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One Trillion Euros for Europe

How to finance a European Silk Road with the help of a European Silk Road Trust, backed by a European Sovereign Wealth Fund and other financing instruments

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Executive Summary

› Much of Europe’s infrastructure is in a bad state, even in some wealthy parts of Europe, such as Germany. Europe’s periphery is underdeveloped and has difficulties to catch up, in part because of substantial infrastructure deficiencies. Real interest rates are negative and infrastructure investment has the potential to finance itself. Current European infrastructure initiatives are insufficient and piecemeal.

› In this context, wiiw proposes a financing model for a European Silk Road, as suggested in Holzner et al. (2018). The new transport infrastructure (a combination of an e-mobility motorway, high-speed rail, ports and logistics centres) would connect the industrial areas of the west with the populous, but less developed, regions in the east of the continent.

› The estimated construction costs of 1 trillion euros (7% of EU GDP) should yield substantial short-, medium- and long-run economic gains along the route (11,000 km overland). Apart from the growth and employment effects of construction activity (2-7 million new jobs during the building period), trade effects are also expected to be significant.

› In order to conduct and finance the project, we propose establishing a European Silk Road Trust (ESRT) as a public limited company, similar to the Austrian ASFiNAG corporation. This would allow for the extra-budgetary financing of investment in infrastructure (and for the project’s operation).

› While the ESRT (owned by the euro area countries, other EU countries and third countries that wish to join in the construction of the European Silk Road) could rely on a public guarantee when it comes to issuing long-term bonds (at currently zero or even negative interest rates), it would formally be part of the private sector, especially as it would have sufficient income of its own from private customers (tolls).

› As a strong core guarantor for the ESRT, we suggest the gradual development of a European Sovereign Wealth Fund (ESWF) by the euro area member states. At a certain point in time, this fund could replace the euro area member states as the major guarantor for ESRT bonds.

› In the initial phase, the European Central Bank (ECB) could reinvest a part of its assets in a way that would (to a certain extent) carry more risk, but also bring greater revenues, following the structure of the Norwegian oil fund. It is estimated that the ESWF would grow over the longer term to about 3% of the euro area’s GDP. This should be sufficient to guarantee the ESRT bonds – even if long-term interest rates move back into positive territory in the more distant future.

› Alternative means of financing include a much smaller ESWF of about 0.7% of euro area GDP in the longer run, sourced from a part of the profits of the ECB, without changing the structure of the ECB’s asset purchase programmes. Other options, which would make use of existing institutions (instead of an ESWF) would include, for instance, a substantial increase in the European Fund for Strategic

Investments (EFSI) and/or a larger capital injection in the European Investment Bank (EIB), in order to finance the ESRT's activities.

- The likelihood of an increase in global interest rates anytime soon is minimal, considering the Japanese experience over recent decades. In the current macroeconomic climate, a 'big push' in infrastructure investment, such as the suggested European Silk Road project, could help to solve both the problem of sluggish growth in the west of the continent and the developmental problems in the east. Moreover, it could constitute a new narrative of cooperation for Europe.

Keywords: infrastructure, transportation, Europe, China, Silk Road, growth, economic integration. industrialisation, international trade, public finance, international financial policy, financial institutions

JEL classification: E61, F36, F38, F42, G18, G28, H54, O18, R41, R42, L92

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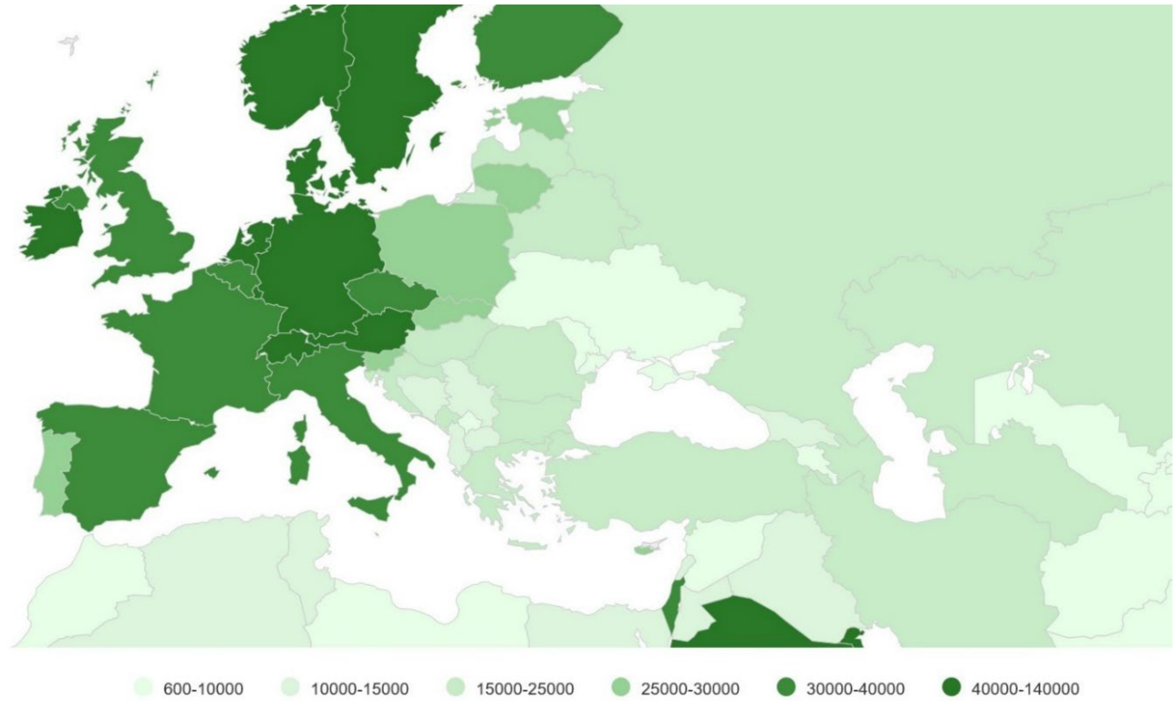
1. THE 'EUROPEAN SILK ROAD'

In Holzner et al. (2018), the authors argue for a 'big push' in infrastructure investments in greater Europe (following the seminal paper by Rosenstein-Rodan, 1943). They propose the construction of a European Silk Road that would link the industrial centres of the west with the populous, but less developed (Figure 1), regions in the east of the continent to promote economic growth and employment in the short, medium and long term.

Figure 1 / GDP per capita in USD PPP at 2011 prices, 2016



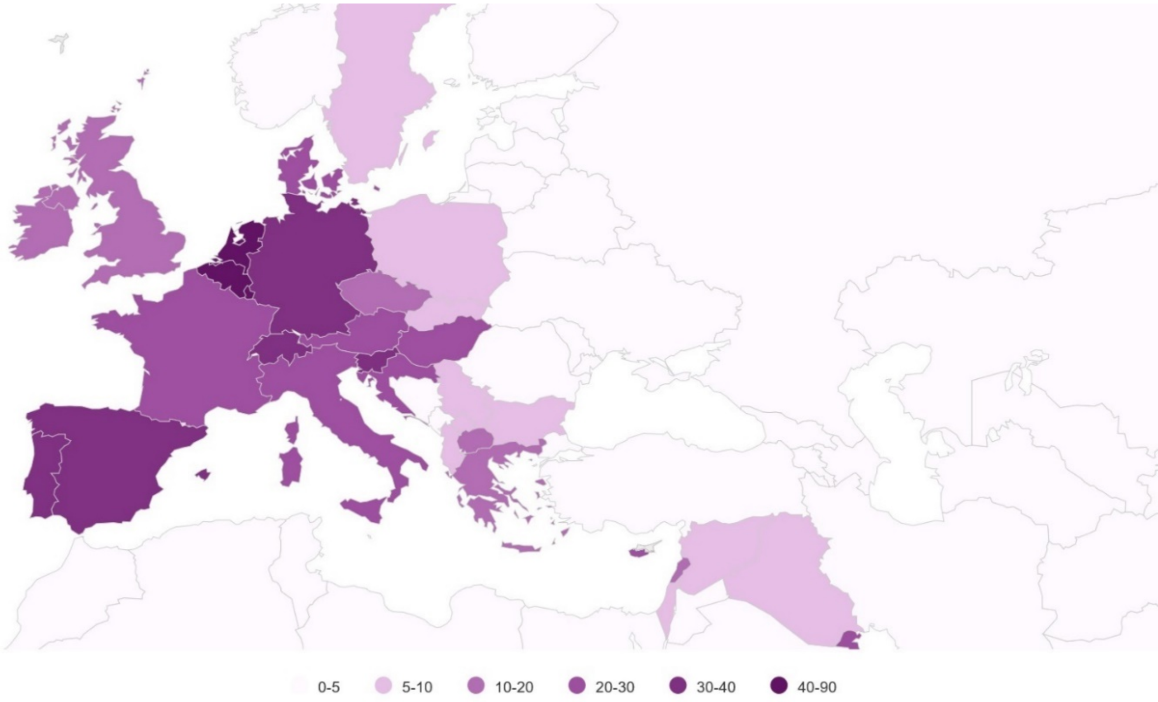
Source: Maddison-Project (cgdppc) January 2018; wiiw; author's own estimates and visualisation.

Well-functioning (transport) infrastructure is seen as a prerequisite for sustainable economic growth and for the eventual catching-up with higher income levels. Modern transport infrastructure, however, is still largely missing in the east of the European continent. This point is indicated, for instance, by the extremely low motorway density (Figure 2).

This initiative should not necessarily be viewed as competition for the Chinese New Silk Road (Belt and Road Initiative), but rather as a complementary project (despite serious differences in the general approach to infrastructure construction concerning, for instance, issues of public procurement and the much higher environmental standards in the case of the European Silk Road). Besides the economic benefits, the European Silk Road project would also bring important political advantages, as more cooperation would result from transnational, joint infrastructure measures.

Moreover, important issues of environmental protection (e.g. reduced congestion along the new infrastructure; less air travel, as use is made of a high-speed train system), personal and cultural exchange could be addressed. The project could be the cornerstone of a new European narrative, as the post-war peace narrative has been fading, and disintegration (e.g. Brexit) is increasingly becoming a threat.

Figure 2 / Kilometres of motorway per 1,000 km² of territory, latest available year as of 2018



Source: NationMaster; CIA World Factbook; World Development Indicators; Eurostat; Wikipedia; author's own estimates and visualisation.

On completion, the European Silk Road would extend overland for around 11,000 kilometres on a northern route from Lisbon to Uralsk on the Russian-Kazakh border, and on a southern route from Milan to Volgograd and Baku (Figure 3). The central parts would be the route from Lyon to Moscow in the north and from Milan to Constanţa in the south. The southern route would link Central Europe with the Black Sea area and the Caspian Sea littoral states. The proposed infrastructure would connect more than half a billion Europeans in the west of the continent with almost the same number of people in the east.

A new state-of-the-art motorway (compatible with e-mobility and autonomous driving) and high-speed railway line, together with a string of logistics centres, seaports, river ports and airports, could set new European standards, including in terms of e-mobility and autonomous driving. Our estimates suggest that a full extension would cost around 1 trillion euros to build, or approximately 8% of the gross domestic product of the countries situated along its two routes. The costs relative to the EU's economic output would amount to about 7% (Holzner et al., 2018).

The cost estimates for the European Silk Road are far below the estimates for the Chinese New Silk Road of up to 7 trillion euros. The investment costs would be more than compensated for by the positive growth effects in gross domestic product, employment and trade.

In a conservative baseline scenario, the calculations show that the European Silk Road construction would have the potential to increase the GDP of the countries involved by an average of 3.5% over an investment period of 10 years, and would increase employment by 2 million. Under particularly favourable circumstances, and if interest rates remain low, the employment effect could even be over 7 million in greater Europe.

Savings in transport time – for instance, on the European Silk Road's northern route by an average of 8% – could enable those countries along the route to raise their exports to Russia by more than 11% (disregarding current sanctions and counter-sanctions). In the context of expanding the pan-European market, the potential benefits of enhanced economic integration are substantial.

Figure 3 / Proposal for a European Silk Road

Source: GEOATLAS.com; map with routes suggested by Holzner et al. (2018).

2. HOW TO FINANCE THE EUROPEAN SILK ROAD

More than 75 years ago, back in 1943, Paul Rosenstein-Rodan proposed an Eastern European Industrial Trust to finance a 'Big Push'. Its capital was to have been provided by the governments of Western and Eastern Europe. Today we would like to propose a similar trust, which would set out to bridge the gaps in infrastructure in greater Europe and to construct a European Silk Road with the aid of an infrastructure investment push. Given the currently extremely low interest rates, and in view of the anticipated immense economic effects, a 'self-financed' investment could be envisaged (IMF, 2014). Currently, there is a huge 'excess of desired saving over desired investment' that could be mobilised, especially in Europe (Summers, 2015, p. 61). This is reflected in the lowest interest rates on record (or at least for the past 400 years).

In principle, there are numerous types of private infrastructure finance (Inderst, 2013). A broad taxonomy would include fixed income bonds and loans, mixed hybrid instruments, and listed and unlisted equity (OECD, 2015). However, there are many challenges to infrastructure finance, although real long-term interest rates are at a historic low and the potential supply of long-term finance has been ample for quite some time (Ehlers, 2014). Furthermore, a number of EU initiatives have been launched to overcome market failures by reducing financing risks. The European Fund for Strategic Investments (EFSI) – established in 2015 and called the *Juncker Plan* – is a prominent example. This is an initiative of the European Investment Bank (EIB) and the European Commission, and aims to boost the economy by mobilising private financing for strategic investments. However, its results have been mixed (EIB, 2018; European Court of Auditors, 2019). This is partly due to the limited funds available. EFSI originally only included a 16 billion euros guarantee from the EU budget, plus 5 billion euros from the EIB's own capital. The guarantee has now been increased to a total of 33.5 billion euros (with a targeted leverage effect of 1:15).

There are other opportunities, too, that are neither debt nor equity financed, but still seek to enable large infrastructure investments. For example, the annual losses from tax evasion (Alstadsæter et al., 2019) and tax avoidance in the countries of the European Union are put at approximately 1 trillion euros (Murphy, 2012). The additional resources made available by the fight against tax evasion and tax avoidance could, at least in part, flow into the expansion of long-term infrastructural measures. However, we are well aware that any form of direct fiscal transfers in Europe is politically extremely sensitive. Therefore, this policy note suggests a financing model that does not rely on a direct transfer scheme, and should therefore be acceptable to all stakeholders.

2.1. The European Silk Road Trust

One practical legal form that the European Silk Road Trust (ESRT) could take would be a public limited company (PLC) similar to the Austrian ASFiNAG corporation. ASFiNAG (Autobahnen- und Schnellstraßen-Finanzierungs-Aktiengesellschaft) was established in 1982 and allows for the extra-budgetary financing of investment in infrastructure (and the operation of that infrastructure) in the area of road construction. While ASFiNAG, which is owned by the Republic of Austria, can rely on a state guarantee when it comes to issuing bonds, it is still formally part of the private sector, especially as it has sufficient income of its own from private customers (tolls).

Nauschnigg (2015a) stresses that the ability of the private sector to finance long-term infrastructure investment is reduced by EU regulations on banks and insurers. Meanwhile, public-sector investments in the EU are hampered by the general restrictions of the Stability and Growth Pact. In the EU – and especially in the euro area – fiscal policy has been largely pro-cyclical, and especially public investment has suffered from austerity policies, which have deepened the crisis (Truger, 2015). Nauschnigg (2015a) shows that the ASFiNAG model has been able to make use of a certain flexibility in the Stability and Growth Pact, and has allowed Austria to implement counter-cyclical infrastructure investments over recent decades.

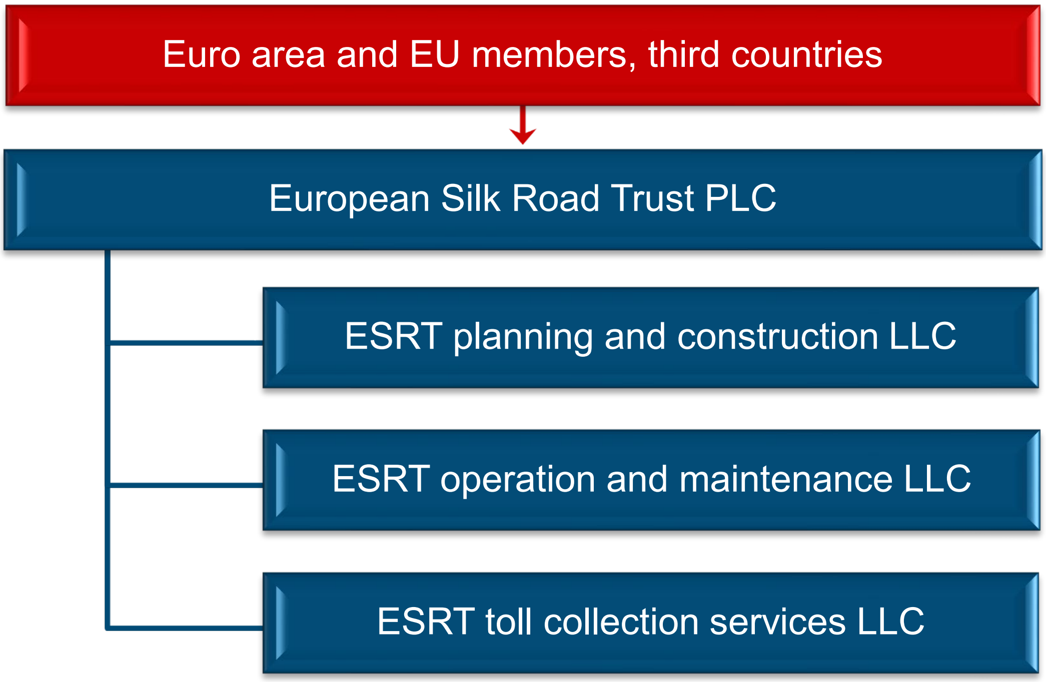
Nauschnigg (2015b) enumerates some of the advantages of the ASFiNAG corporation, aside from higher infrastructure investments: low-cost funding due to public guarantees for the corporation's debt; better presentation and accounting treatment of investments, compared to outright public infrastructure investments; increased pressure on road users to pay the route costs; more efficiency and flexibility from a non-state administration; and a central administration that makes use of synergies and minimises transaction costs. Overall, ASFiNAG combines the advantages of the private sector (efficiency and flexibility) with those of the public sector (low financing costs).

The ASFiNAG model has also been considered as a blueprint for extra-budgetary investment vehicles in other countries. Thus, for instance, both the German parliament (Deutscher Bundestag, 2017) and the German government (Expertenkommission, 2015) analysed this option. Although, in September 2018, Germany established a centralised corporation responsible for the motorways (Die Autobahn GmbH des Bundes), it is not allowed to raise funds on the financial markets. However, in the future it will be financed from the toll revenues collected.

Nauschnigg (2015a) further elaborates on an Infrastructure Investment System, where each euro area country has one National Infrastructure Investment Agency, similar to ASFiNAG. At the euro area level, a Euro Area Infrastructure Investment Agency (€IIA) would have coordination functions and would issue Eurobonds amounting to 1% of euro area GDP for infrastructure investment. To avoid transfers among countries, each government would provide secure collateral for the financing received from the €IIA, such as future profits of the national central banks (NCBs). For more investment, additional collateral could come from member states pledging the income from potential future taxes agreed at the euro area level, such as taxes on financial transactions, financial activities, flights, CO_2 emissions or corporate income. All of this would have the potential to strengthen the counter-cyclical capabilities of the euro area.

In our own proposal, we want to suggest the establishment of a single European Silk Road Trust PLC, owned by the euro area countries, the EU countries and third countries that wish to join in the construction of the European Silk Road. A single ESRT PLC, based on the ASFiNAG model, would be needed to manage the massive cross-border activities of the European Silk Road project. A professional centralised authority, with a properly designed project, would also have better standing with the financial markets when issuing its own ESRT bonds (according to Ehlers, 2014, a lack of investable projects is one of the main reasons why the vast resources of the capital markets have been underutilised when it comes to financing infrastructure). Moreover, there would be less chance of its being seen as an extension of the European Central Bank or a euro area fiscal capacity, which several member states currently do not want to accept. Also, ideas related to the common issuance of government bonds (Eurobonds), as well as common European taxes,[1] are (at least for the moment) political no-goes.

Figure 4 / ESRT PLC architecture



Source: author's own design.

The architecture of ESRT PLC could be as shown in Figure 4. The members of the euro area, as well as the remaining members of the European Union and third countries, would own 100% of ESRT PLC. The ESRT would consist of three main limited liability companies (LLC) responsible for: i) planning and construction, ii) operation and maintenance, and iii) toll collection services. Given that most of its revenue would come from tolls, it would be considered part of the private sector. The fiscal rules in the Stability and Growth Pact would not then apply to the ESRT's investment projects. With the guarantees of its public owners, the trust could likely raise money on the financial markets via an ESRT bond, at interest rates similar to those of the euro area countries with the best investment grades – thus, currently at zero interest or even at negative rates.

Realistically, major euro area members close to France and Germany would begin with the establishment of the ESRT PLC and the construction of the European Silk Road – e.g. with the first construction lot connecting Paris with Berlin. Under the current monetary conditions at the zero lower bound, the risks of not servicing the bonds are practically non-existent. However, future potential interest rate rises (although highly unlikely anytime soon, considering, for example, the Japanese experience in recent decades) might pose a threat to the long-term refinancing of the ESRT bonds. Hence, over the medium to long term, ESRT PLC needs a strong core guarantor. To this end, we suggest the gradual development of a European Sovereign Wealth Fund by the euro area member states, as described in

1 http://tdem.eu/en/a-budget-for-europe/

the following section. At a certain point in time, this fund could replace the euro area member states as the main guarantor for ESRT bonds.

2.2. The European Sovereign Wealth Fund

The creation of a European Sovereign Wealth Fund (ESWF) for the euro area could have the (initial) indirect goal of simulating euro area fiscal policy – inter alia by acting as a guarantor for ESRT PLC – in a situation where most euro area governments have been unwilling (or unable) to conduct an appropriate counter-cyclical fiscal policy over the past decade (let alone perform a coordinated big push in infrastructure). Former European Central Bank President Mario Draghi has repeatedly urged euro area governments to initiate a significant fiscal response to an economic slump.[2] Similarly, ECB President Christine Lagarde has called on European governments to launch a fiscal stimulus.[3] For the majority of economists, it is of vital importance for the euro area to have, besides a common monetary policy, also a common fiscal policy (beyond the repackaging of existing European budget items, such as in the planned Budgetary Instrument for Convergence and Competitiveness, BICC).[4] An ESWF backing ESRT PLC could be a first decisive move in this direction, while at the same time accepting the current political and legal constraints.

Back in 2008, French President Nicolas Sarkozy suggested the creation of a Sovereign Wealth Fund (SWF), with the purpose of protecting European companies from foreign take-overs (Dimitrakopoulos et al., 2009). At the time, the proposal evoked negative reactions in Germany (where the mood might have started to change by now), as well as in the UK and the European Commission (Schelkle, 2012). US officials were also concerned (Guha, 2008). Later, in 2009, the European Economic and Social Committee suggested: ‘Thought should also be given to the idea of a European bond from a European sovereign wealth fund’ (EU, 2009). However, the idea appears not to have been fleshed out until more recently, when, in an internal Commission document, a 100 billion euros European Future Fund was suggested, in order to finance European industrial champions to compete with US companies such as Apple and Google, and China’s Alibaba.[5]

In academia, Meyer (2016) made a new proposal for an SWF for the euro area. This was based on earlier ideas in Corneo (2014) for a euro area SWF and in Corneo (2016) for a national-level socially responsible SWF and a federal shareholder institution. According to Meyer (2016), the euro area SWF should be financed by issuing joint bonds or via mechanisms involving the ECB. The returns from a globally diversified investment portfolio would allow the principal and interest to be repaid; the size of the fund to be increased; and returns channelled into a euro area budget. Bonds should not be refinanced when they reach maturity: that would help allay some of the concerns raised in the past about Eurobonds, as once the principal is repaid the SWF is liability free. In the famous Franco-German ‘14 economists’ paper (Bénassy-Quéré et al., 2018), the term SWF appears only once – when a fiscal stabilisation fund and its investment form is briefly discussed.

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2 https://www.bloomberg.com/news/articles/2019-07-25/draghi-urges-significant-fiscal-response-to-an-economic-slump

3 https://www.ft.com/content/0ff70e24-cef8-11e9-99a4-b5ded7a7fe3f

4 https://www.consilium.europa.eu/en/press/press-releases/2019/10/10/term-sheet-on-the-budgetary-instrument-for-convergence-and-competitiveness-bicc/

5 https://www.ft.com/content/033057a2-c504-11e9-a8e9-296ca66511c9

In fact, a European SWF focusing on European equity already exists (Rose, 2014). However, it is there to serve the Norwegian people, once the oil and gas reserves are depleted. The Norwegian Government Pension Fund Global (GPFG), established in 1990, currently (at the end of the second quarter 2019) holds a breath-taking 913 billion euros in market value, or 1.5% of more than 9,000 listed companies worldwide and 2.6% of listed companies in Europe.[6] As a share of global GDP, this adds up to more than 1%. The GPFG has an asset allocation of 69.3% equities, 2.7% unlisted real estate and 28.0% fixed income. The Norwegian fund's largest (global – mostly US and Swiss) equity investments as of the end of 2018 were in Microsoft, Apple, Alphabet, Amazon, Nestlé, Royal Dutch Shell, Roche, Novartis, Berkshire Hathaway, Johnson & Johnson and Facebook. Since the 1990s, the Norwegian fund has generated an average annual return of almost 6% (some net real 4% after management costs and inflation).

Aside from the handful of contributions mentioned above, to the best of our knowledge there have been no other suggestions for a truly European SWF. Consequently, an ESWF has so far not played any role in the general discussions for reform of the euro area, as the term 'wealth fund' does not appear in any of the contributions to the discussion, e.g. those contributions collected by the Centre for Economic Policy Research (Baldwin and Giavazzi, 2015; Corsetti et al., 2015; Baldwin and Giavazzi, 2016; Corsetti et al., 2016; Bénassy-Quéré and Giavazzi, 2017; Campos and Sturm, 2018; Marimon and Cooley, 2018). The contributions have, inter alia, focused on the lessons learned from the crisis, the reform of the crisis lending framework, the creation of a liquid safe asset, a sovereign debt restructuring regime, the delinking of banks from sovereigns, the reform of the Maastricht rules, the completion of the banking union, a common fiscal policy, structural and institutional reform, a banking union, a European unemployment insurance system, a jobs union, a European Monetary Fund and a fiscal union.

Nor have the more official proposals of French President Macron in September 2017,[7] the European Commission in December 2017 (EC, 2017), the Franco-German Meseberg roadmap of June 2018 (BMF, 2018), the Euro Summit statement of the EU Council in December 2018 and June 2019 (EU Council, 2018; 2019) or the Franco-German Treaty of Aachen (2019) mentioned a sovereign wealth fund.

Many of the recommendations in the discussion are driven by economists' convictions about an ideal (or at least second-best) solution to the problems of the euro area, and largely disregard the constitutional restrictions and the political economy of reform in the euro area. Consequently, the actual outcomes in the negotiations so far have been very modest.

Arguably, the most realistic actor for reform is the European Central Bank, as is evident from its crisis management. With various measures of unconventional monetary policy, the ECB has tried to increase inflation at the zero lower bound, against the backdrop of (at best) very modest support from fiscal policy. This, in turn, has led the German Federal Constitutional Court to the view that 'significant reasons indicate that the ECB decisions governing the asset purchase programme violate the prohibition of monetary financing and exceed the monetary policy mandate of the European Central Bank, thus encroaching upon the competences of the Member States'.[8] However, in December 2018, the Court of

6 https://www.nbim.no/en/the-fund/market-value/

7 https://www.elysee.fr/emmanuel-macron/2018/01/09/president-macron-gives-speech-on-new-initiative-for-europe.en

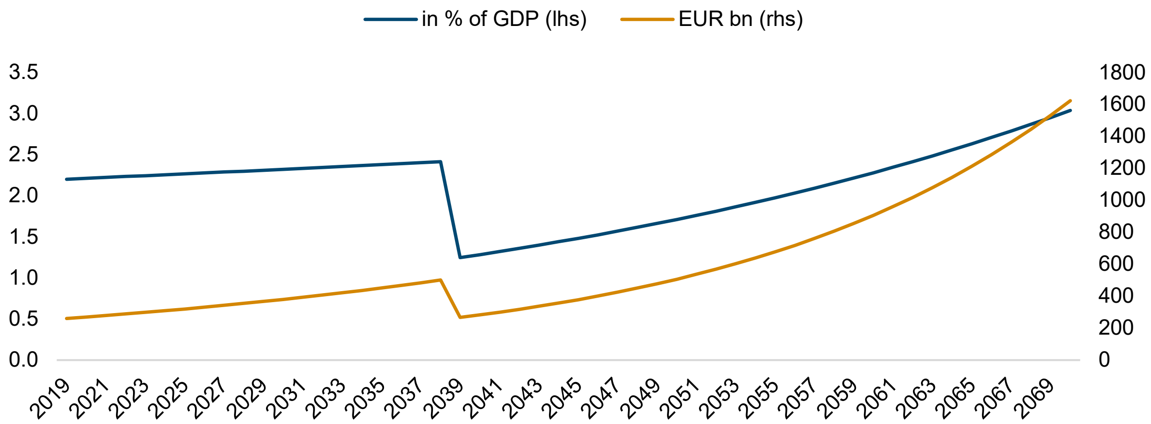
8 https://www.bundesverfassungsgericht.de/SharedDocs/Pressemitteilungen/EN/2017/bvg17-070.html

Justice of the European Union rejected these arguments and the matter will now be sent back to Germany's federal constitutional court for a final verdict.[9] Thus, the ECB has found itself treading a fine line with almost para-fiscal policies.

This path might lead to further innovations that could simulate non-existent euro area-wide fiscal policy. Certainly, potentially permanent transfers will not be allowed by the courts, based on current law and political circumstances. Hence, our own recommendation involves the introduction of a European Sovereign Wealth Fund by the ECB, in cooperation with the NCBs and the national finance ministries (NFMs). At a certain point, it should act as a guarantor of the ESRT bonds financing the European Silk Road project, with the aim of supporting monetary policy to meet the inflation target, without breaching Article 123 of the Treaty on the Functioning of the European Union (TFEU) on direct central bank financing of the public sector. The ECB's national capital owners (i.e. the NCBs) should never have their capital share put at risk as the fund's revenue would be used in the unlikely event of a loss of capital. We suggest that the structure of the ESWF should be similar to the global pension fund managed by the Norwegian Central Bank.

In the initial phase, the ECB could reinvest part of its (consolidated) assets of 4.7 trillion euros (as of 31 December 2018) in such a way that (to some extent) it would carry more risk, but also bring higher revenues, following the structure of the Norwegian oil fund. This could involve assets amounting to about a quarter of a trillion euros, which is roughly equivalent to the ECB's own (disregarding the NCBs' similar holdings) securities held for monetary policy purposes (in the order of 252 billion euros). Euro area NCBs (and by extension NFMs) should concede the revenues stemming from these funds. Applying an average annual return figure of 3.5% (which is roughly halfway between the Norwegian and the current ECB rate of return) would yield in the first year almost 9 billion euros in revenues.

Figure 5 / ESWF volume in billion euros and as a percentage of euro area GDP, large version



Source: ECB; Eurostat; author's own calculations.

If started in 2019, and with reinvestment of all the revenue, the fund would double in nominal terms by 2039. Apart from being a substantial fund to guarantee the real investments of ESRT PLC, the ESWF would also be a tool to simulate global taxation of the world's top multinational companies via dividend

9 https://curia.europa.eu/jcms/upload/docs/application/pdf/2018-12/cp180192en.pdf

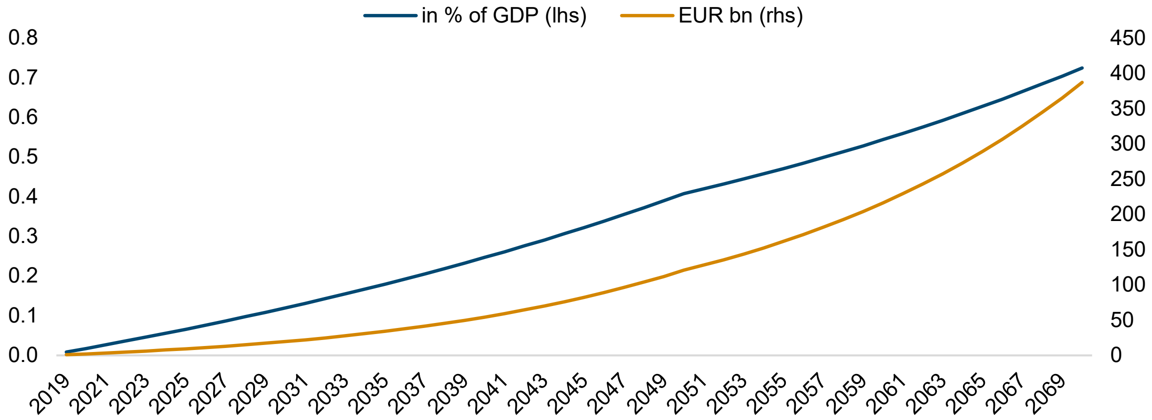
payments. The accumulated revenues could be put into a separate fund that is not on the ECB's balance sheet; this could allow the restoration of the initial balance sheet structure of the ECB and a related reduction in risks for the ECB and the NCBs.

Given the starting size of the ESWF (about 2.2% of the euro area's GDP – Figure 5) and the potential withdrawal from the ECB balance sheet of an estimated 1.2% of euro area GDP in 2039 (and the replacement of euro area governments as guarantors of the ESRT bonds), the ESWF level would only surpass the initial 2.2% of GDP in 2059 (assuming an average nominal euro area GDP growth rate of 3% and permanent reinvestment of the revenues, now at a rate similar to the Norwegian SWF of 6%). By 2070, the size of the fund would exceed 3% of euro area GDP. This should be more than sufficient to guarantee the ESRT bonds – even if long-term interest rates move back into positive territory.

However, even a temporary and only partial change in the structure of the ECB's asset purchases might be seen as a breach of Article 123 of the TFEU and may require an amendment to the treaty, which could be difficult to achieve. Thus, in a smaller version of the ESWF the ECB does not change its behaviour, but only some of the profits are channelled into an ESWF outside the ECB's balance sheet (similar to the reimbursement of profits made by euro area central banks on their holdings of Greek bonds).[10]

Over the past decade, ECB profits have on average been above 1 billion euros. In 2018, they increased to more than 1.5 billion euros, and were disbursed according to the capital key, via the NCBs to the NFMs. In this smaller version of an ESWF, two thirds of the profits (starting with 1 billion euros in 2019 and increasing by 2% in each year, following the historical growth rate of ECB profits) would be redirected from the NFMs to the ESWF. There, the funds would be reinvested, following the Norwegian example, with annual returns of 6%.

Figure 6 / ESWF volume in billion euros and as a percentage of euro area GDP, small version



Source: ECB; Eurostat; author's own calculations.

10 https://www.esm.europa.eu/press-releases/efsf-approves-reimbursement-and-reduction-step-interest-margin-greece

If the fund reaches a volume compared to total costs of the ESR (corrected for an annual 2% construction cost inflation) of 1:15 (EFSI's targeted leverage effect), the contributions from the ECB's profits could be phased out by 2051 (Figure 6). By 2069, the smaller version of the ESWF should surpass 0.7% of euro area GDP. This is likely to be sufficient for the long-run guarantor function for the ESRT as well. However, it is possible that in this case the ESRT's bonds would be traded with a higher risk mark-up. An advantage is that the smaller ESWF would be fully operational from the very beginning. Both versions of the ESWF might also be used for other important common European projects, such as the 1 trillion euros Sustainable Europe Investment Plan proposed by the new president of the European Commission (von der Leyen, 2019).

2.3. Existing alternative financing instruments

While the creation of an ESWF might be advantageous in the longer run for financing various common European projects, it has to be admitted that the establishment of a new institution is always much more complicated than the expansion of an existing one. One alternative would be to increase the size of the EFSI substantially, and include the direct financing of the ESRT operations. However, the EFSI functions by mobilising mostly private capital to co-finance projects. Most transport sector projects in the EFSI portfolio are fairly small, with an EFSI financing component of well below 100 million euros. It remains doubtful whether EFSI would be able to manage to finance a 1 trillion euros infrastructure project.

In any case, that would involve an increase in the guarantees of the EU budget and the EIB from the current 33.5 billion euros to over 100 billion euros (assuming again a leverage of 1:15). That would probably make it necessary for the EU member states to increase the EIB's capital (the subscribed capital of the EIB at the end of 2018 amounts to 243 billion euros, of which 21.7 billion are paid in, the rest being callable). (A further complicating factor is the looming Brexit and the UK's possible withdrawal from EU institutions.)

Similarly, the EIB would need a substantial capital increase if the ESRT activities were to be directly financed by it – another alternative financing option via an existing institution. In turn, the ECB could buy EIB bonds to finance loans to the ESRT. It has to be noted, however, that typically the EIB only covers up to 50% of a project's total cost with loans. Thus, either private co-financing would have to be found, or else the EIB regulations would need to be revised.

Similar modes of financing are discussed in the context of large-scale green investments and related environmental loans.[11] In this regard, it is interesting to mention the Wise Persons' report on the European financial architecture for development (Wieser et al., 2019). The Wise Persons Group suggests the consolidation and streamlining of development finance and climate activities outside the EU into a single entity, a European Climate and Sustainable Development Bank (ECSDB), in order to avoid overlaps and to strengthen the EU's presence, role and long-term capacity to deliver on EU development priorities.

The group considers three options: i) Turning the European Bank for Reconstruction and Development (EBRD) into such an institution, by transferring the extra EU activities of the EIB to the EBRD; ii) Creating a new mixed-ownership bank with the EIB, the EBRD, EU member states and the European

11 https://escoriallaan.blogspot.com/2019/02/green-money-without-inflation.html

Commission as shareholders; iii) Forming a subsidiary for EIB's extra-EU activities and participating in it as a minority shareholder alongside EU member states, the European Commission and national development banks. Again, all this would imply important institutional changes and would require significant financial resources. Since it is suggested that the ESR should connect EU and non-EU economies, the ESRT could also be financed by a future ECSDB.

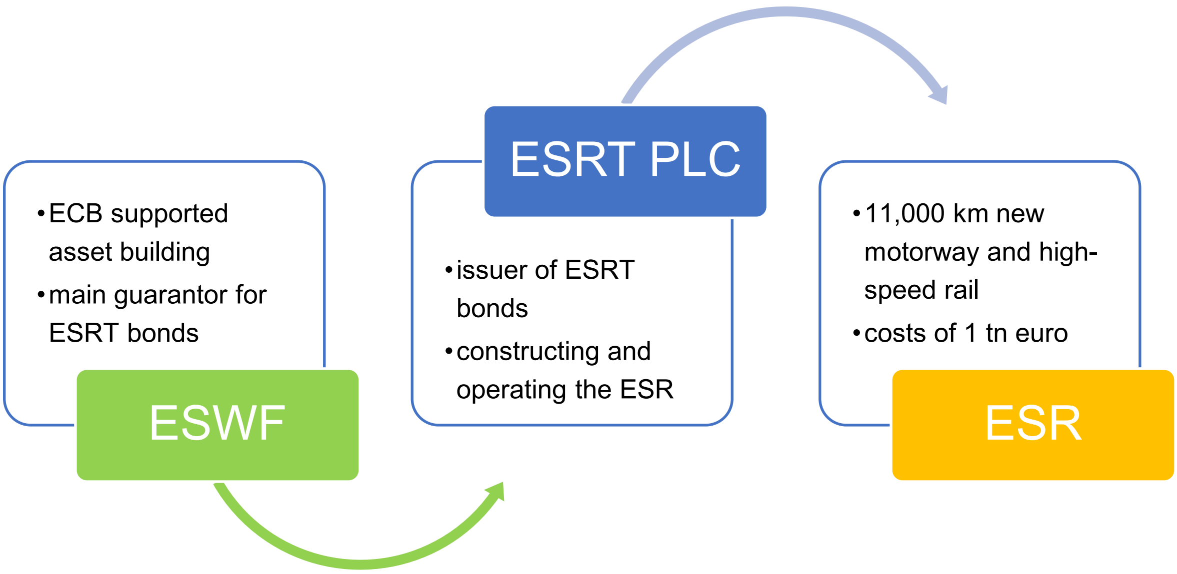
3. SUMMARY AND CONCLUSIONS

This policy note discusses the financing of a European Silk Road, as suggested in Holzner et al. (2018). The new transport infrastructure (a combination of motorway, high-speed rail, ports and logistics centres) should connect the industrial areas of the west with the populous, but less developed, regions in the east of the continent.

It is expected that the estimated construction costs of 1 trillion euros (7% of EU GDP) would yield substantial short-, medium- and long-term economic gains along the route (11,000 km overland). Apart from the growth and employment effects of the construction activity (2-7 million new jobs during the building period), it is estimated that the trade effects would also be significant.

In order to conduct and finance the project, we suggest establishing a European Silk Road Trust as a public limited company, similar to the Austrian ASFiNAG corporation. This would allow for the extra-budgetary financing of investment in infrastructure (and for that infrastructure's operation). While the ESRT (owned by the euro area countries, other EU countries and third countries that would like to join in the construction of the European Silk Road) could rely on a public guarantee when it comes to issuing long-term bonds (at currently zero or even negative interest rates), it would formally be part of the private sector, especially as it would have sufficient income from private customers (tolls) of its own.

Figure 7 / The ESWF, the ESRT PLC and the ESR



Source: author's own design.

As a strong core guarantor for the ESRT, we suggest the gradual development of a European Sovereign Wealth Fund by the euro area member states. At a certain point in time, this fund could replace the euro area member states as the main guarantor for ESRT bonds. In the initial phase, the ECB could reinvest part of its assets in a way that would (to a certain extent) carry more risk, but also bring higher revenues, following the structure of the Norwegian oil fund. It is estimated that the size of the ESWF would grow over the longer run to about 3% of the euro area's GDP. That should be sufficient to guarantee the ESRT bonds – even if long-term interest rates move back into positive territory in the more distant future.

Alternative means of financing include a much smaller ESWF of about 0.7% of euro area GDP in the longer run, sourced from some of the profits of the ECB, without changing the structure of the ECB's asset purchase programmes. Other options, using existing institutions instead of an ESWF, include substantially increasing the EFSI and/or a larger capital injection into the EIB, in order to finance the ESRT activities.

However, the likelihood of an increase in global interest rates anytime soon is minimal, considering the Japanese experience over recent decades. A 'big push' in infrastructure investment such as the suggested European Silk Road project in the current macroeconomic climate could help to solve both the problem of sluggish growth in the west of the continent and the developmental problems in the east. Moreover, it could constitute a new narrative of cooperation for Europe. While 1 trillion euros is admittedly a large sum of money, this policy note shows that the project could be financed with the help of a European Silk Road Trust, backed by guarantees of a European Sovereign Wealth Fund.

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