Opinion of the Economic and Social Committee on the role of the EIB (20 September 2000)

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Opinion of the Economic and Social Committee on 'The role of the European Investment Bank (EIB) in European regional policy' (20 September 2000)

On 2 March 2000, the Economic and Social Committee, acting under the third paragraph of Rule 23(3) of its Rules of Procedure, decided to draw up an opinion on The role of the European Investment Bank (EIB) in European regional policy (1).

The Section for Economic and Monetary Union and Economic and Social Cohesion, which was responsible for preparing the Committee's work on the subject, adopted its opinion on 5 September 2000. The rapporteur was Mr Roy Donovan.

At its 375th plenary session of 20 and 21 September 2000, (meeting of 20 September), the Economic and Social Committee adopted the following opinion by 101 votes in favour to two votes against, with two abstentions.

1. Introduction

1.1. This opinion falls into three parts. The first part examines briefly the notion of regional policy or, in the European Investment Bank's terminology, 'convergence and regional development'. The second part looks at the priority which the EIB gives to regional policy and raises some questions about the implementation of that policy through the various lending operations. The final section presents some conclusions and recommendations.

2. What does Regional Policy Mean and why is it desirable?

2.1. The reduction of income disparities between geographical areas, countries or regions and also in rural areas within countries is generally regarded as desirable. The main arguments advanced in support of this view can be grouped under the following headings:

1. Equity in the distribution of income, living standards and life choices;

2. Maintenance of cultural diversity;

3. Preservation of quality of life;

4. Protection of the environment by avoiding congestion, pollution etc., in the most economically advanced countries or regions;

5. Avoidance of adverse demonstration effects e.g., excessive wage demands in a relatively poor region triggered by higher living standards in a more productive region;

6. Exploitation of the comparative advantage of individual countries and regions;

7. In a monetary union, there is a need to avoid shocks which damage one country more than others. This is because the country so affected cannot use the exchange-rate (or interest-rate) instrument(s) to solve its particular problems. Such 'asymmetric' shocks would be less likely to occur where there is a significant degree of economic convergence. (This is part of the rationale behind the strategy for structural and cohesion funds and other EU initiatives in which the EIB plays a major role).

2.2. These arguments are compelling but it should be noted that there can be costs involved in regional policy. For example, if for cultural or environmental reasons, a government provides incentives for people to stay in relatively undeveloped regions rather than migrate to conurbations, then such a policy clearly has to be financed out of the public purse. Even if a government or agency sets up manufacturing or other enterprises in the less developed regions there may still have to be an element of subsidy involved. Nevertheless, many governments and agencies, seem to take the view that such costs are worth incurring. It is possible that the IT revolution by lessening the dependency on cities and the need for 'clustering', will give regional policy a major boost with little, if any, cost to central exchequers.

2.3. For an economic union to work (and particularly a monetary union) it is often argued that automatic fiscal transfers are needed. This model of 'fiscal federalism' is the one which applies in the US and some European countries. If a particular State suffers a loss of income in one year it will receive transfers from the Federal Budget in the form of unemployment payments, subsidies etc. Despite this, however, the evidence suggests that some States have remained in 'relative poverty' for many years.

2.4. The EMU does not follow this model. Indeed, structural and cohesion funds are seen as a substitute for fiscal federalism – but many would contend that these funds are a rather poor substitute; and they are not, of course, automatic. Hence, it may prove difficult for some members of EMU to catch-up on the average EMU per capita income level.

2.5. There is, however, a contrary view in the literature which suggests that there may be an automatic tendency for countries with reasonable infrastructures, legal frameworks and enterprise cultures to converge on their more advanced partners.

2.6. While, historically, there have been some exceptions to this process of convergence there is still an important question to be asked: To the extent that convergence may be automatic is there any need for special measures and institutions to bring it about or accelerate the process? The answer is probably 'yes', especially in a monetary union which does not have fiscal federalism.

3. How the EIB implements regional policy

3.1. The European Investment Bank, founded in 1958, is first and foremost a bank. Its goals are described in the 1998 Annual Report, page 11 as follows (2):

'The main tasks of the EIB, the EU's financing institution, is to contribute, through its long-term loans, towards the integration, balanced development and economic and social cohesion of the Member States of the Union. In performing its mission, **the Bank places the emphasis, first and foremost, on promoting convergence and regional development**, while at the same time supporting the other economic priorities defined by its Board of Governors, particularly in the field of trans-European networks (TENS), energy and small and medium enterprises (SMEs), or through encouraging growth and employment with financing for projects in the health and education sectors.

Loans granted by the EIB in favour of economically sound projects therefore encompass a wide range of activities: communications networks; energy; protection of the natural and urban environment; industry and services; health and education. (Emphasis added)'.

3.1.1. The Bank thus has a very close link with EU regional policy. Accordingly, in January 1999, its Board of Directors adopted a first operational plan based on the strategic framework approved by the Board of Governors in June 1998.

3.1.2. The operational plan states that within the Union, top priority is given to objectives which include 'fostering regional development and the Union's cohesion, especially by means of close cooperation with the Commission in implementing Agenda 2000'.

3.1.3. However, the EIB must reconcile its institutional nature with respect for the principles of efficiency required of a bank which operates on the capital markets.

3.2. While the principal aim of the EIB is to promote convergence and regional development it is quite clear that there are several other objectives as well. Some of these are referred to in the above passage but there are other aims and objectives mentioned elsewhere in the Annual Report. These are:

– supporting the successful launch, and consolidation of Monetary Union and the single currency;

– developing the euro-denominated capital markets;

– implementing the programme in support of growth and employment in Europe (3);

– lending for labour-intensive investment;

– urban renewal;

– preserving the environment;

– sustaining the competitiveness of European industry;

– supporting countries applying for membership of the Union (4);

– strengthening the economic and social fabric of the Union;

– supporting the Union's external aid and co-operation policies in over 120 countries throughout the world.

3.3. On the face of it, this list of objectives would seem to be unwieldy and lacking in focus. In practice, however, it may be less so because a fairly high proportion of total lending is allocated to the less favoured regions.

3.4. The overall lending profile of the EIB in 1999 was as follows:

Total lending 1999 in EUR billion ([1])

31,8
of which

27,8 to the 15 Member EU State + **4,0** to European non-member States [of which :]

2,4 to 10 applicant countries and Cyprus + **1,6** to many other countries ([2])

(1) Defined as ‘Finance Contracts Signed’. Figures for actual disbursements are slightly lower.
(2) Euro-Med partnership, African, Caribbean, Pacific, South Africa, Latin America, CEEC.

3.5. The EUR 1,6 billion allocated to the ‘Other’ country category is very thinly spread across almost 100 countries and would have little, if any, effect on the growth rates or convergence tendencies in those countries. The burden of administration involved in this area of the EIB's lending programme must be very high relative to the benefits accruing to the countries concerned.

3.6. The EUR 2,4 billion allocated to the 10 applicant countries and Cyprus could probably be deemed to be on the low side since these countries, almost by definition, need to converge quite rapidly to be ready for EU membership.

3.7. The other side of this coin is that the EUR 27,8 billion going to the existing 15 EU Member countries is probably too high. Most of these countries are already well developed and their own firms and parastatals would have fairly ready access to development finance. While firm data is hard to come by, there is some evidence that these countries are already converging. The contribution of the EIB to this process will be touched on later.

3.8. The 15 EU Member countries are divided into about 150 sub regions (e.g., 23 in France, 21 in Italy, 4 in Belgium, etc.) while Ireland and Luxembourg are defined as individual regions in themselves. The GDP per capita data used to establish which sub-regions are above or below the EU average refer to 1995 and so are out of date, but they do imply quite large disparities. For example, the Hamburg region has a GDP per capita almost twice the EU average while the figure for Andalucia is about a half. Hence, the wealthiest region in Europe is about 4 times better off than the poorest. Again, because of paucity of data, it is not clear whether these disparities are becoming less over time or whether the sub-regional focus of the EIB is making a significant difference to convergence.

3.9. One rather surprising feature is that the EIB does lend on quite a large scale to the most advanced EU countries. The tables in the appendix set out the payments on a country and regional basis. It is also notable that many of the sub-regions which exceeded the EU average GDP per capita figure received considerable financing. This is because support for the (TENs) and energy are included in the Bank's remit as is evidenced by the following projects:

– construction of motorway section in Upper Bavaria (Germany);

– tramline in Orléans (France);

– power station near Turin (Italy);

– development of gas fields in the North Sea (UK);

– extension of mobile telephony network (UK).

3.10. It is unlikely that these (and other similar) projects could not have gone ahead without the help of the EIB. It might also be borne in mind that when productive projects are located in already developed regions there are likely to be synergy effects, economies of scale and so on. These of course help growth and employment in the country in question but, ceteris paribus, they would tend to widen, rather than reduce, regional disparities.

3.10.1. The question arises as to whether the poorer regions are capable of bringing forward bankable projects on their own or not. It would appear that in many of these areas finance without the support of all the other Community initiatives will not be sufficient therefore the maximum degree of cooperation and coordination of the activities of the EIB, EU and the social partners is essential.

3.11. Formulated in response to the Amsterdam European Council Resolution on Growth and Employment (June 1997), the Amsterdam Special Action Programme enabled the Bank to undertake new tasks with regard to mobilising additional resources designed to contribute to economic growth and stimulate employment

3.11.1. This programme, initially spanning three years (September 1997 - 2000), has three components (5):

– a ‘SME Window’ intended to provide new venture capital instruments offering equity finance for high-technology and growth-oriented SMEs. The risks associated with such operations are offset by a 1 billion reserve set aside from the Bank's operating surpluses (6);

– expansion of Bank financing into the areas of health and education; as these have become fully-fledged objectives in their own right (in July 1999) (7);

– intensification of the Bank's already substantial support for investments in TENs and other large-scale infrastructure networks, as well as for investment in urban and rural renewal and environmental protection (8). This support can also take the form of financing for preliminary or feasibility studies for TEN projects in the fields of transport and the environment.

4. Conclusions and Recommendations

4.1. It would seem that regional policy (leading to convergence) is a desirable goal, especially in EMU where fiscal federalism does not exist and where asymmetric shocks should be minimised. While there may be some automatic tendency for countries to converge and while the IT revolution and the New Economy paradigm may strengthen this process, there is still a major role for an agency such as the EIB.

4.2. It does appear, however, that many additional (non-core) tasks have been added on to the EIB's mandate over the years with the result that the Mission Statement is now rather too diffuse and its lending thinly spread, especially across non-European countries.

4.3. Consideration might be given to re-balancing the Mission Statement so as to increase the focus on regional policy and convergence. In practical terms this could mean less lending to the developed EU countries (and some of their sub-regions) and more to the applicant countries. There may be a role for the EIB in developing EU entry criteria for the accession countries. This could be viewed as a quid pro quo for increased financing.

4.4. It is doubtful if access to long-term development finance is problematic in developed EU countries – and certainly not as problematic as it was in 1958 when the EIB was founded. The Governments of many EU countries have their own schemes for financing (and indeed, subsidising) small and medium enterprises (SMEs).

4.5. There are also alternatives to bank finance e.g. equities, bonds, retained earnings, etc. The constraint in most developed countries is not so much finance as well-conceived project ideas. Might it be possible for the EIB to do more in terms of project advice, especially in the area of new technology where Europe as a whole is significantly behind the US? Should there be EIB advisors resident on a permanent basis in the poorest sub-regions to ensure optimal project development and convergence?

4.6. Consideration might also be given to overlap and duplication among different lending agencies (EIB, EBRD, National development banks etc.) so that each institution would play to its strengths.

4.7. One of the major economic problems in the EU is lack of structural reform. Is there anything the EIB could do to accelerate this process? It is probable that many well-conceived project loans and global loans are not as productive as they might be because of distorting rigidities in the market. Clearly the EIB could not impose conditionality on national governments but is there anything it could do to free up markets at sub-regional level? The process of economic convergence involves ‘creative destruction’ which can be painful in the short term and which is often resisted by Governments unless they are committed to structural reform. In many instances the latter is more important to the convergence process than development finance per se.

4.8. Is there a danger that the EIB's activities in respect of the environment might be counter-productive? It is argued in some quarters that taxation and other sanctions against the pollution are far more effective than financing environmental projects as such. Both approaches can presumably go hand in hand but there may be occasions where prevention (by sanction) is better than cure (by project finance).

4.9. The precise methods of project evaluation are not readily apparent though presumably pay-back periods and cost/benefit ratios are analysed. There may, however, be a need to put a system in place to evaluate whether, and to what extent the finance provided does actually lead to greater convergence? Follow-up studies of this kind are important to see if an institution's core mission is actually being realised.

4.10. The Banks recent launch of 'Innovation 2000 Initiative' is a quick and welcome response to the March 2000 Lisbon Council guidelines for developing a 'knowledge based society driven by innovation'. This initiative is designed to channel EIB financing into five areas:

1. human capital formation;

2. research and development;

3. information and communications;

4. diffusion of technology networks innovation;

5. development of SMEs and entrepreneurship.

There is provision for EUR 12 to 15 billion over the next three years for this initiative but the Committee feels that the amount should be increased and its application speeded up.

4.11. Finally, in evaluating convergence the EIB should not confine itself solely to economic indicators but should broaden the parameters to include social indicators along the lines already established by the United Nations.

Brussels, 20 September 2000.

The President
of the Economic and Social Committee
Beatrice RANGONI MACHIAVELLI

(1) Cf. Opinion ESC 225/94 'The role of the EIB in regional development' by Mr E. Muller – OJ C 133, 16.5.1994.
(2) Annual Report 1998, p. 11.
(3) In response to the Amsterdam Special Action Programme.
(4) Through the pre-Accession Lending Facility.
(5) For a detailed description see pages 16 and 17 of the 1998 Annual Report.
(6) The results are analysed in the section on 'Promoting SMEs' on pages 28 and 29 of the 1999 Annual Report.
(7) A separate sub-chapter has been devoted to them on page 16 of the 1999 Annual Report.
(8) Operations corresponding to these various objectives are described on pages 19 to 24 of the 1999 Annual Report.