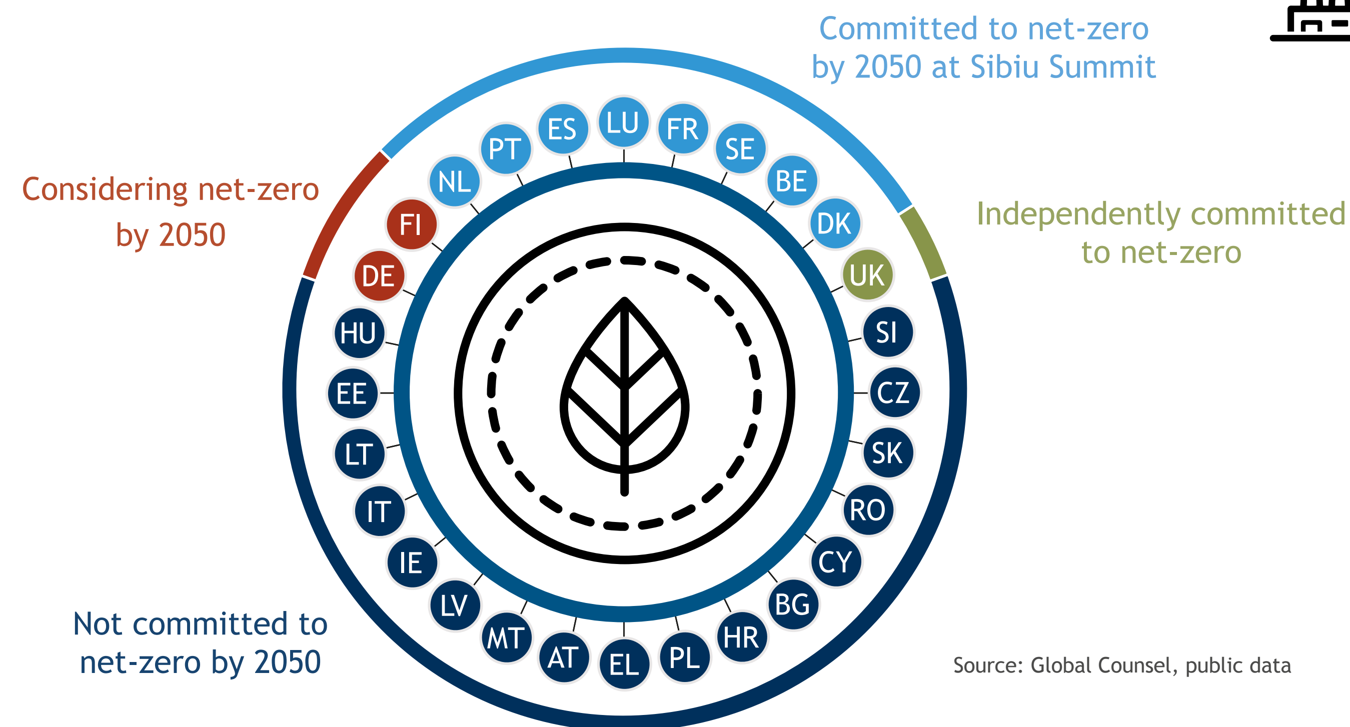
One area that will be highly impacted is gas infrastructure. In its communication 'A Clean Planet for All', the European Commission sets out eight scenarios for 2050, achieving a range of emissions reductions. Two of these scenarios achieve net-zero natural gas consumption, with falls of 82-88% compared to 2015 levels. While these aggregate figures obscure changes in rate of decline and geographical disparities, they highlight the challenge facing gas infrastructure operating on the presumption of on-going use of natural gas at current levels - both new projects and existing assets.

The news is not all bad for gas infrastructure investors. The Commission's communication also highlights that low-carbon gases, such as hydrogen and biogas, have important roles to play in decarbonising industry, heat and in some parts of power and transport. They may extend the useful life of existing infrastructure - for example where hydrogen or biomethane can be blended into the existing gas grid - but they will also offer new infrastructure opportunities. The need for significant volumes of hydrogen has the potential to drive new industrial clusters around renewable power, hydrogen production and carbon capture and storage (CCS).

In the short term, two policy issues will be important to watch. First, the next Commission is expected to initiate a major legislative reform of EU gas regulation in its first year. This will update existing regulation on the single market for natural gas. But it will also begin to develop the regulatory framework - and perhaps set a target for - low-carbon gas in the European energy system. This will provide an early signal of where the Commission believes there is potential for decarbonised gas to play a role, with corresponding opportunities for infrastructure investors. Focus is likely to fall on hydrogen and e-gas (chemically synthesised gas using renewable power) in particular.

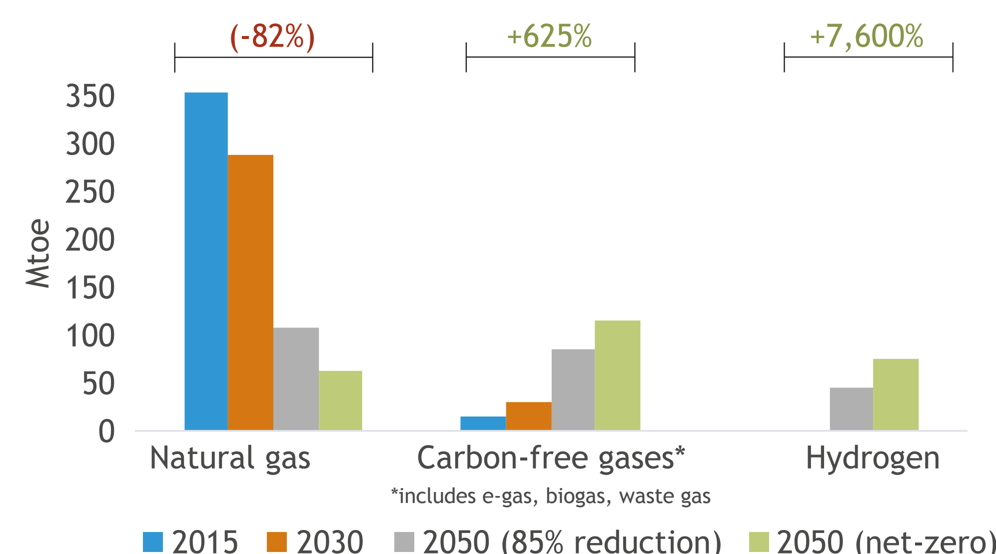
The second important policy area will be the Connecting Europe Facility (CEF), a CEF European Commission-administered funding instrument for infrastructure projects across the EU. The Connecting Europe Facility (CEF) will be renewed and expanded for 2021-2027, however the Commission has been asked to evaluate the Trans-European Networks for Energy (TEN-E) regulation that sets the terms under which projects can qualify for CEF funding (as Projects of Common Interest). The Commission has explicitly been instructed to ensure that the TEN-E regulation is compatible with EU climate and energy targets. While this is unlikely to disqualify natural gas infrastructure projects - such as LNG import and pipeline projects - it may diminish, or set conditions on, their ability to access funding, with low-carbon gas infrastructure reaping the reward from any consequent ambitious revisions.





Source: Global Counsel, public data

Net-zero 2050 impact on consumption of gaseous fuels



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Source: Eurostat (2015), Primes, Global Counsel

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