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The European Investment Bank:
A useful inspiration for emerging countries?

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I. Introduction

Since its beginning, European trade integration has been accompanied by the creation of major financial mechanisms. Such mechanisms and the resulting financial transfers were seen as both an economic and political condition for making economic integration effective and equitable. These mechanisms included both grants (through the Structural Funds) and loans (mainly through the European Investment Bank) and most recently guarantees (European Investment Fund).

As discussed below, these financial mechanisms had two major aims: (1) reducing income differentials within the European Community (and later Union), between countries and regions, particularly those resulting from trade liberalization, and (2) allocating major financial resources to facilitate the functioning of an increasingly integrated market, for example by financing inter connection of national networks in transport and telecommunications. Whilst other aims have later been added, these two have remained central.

It is important to stress that very large - and overall growing - resources have been allocated in Europe consistently for these aims. To an important extent this dynamic has been driven by the relatively poorer countries, which during the negotiations for their joining the Community have put as a pre-condition the creation or sharp increase, of grants and loans. The first such case was when Italy –before joining the EEC– pressed in the mid 50's for the creation of the European Investment Bank, largely to help fund infrastructure in the poorer Southern Italy. Strong institutions, like the European Commission and the European Investment Bank have contributed also to the sustained dynamic of financial transfers.

Each regional integration process differs, but it seems clear that the broadly very successful European experience of financial mechanisms to support trade (and increasingly broader) integration may have interesting and important lessons for other regional integration processes, particularly those involving developing countries.

This paper focuses mainly on the experience of the European Investment Bank (EIB), a bank that lends more than the World Bank. Nevertheless, first (section II) we analyze the broader context of fiscal (grants) and financial (loans) mechanisms linked to European integration. We outline their historical evolution, describe their rationale and main features and highlight their scale. As we discuss below, fiscal transfers via the structural funds have represented very high proportions of the GDP of poorer countries (between 3% and 4% of GDP for Portugal and Greece during the nineties). Significant resources (both loans and grants) have been transferred recently even during pre-accession periods. Thus, poorer countries of Eastern Europe have had loans from the EIB equal to around 1% of GDP well before they joined the Union. In the 1990's also significant fiscal transfers were made to East European countries before they joined the EU, via special pre-accession mechanisms.

Section III is dedicated to the EIB which was created to help achieve the goal of economic convergence. In its early stages, capital markets were incomplete and underdeveloped, so there was a strong case –both theoretically and politically- to deal with such market imperfections through the creation of a public bank that would help channel savings from the more developed parts of the Community to the less developed parts, and that would also help integrate European infrastructure to support trade integration.

In later periods, as European capital markets developed, and the nature of market imperfections changed, the needs that the EIF had to meet have also evolved. The problem became more one of asymmetric information. In this context, the EIB plays an important signalling role to private lenders, given its well established reputation including its expertise and thoroughness in careful project evaluation by specialized teams of engineers and economists (see section III.C).

Another interesting feature of the EIB's evolution is its relatively low levels of lending in the initial phase (first decade) with very large increases afterwards. The paper (in section

III.F) provides an analysis of these trends that had not been previously done. Then in section III.G, it outlines key sectors of operation and provides a more detailed analysis for EIB lending in 2003.

Section III.H concludes by outlining key policy issues at the EIB today, arguing that in today's environment in Europe, the role of a public bank –like the EIB- might be more pertinently seen in assuming risks (e.g. via guarantees, venture capital, etc.). In developing countries, particularly the relatively poorer ones, where market imperfections still prevail , especially in capital and credit markets for long term finance, the role of regional public banks in integration processes should, however, probably be more similar to that of the EIB in its early stages. That is, explicitly supporting via loans an integrated infrastructure and assistance to poorer regions. Nonetheless, the issue of greater focus on mechanisms such as guarantees and other risk bearing instruments, rather than on pure loans, has also increasing relevance for integration amongst developing countries. Finally, the central lesson from the EIB experience is the importance of a large and dynamic public bank to support integration and convergence processes.

II. Financial Mechanisms within the EU

A. Introduction

The implementation of EU Structural Policy is supported by six major financial instruments: the four Structural Funds, the Cohesion Fund, and the European Investment Bank. This section of the paper presents an overview of the evolution of EU regional policy and the financing mechanisms created to support regional development and cohesion. It begins by looking at the EU Structural Funds and the Cohesion Fund, as well as the activities of the European Investment Bank (EIB) and the European Investment Fund (EIF) – now brought together as the European Investment Group (EIG). Then, it gives a brief overview of the EU programmes created to support the accession countries of Central Europe that plan to join in 2004, as well as EIB lending to those countries.[2] It concludes by examining the distribution of EU funds to different European countries

European regional policy has developed gradually, influenced by successive periods of deepening and widening. The major stages, and the financing mechanisms created, are outlined in Table 1.

Table 1. The Development of EU Regional Policy and the main Financing Mechanisms

Year	*Context*	*Main Events*
1957-75	The preamble of the Treaty of Rome refers to the need "to strengthen the unity of their economies and to ensure their harmonious development by reducing the differences existing between the various regions and the backwardness of the less favoured regions".	1958: The **European Investment Bank** was set up under the Treaty of Rome to provide long-term loans in support of European integration. A key objective of the EIB is to strengthen the economically weaker regions. 1958: The two sector-based Structural Funds, **the European Social Fund** (ESF) and the **European Agricultural Guidance and Guarantee Fund** (EAGGF) were set-up.
1975-85	The northern enlargement of the EU increased regional imbalances. The UK lobbied for an EU Regional Policy in its accession negotiations.	1975: Creation of the **European Regional Development Fund** (ERDF) to redistribute part of the Member States' budget contributions to the poorest regions.
1985-93	The introduction of the Single European Act, together with further enlargement involving three less developed countries – Greece in 1981, and Spain and Portugal in 1986 – provided further impetus for EU regional policy.	1986: The Single European Act lays the basis for a genuine cohesion policy designed to offset the burden of the single market for southern countries and other less favoured regions. 1989-93: **The European Council** in Brussels in February 1988 overhauls the operation of the Structural Funds and **doubles the resources** allocated to them.
1993-2000	The Treaty on European Union, which came into force in 1993, designates cohesion as one of the main objectives of the Union, alongside economic and monetary union and the single market.	1993: The **Cohesion Fund** is created to support projects in the fields of the environment and transport in the least prosperous member states. Alongside the Structural Funds, a new **Financial Instrument for Fisheries Guidance** (FIFG) is created. In 1994, the **European Investment Fund** was created to provide guarantees for infrastructure

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		and SME investment.
	In 1993, the Copenhagen Council's invites the central European countries to apply for membership of the EU. In 1997, the present enlargement process was launched.	The **Phare Programme**, which was set up in 1989 to provide support to the countries of Central Europe during transition, is re-oriented in 1993. From 1997, Phare becomes totally focused on pre-accession assistance – becoming the first of three pre-accession instruments.
2000-2006	The future enlargement of the EU, with 10 Central European countries, will increase the demands on the EU budget for cohesion.	1999: the Structural Funds and the Cohesion Fund are reformed. The **Instrument for Structural Policies for Pre-accession** (ISPA) and the Special Accession Programme for Agriculture and Rural Development (SAPARD) complement the PHARE programme to promote the economic and social development of applicant countries in Central Europe. In 2000, the European Investment Fund becomes part of the EIB, focusing on venture capital and guarantees for institutions financing SMEs.

Source: Own elaboration

B. EEC and EIB: Funds for an Equitable Development

In the preamble of the Treaty of Rome that first created the European Economic Community (EEC) in 1956, the member countries explicitly called for "ensuring harmonious development by reducing the differences existing between the various regions and the backwardness of the less favoured regions." As a result of this clear objective, and of the underlying vision that financial transfers are both a political and economic condition for making economic integration effective and equitable, the European Community created since its beginning, major financial mechanisms, both via loans and grants.

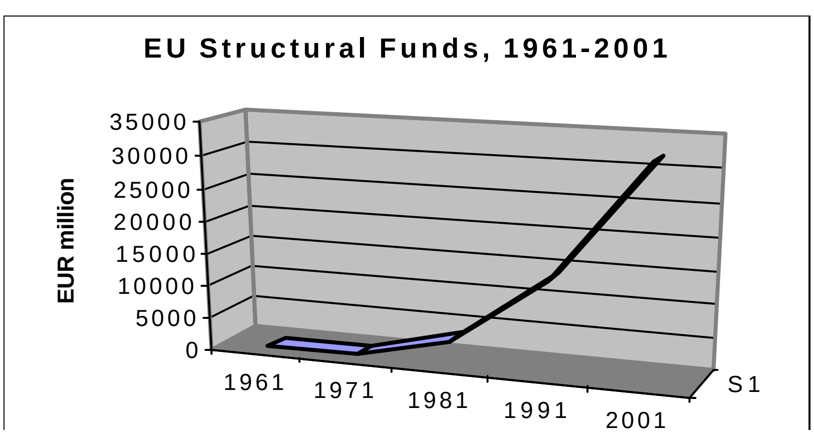
These major institutional mechanisms created in the EEC, responded to widely accepted analysis in economics, that show that trade liberalisation both contributes via economies of scale and other mechanisms to more rapid growth overall, but due to inherent asymmetries also leads to relatively less rapid growth (or even decline) of relatively poorer areas, (See Griffith-Jones et al, 1992). Besides creating mechanisms necessary to reduce potentially growing inequalities between regions and countries, resulting from trade liberalisation, the Community since the beginning allocated major financial resources to inter-connect national networks (in transport, telecommunications, etc) and to facilitate the functioning of an increasingly integrated market.

The European Investment Bank, created at the same time as the EEC, to foster the objectives of a harmonious development and compensation of the losers, committed a high proportion of its loans to finance infrastructure in poorer regions and countries. Italy, where there was much poverty in the South, played a key role in pressing for the EIB's creation. Several Structural Funds were created to provide grants for poorer regions and specific sectors (especially agriculture). The three Structural Funds first created were the European Social Fund, the European Agriculture Guidance and Guarantee Fund (the basis for CAP) and the European Regional Development Fund. Furthermore, an additional large Fund (the Cohesion Fund), was created when Portugal and Spain joined, as a result of pressure from the new members, particularly from Spain.

When in 1989, the Berlin Wall fell and the transition to the market and democracy began in Central and Eastern Europe (CEE), fairly generous mechanisms were created quickly by the then European Community to support the transition to the market. The main European instrument for providing grants to the transition countries was Phare. The transfer of know-how was seen as equally, if not more important, as the financial assistance provided. The previously existing European Investment Bank (EIB) lent on an important scale to these countries, and a new development bank, the European Bank for Reconstruction and Development (EBRD), was established (with both European and other members - e.g. US, Japan and others - on its Board) which lend to this region and also to the former Soviet Union, in support of the transition. In spite of its name, the EBRD is not solely responding to European interests, in that way different from the EIB.

In 1997, the European Union's Council officially launched the current round of EU enlargement, with 10 countries from Central and Eastern Europe negotiating accession to the EU. To assist the process of accession, the financial instruments and mechanisms previously used to support transition to the market in those countries were transformed fairly easily and seamlessly into mechanisms for preparing integration of these countries into the European Single Market which is a significantly more advanced stage of trade integration than a free trade area. The evolution of EU Structural Policy has led to the creation of four Structural Funds: the European Regional Development Fund (ERDF), the European Social Fund (ESF), the Guidance Section of the agricultural fund (EAGGF), and the Financial Instrument for Fisheries Guidance (FIFG). Through these four funds, the European Union grants financial assistance to resolve structural economic and social problems. Moreover pre-accession funding became in the 1990's, far larger than in the past, and its aims became more ambitious, focusing particularly on countries preparing to integrate effectively into the Single Market whilst also providing resources for poorer regions and people, as well as supporting cross-border communications. Post accession funding will become slightly less generous than in the past (especially for agriculture), but will still be massive.

Since their creation, the Structural Funds and the Cohesion Fund have represented the main instruments of social and economic cohesion policy in the European Union. The Structural Funds underwent major reform in 1988, and again when the Cohesion Fund was introduced in 1993. Since the 1988 reforms, EU Structural Policy has become even more significant in financial terms. By 1999, the Structural Funds and the Cohesion Fund together accounted for around one-third of the budget for EU policies and amounted to some 0.5 per cent of EU GDP (see Table 3, page 15). As we discuss below, (see Table 2) it represented very high proportions of the GDP of the poorer countries (almost 4% for Portugal and Greece).



Graph 1. EU Structural Funds, 1961-2001

Source: European Commission

Note: the figures represented in Graph 1 are not inflation adjusted for inflation. However, even in real terms the scale of structural funds increased significantly.

Graph 1 shows the dramatic increase in the level of funding available through the Structural Funds over the last 40 years. In 1961, some EUR 8.6 million was allocated through the Structural Funds. This figure rose to EUR 11.8 million by 1971. Total EU expenditure on the Structural Funds reached nearly EUR 14 billion by 1991 and some EUR 32 billion by 2001.[3]

In terms of the distribution of funds, Table 2 shows that between 1989 and 1993 the five recipients of the largest share of Structural Fund financing were Spain (21%), Italy (17%), Portugal (13%), Greece (12%) and Germany (9%). In the later 1994-99 period, which includes the Cohesion Fund, the major recipients were again Spain (23%), Italy (14%), Germany (14%), Portugal (10%) and Greece (10%). Table 2 also indicates the importance of these funds to the economies of the recipient countries by showing the annualised funding received as a proportion of their GDP. In both periods, EU structural funding represented a significant proportion of GDP for Portugal, Greece, Ireland, and Spain. <u>In 1994-99 Structural Funds represented 4.0% of Portugal's GDP, 3.7% of Greece's GDP, 2.8% of Ireland's GDP and 1.7% of Greece's GDP.</u>

Table 2. EU Structural Funds 1989-93 and the Structural Funds and Cohesion Funds 1994-99, in ECUm (and as a percentage of EU total) and as percentage of GDP

	1989-93 Ecu millions (% of EU12)	**1989-93 % GDP[1]**	**1994-99 Ecu millions (% of EU15)**	**1994-99 % of GDP[2]**
Belgium	740 (1.2)	0.11	1808 (1.3)	0.18
Denmark	402 (0.6)	0.08	741 (0.5)	0.11
Germany	6015 (9.5)	0.13	19519 (14.1)	0.21
Greece	7528 (11.9)	2.65	13980 (10.1)	3.67

[3] European Commission, 2000.

	1989-93 Ecu millions (% of EU12)	1989-93 % GDP[1]	1994-99 Ecu millions (% of EU15)	1994-99 % of GDP[2]
Spain	13100 (20.8)	0.75	31668 (22.9)	1.74
France	5907 (9.4)	0.14	13334 (9.6)	0.22
Ireland	4460 (7.1)	2.66	5620 (4.1)	2.82
Italy	10753 (17.1)	0.27	19752 (14.3)	0.42
Luxembourg	55 (0.1)	0.17	83 (0.1)	0.15
Netherlands	725 (1.1)	0.07	2194 (1.6)	0.15
Portugal	8450 (13.4)	3.07	13980 (10.1)	3.98
UK	4816 (7.6)	0.13	11409 (8.2)	0.25
EUR12	62951 (100)	0.29		
Austria			1432 (1.0)	0.19
Finland			1503 (1.1)	0.40
Sweden			1178 (0.8)	0.37
EUR15			138201 (100)	0.51

[1] based on annual average structural fund totals, and on average GDP 1989-93
[2] based on annual average structural fund totals, and on GDP in 1994
Source: European Commission

In the case of poorer countries like Portugal and Spain, where time allows for more precise measurement of outcomes, the impact of post-accession EU funds has been very positive especially in contributing in a major way to significant convergence with average European income per capita; it can also be clearly seen in physical developments, such as the increase in new road and rail links, particularly those connecting with other European states. This has greatly facilitated trade integration.

The EIB expanded its lending further to the candidate countries, and plans to significantly expand its lending after the countries joined the European Union. EIB lending in the ten Accession countries comes in two forms. First, there are EIB loans that are governed by mandates from the EU that are accompanied by a guaranteeing mechanism. Second, there is the Bank's own Pre-Accession Facility, where lending is not covered by such guarantees. Of the EUR 14 billion lent between 1990 and 2000, around EUR 4.5 billion was made available under the EIB's Pre-Accession Facility.

Table 3 details EIB lending to the Central European Accession countries between 1996 and 2000. Between 1996 and 2000, the EIB lent a total of EUR 10 billion in Central Europe, with Poland, Romania and the Czech Republic receiving the largest share of the lending in Euro terms. Represented as a proportion of GDP, the poorer countries - Romania, the Slovak Republic and Bulgaria received the highest share of EIB lending to the region (around 1% of GDP). On average the Accession Countries received 0.6% of GDP as EIB loans, a significant amount.

Table 3: EIB Lending to the Accession Countries of Central Europe 1996-2000, in EUR million

	Total 1996-2000	% GDP[1]
Poland	2738	0.3
Romania	1916	1.0
Czech Republic	1720	0.6
Hungary	955	0.4
Slovak Republic	925	0.9
Slovenia	655	0.7
Bulgaria	573	0.9
Lithuania	213	0.3
Latvia	198	0.5
Estonia	113	0.4
Total	10005	0.6

[1] Calculated using GDP in 2000.
Source: European Investment Bank

The EIB is a complementary source of funds, and its activities are always undertaken in conjunction with the project promoter's own resources and other sources of long-term finance. In the case of co-financing arrangements with the grant aid programmes of the European Commission, co-financing helps the EIB to accelerate transport and environmental schemes and also to focus on regional development programmes and projects in other sectors[4].

C. Lessons learned for Developing Countries

1. Financial Mechanisms for Accession can Contribute towards Convergence between the Rich and Poor Countries and Regions if they are Effective and Provided in Adequate Levels

The scale and broad coverage of financing mechanisms utilised by the European Union countries to aid countries pre- and post- accession has been extensive. European Union grant financing and EIB loans have together represented a meaningful proportion of each country's GDP and total investment. Added to this, the budget figures for EU Structural Funds do not immediately convey their significance for the economically weaker areas of the Union. As resource transfers are very heavily concentrated on the poorer areas of the EU, where economic activity is relatively low, they are of a considerable size. Also, as Structural Fund allocations are based on the principle of co-financing, with individual member states contributing resources to supplement EU funding, they can act as a catalyst for higher levels of resource transfers to poorer regions.

Policies designed to improve economic and social cohesion among member states are also very important in political terms. First, they help to unite member countries around a common goal. In the European context, for example, there has always been a strong sense of a European model of society, comprising elements such as a social market economy, free trade, democratic systems and social cohesion. The financial mechanisms to support regional integration in the EU are very much based in upholding this model of society. Second, cohesion policies are important in order to maintain the support of poorer and weaker states and regions for the trade integration project. Though the level of integration ambition may be somewhat smaller at present in regional groupings in developing countries, even free trade areas require sustained political support.

[4] See a more detailed analysis of the key sectors of operations of EIB in sections III.F and III.G

As regards effectiveness of different pre-accession instruments, unfortunately there is as yet no formal evaluation carried out by the European Commission or the authorities from the countries which received it. Our analysis, interviews and experience lead us to suggest the following elements: a) A structural programme like that given to Eastern Europe of pre-accession financing is far superior to the more ad-hoc pre-accession provided to Portugal. b) Given their larger scale and their greater flexibility, EIB loans are an extremely valuable part of the pre-accession package in areas such as infrastructure, SMEs, etc. EIB loans were disbursed more easily and in a more agile way. c) On balance, the three grant programmes in the transition countries seem to all work effectively. A general lesson seems to be that these programmes operate better the more decentralised the decisions are. d) In fact, greater effectiveness and agility is also supported by the EIB, opening offices in member countries and by the EC country offices having greater autonomy to approve programmes, rather than involving Brussels. e) Though the European experience shows it is valuable to support a number of dimensions, the PHARE experience suggests effectiveness improves with focus on a fairly limited number of programmes linked to the priorities defined in the trade integration programme. As Devlin et al (2002) clearly points out, limited number of programs – together with other factors such as clearly identified objectives, and work programs – help make cooperation programmes successful. Problems of absorptive capacity, especially in smaller countries can more easily be overcome, if assistance is focussed on a fairly limited and relatively specified programme, as this facilitates provision of sufficient finance and technical assistance that can help overcome problems of implementation.

2. Countries joining the European Union have been able to Influence the terms of their Accession

Historically, countries joining the European Union have had, sometimes substantial, leverage in influencing the terms of their accession. Italy, a relatively poor country at the time, pushed for the creation of the European Investment Bank (EIB), especially to lend to the poorer Southern regions , when the European Community was established. Pre-accession negotiations between the UK and the EC led to the creation of the European Regional Development Fund (ERDF), and negotiations with Spain resulted in the setting up of the Cohesion Fund to assist the poorer countries of the Union in adjusting to the Single Market. In the ongoing negotiations with the ten countries of Central and Eastern Europe, Poland has managed to achieve concessions for its accession to the Union. The poorer countries should conduct negotiations on a trade integration bargaining strongly for financial mechanisms, with the knowledge that they are bringing something valuable to the table. Equally, the richer countries can learn from the European experience that assistance to poorer countries and regions will result in a better functioning trade integration, and a more prosperous region.

3. Institutional Innovation will be Important and Decentralization of Decision-making and Distribution is a Key Success Factor

The European Union has a strong institutional base in the European Commission, as well as other institutions such as the European Parliament, EIB etc. These are located in cities that are not the major centres of economic power in Europe – eg. in Brussels, Strasbourg and Luxembourg, rather that London, Paris or Frankfurt. The EIB has played a key role in providing large loans to new members both pre and post-accession, to help support the integration process, EIB loans have been more significant in financial terms than EC grants in most countries

Financial innovation and flexibility is the result of these processes. In the EU, there are a mix of grants (European Commission), loans (EIB), and guarantees (EIF) that work well to respond to different funding needs, and can work together. Indeed, EIB lending can play an important catalytic role in helping to attract other funding sources to projects, even if the EIB investment is not particularly large (e.g. Volkswagen in Czech Republic). EU financial mechanisms have also needed to be flexible over time, responding to new stages in the European project (such as the Cohesion fund when the Single Market was introduced) and the introduction of Pre-Accession funding strategies for the Central European countries.

III. The EIB

A. The Creation of EIB and its Central Role within the EU in the Early Stages

As mentioned in the previous section, the EIB was created in 1956 with the Treaty of Rome along with the European Economic Community. In fact, Article 2 of the Treaty referred to the objective of

> "…establishing a Common Market and progressively approximating the economic policies of Member States, to promote throughout the Community a harmonious development of economic activities, a continuous and balanced expansion…"

Furthermore in the preamble of the Treaty the contracting partners went even further by calling for a reduction in "the differences existing between the various regions and the backwardness of the less favoured regions"

There were several provisions in the Treaty for the creation of instruments which could contribute towards this "harmonious development" and the reduction of regional disparities. The European Investment Bank (EIB), the most powerful instrument in the Treaty, was established in order "to contribute to the balanced and smooth development of the Common Market in the interest of the Community" (Treaty of Rome, Article 130). The EIB was intended as a source of relatively cheap interest loans and guarantees which would facilitate the financing of:

> "(a) projects for developing less developed regions; (b) projects for modernizing or converting undertakings or for developing fresh activities called for by the progressive establishment of the common market; (c)

> projects of common interest to several member states, which are of such size or nature that they cannot be entirely financed by the various means available in the individual member states" (Treaty of Rome, Article 130).

The EIB was therefore created especially as <u>a Bank to support the European integration process</u>. Its three objectives, outlined in the paragraph above, reflected three major concerns, expressed during the process of negotiation of the Treaty of Rome. The first was to help reduce the gulf between relatively prosperous and relatively poorer regions. It was also based on the fear that, if not compensated for, European Integration could increase imbalances. In the negotiations of the Treaty of Rome, the Italian government pressed very strongly for the creation of the EIB, with this purpose; according to some sources, it even put the creation of the EIB and its concentration on lending to Southern Italy as a pre-condition for Italy to join the EEC. The second major concern was to help "senile industries", and/or areas where such industries were dominant, which could not, on their own, face competition, but required support for modernization, conversion or development of new activities. The third concern was for the need to finance investment which helped integrate the European economies, and which related to several member states or to the Community as a whole. This refers in particular to the area of cross-frontier communications (and especially transport). This concern was related to the fact that much of existing infrastructure at the time was geared to meeting domestic needs; the creation of the EEC lead to a new dimension and new cross-border needs. It is noteworthy that these three aspects (possibly in somewhat different proportions) could also be central as supportive measures to other integration processes.

As regards the first aspect, regional development, the European Investment Bank remained till 1975 (when the European Regional Development Fund was created) the sole important Community source of funds for general financing of regional development prospects. A very large proportion of EIB lending, estimated at 75 per cent in the 1958-1978 period, was channeled to investment in disadvantaged areas[5].

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[5] Based on estimates in: EIB (1980), <u>Report on the EIB's Activities in its First Twenty Years, 1958-1978</u>, Luxembourg.

The EIB was set up as a separate legal entity from the EC Commission although it was part of the Community, and was committed to pursuing EC objectives in the public interest. This legal distinction implied that the Bank had to raise most of its own funds, on the markets. The idea therefore was to create an autonomous project-financing body capable of financing the bulk of its loans out of the proceeds of borrowing. However, the capital of the EIB was totally provided by the EEC member governments.

To summarize, the common goal of economic success spread over the entire Community a prime political objective was income convergence. As currencies in the mid-fifties were still not fully convertible and capital markets underdeveloped there was a strong case, both theoretically and politically, to deal with these market imperfections through the creation of a public bank. The main mission of this bank was to assist in channeling savings from the more developed parts of the Community to the less developed parts (regional development). At the same time it was recognized that a customs union needed to complete and transform its essentially juxtaposed national infrastructure into an integrated European infrastructure (European integration).

The European Commission was given the job to make available funds on a grant basis to assist lagging regions. As grant money is in limited availability and as it was felt that for many projects the problem was not lack of returns but the financial constraint it made sense to complement grant facilities with loans. This was the job given to the EIB.

B. The institutional set up

The EIB is an international non-profit organization with its headquarters in Luxemburg. Its shareholders are the member countries of the European Union.The Bank is designed as the “Hausbank” of the European Union. As such it receives its strategic lending missions (for which type of lending in which parts of the outside world) from its Board of Governors after discussion in the Ecofin Council. It follows the policies set by the European Commission and ensures that the projects it finances respect European guidelines, for example, European environmental guidelines. The EIB respects a division labor with the Commission (for example on economic forecasts) and with other international organizations such as the World Bank and the IMF. Its own policy analysis is therefore very limited. The EIB does not make sectoral (a World Bank or Commission job) or macro policy (an IMF or Commission job) analyses or recommendations.

As a result the EIB has a very lean staff (some 1,200 in 2003) and low expenses in relation to loan volume. Its activity is focused on the European Union (close to 90 % of outstanding loans) although over time it has increasingly been asked to operate also outside the Union.

Each Member State's share in the Bank's capital is calculated in accordance with its economic weight within the European Union (expressed in GDP) at the time of its accession. For the 10 new countries, the portion of subscribed capital to be paid in (5%) will be so in eight installments. Futhermore, it is worth mentioning that the accession of ten new Member States to the European Union on 1 May 2004 has had the effect of introducing statutory amendments relating to EIB capital shares and governance. In Annex 1, the present structure of governance is described. Also, after the recent enlargement, the Bank's subscribed capital was increased from 150 billion to 163.6 billion in line with the participation of 10 new member countries.

C. The Mission

The EIB's lending has been limited to financing projects. Recent developments (see below) create more flexibility. The focus on project lending excludes program financing such as balance of payments support, poverty reduction, sector reforms and the like. In general, the Bank only lends up to 50% of the project cost. Often the EIB lends as little as one third of the total funding required for a project. This implies that the multiplier effect on recipient economies is increased (see below). At times, and on political requests, this limit is increased to 75 % to speed up financial support during downturns of the business cycle or other priorities.

This introduces an interesting explicit element of counter-cyclicality in the lending operations of the EIB that should help support economic activity –and especially investment- in periods of economic down turn.

A public sector bank finds the justification for its existence in market imperfections.[6] When the Bank was created the major market imperfections resided in capital controls, a little developed and segmented capital market and an uneven development of the banking sector across the Community. Indeed, it could be argued that markets were incomplete or even missing for longer term funding in the relatively poorer countries of the European Community –first the South of Italy, then new entrants like Greece, Portugal or Ireland, and more recently the new accession countries, in Central and Eastern Europe. What are the justifications today?

Except for rated borrowers the market is still characterized by pronounced market imperfections arising from information asymmetries. Asymmetric information arises because one party to the contract (the borrower) has more and better information than the other party (the lender or investor). Asymmetric information leads to two problems in the financial system: adverse selection and moral hazard.

Adverse selection is an asymmetric information problem that arises before the lending occurs, when parties who are the most likely to produce an undesirable outcome for a financial contract are most likely to try to enter the contract and thus be selected. For example, managers of businesses who want to divert funds to less productive uses, such as to enlarge their own pay, are likely to be the most eager to raise external funds. To minimize that risk investors may decide not to invest even if there are attractive investments in the market-place, thus penalizing those with good projects.

[6] For more discussion see Stiglitz (1998)

Moral hazard occurs after the financial contract is concluded, when the receiver of funds has incentives to misallocate funds and engage in activities that are undesirable from the lender's point of view. For example, the borrower may use the funds for activities that produce a higher expected return at a higher risk. As a result, investors may again decide that they would rather not provide a firm with funds, so that investment will be at sub-optimal levels. In order to minimize the moral hazard problem, investors must have information so that they can monitor managers' activities and make sure that funds are used to maximize the value of the firm.

The asymmetric information problem illustrates that the provision of reliable information is crucial to the ability of financial markets to perform their function efficiently and to screen out good from bad credit risks.

One answer to the asymmetric information problem is for a lender to collect the necessary information to screen and monitor investments. This is what banks usually do when they establish a long-lasting and ideally exclusive (from the banks' point of view) relationship with a near-by customer. But, in general, there are two barriers to information collection. The first is its cost, particularly when more than one lender are potentially or actively involved. The second problem is the free-rider problem. It is a problem because investors who do not spend resources on collecting information can still take advantage of information that other institutions have collected. If Bank A lends to a firm it gives a signal to other potential lenders that it has collected information and finds it satisfactory. The value of this signal that disseminates information to the market is positively correlated with the reputation of Bank A and becomes a "public good". This provides the incentives to free riding.

One solution to the problem of asymmetric information is that a public bank incurs the cost of information collection. The EIB does that and acts as a "delegated monitor" (Leland and Pyle, 1977). It carries out a very detailed evaluation of projects going beyond the typical analysis of a commercial bank and monitors the loan carefully. Having established a high reputation as a careful evaluator and as a conservative bank with an excellent track record (only very few loans of the Bank experienced difficulties) the value of the signal of a Bank loan is high. The Bank only finances part of a project so that its participation is a signal for free-riding banks to finance the remainder of the capital needs.

The project focus of EIB lending diminishes the moral hazard somewhat. Monitoring is easier than with a general loan to a company, as diversion of funds to other uses with higher risk is more limited. A large part of Bank lending is carried out with repeat borrowers that value access to EIB funding.

However, there are also features that mitigate, but certainly does not eliminate the value of the Bank's signaling. First, the Bank only lends to large, solid borrowers for which information symmetries are less pronounced. Second, the Bank usually but not always enjoys high seniority and guarantees. So it is not exposed to the same risk as other borrowers. Third, the Bank lends either to projects for which there may be a rated promoter or there may be no rating and no track record. In the first case, say, a utility plant of a large electricity concern, the evaluation of the project has less value to other potential lenders which are only concerned about the electricity concern's capacity to service the loan. But in the second case the Bank's signaling is of great value. Consider a project such as an airport financed and operated under a private-public-partnership scheme in which several banks may be involved. It would not be optimal for every bank involved to collect all of the complex information. The Bank's evaluation and participation is then a signal with great value as a public good and the Bank's participation may be the key to successful completion of the financing arrangement.

It could be argued that the role of the EIB could be further improved, if it lent more to the more risky borrowers. Furthermore, EIB should perhaps shift a far larger part of its operations from providing funds without assuming the risks (as it currently requests guarantees, which implies the guarantors bear these risks); to those where the EIB assumes more the risks (e.g. via guarantees) and private lenders would provide the loans.

Nonetheless, it is important to underscore that the EIB has already started making this shift by the creation of the European Investment Fund -of which the EIB is the largest shareholder. As discussed below, the EIF provides guarantees, takes equity participation and supports venture capital funds – taking thus this new role of assuming risk. Interesting lessons may exist here for regional banks' lending to developing economies.

Over time the scope of eligible projects has widened considerably. In its lending activity the Bank needs to observe *subsidiarity*. This means, in principle that the Bank only lends to projects when there are no other means available. This is a sound theoretical principle but difficult to make operational. At some price other -private- funds tend to be available to solid borrowers which are the ones to which the Bank currently tends to lend. But if subsidiarity has to be assessed on the basis of the alternative financing cost what is the cut-off spread? Therefore, in current practice borrowers make the decision. If the Bank's offer in terms of cost is more favorable than alternatives, the borrowers will request a Bank loan and the Bank's more favorable offer contributes to the success of the project. Possibly, it could be more efficient if the EIB were able to define a benchmark (that could naturally be adjusted over time), that would indicate the cut-off minimum spread over alternative funding for which the EIB would lend.

While subsidiarity is an issue difficult to deal with, the EIB attaches great value to cooperating closely with banks and other financial institutions (for details, see Appendix 3). The EIB lends to the public and private sectors. During the first decades of its operations lending was heavily concentrated on the public sector, at that time in many countries nearly exclusively responsible for infrastructure projects. Such projects are highly capital-intensive and require long periods of financing. However, the Bank was designed as a long-term lending institution because market imperfections have been most pronounced in that segment. Since its creation the Bank has made loans with maturities up to 30 years according to the project needs. Over time as the capital markets developed and the expertise to finance infrastructure evolved and spread, the private sector gained importance.

The Bank lends in all convertible currencies on demand of customers. It lends at fixed rates for the life of a loan, at variable rates, or with options at resetting or conversion of lending conditions. An interesting and positive side-product of the EIB's borrowing in different currencies, e.g. those of Central and Eastern European countries, is that it has quite significantly contributed to the development of local currency markets in those countries.

As few banks lend for long maturities at fixed rates, the Bank has acquired a unique reputation for fixed-rate long-term lending. The social value of fixed rate lending is however debatable. Simulations carried out by Bank staff suggest that for long maturities, the normally positively sloped yield curves always yield *ex-post* lower total financing costs. This means that for all loans examined (for different periods, and for different currencies- prior to the creation of the Euro), it would have been *ex-post* cheaper to have borrowed on variable interest rates from the EIB than have taken a fixed interest rate loan from the EIB. Fixed interest rates do have the advantage of providing more certainty; however, this higher certainty relates more to nominal interest rates, whereas variable interest rates tend to be more closely correlated with inflation, implying that nominally variable interest rates may actually be less variable in real terms.

Loans benefit from a grace period for gradual repayment of normally 3 years or more if the project profile makes a longer grace period desirable. Beyond the grace period loans are serviced by interest and loan repayment.

For loan origination shareholders provide an important input. Over time the growing reputation of the Bank and repeated operations with satisfied customers as well as the Bank's marketing have sustained lending growth.

For a project to receive EIB financial support it must first be eligible.[7] This means it must fall into one of the categories of projects to which the Bank lends. For example, for a long time public housing has not been eligible. Then it must satisfy the Bank's exacting

[7] See Appendix 3 for eligibility criteria as of 2004.

borrower quality standards. Not enough, the borrower if not a government must provide adequate guarantees. In addition to the quality conditions to be satisfied by the borrower, the project must be financially and economically sound. As the main objective of the Bank is to contribute to the Community's economic performance (regional development, European infrastructure, high environmental standards, European competitivity and energy security) the project must be financially sound and must have a high social return. This social return (the internal rate of return augmented by externalities such as employment creation, knock-on effects) is always difficult to assess and hence leaving scope for political desiderata. The Board of Directors is the arbitration court for such matters.

To assess the social return and the conformity to EU policies (international competitive bidding, environmental standards, etc) of a project, it is evaluated by a team comprised of lending officers, economists and engineers. With less sophisticated borrowers this evaluation can lead to project modification and improvement. The scope for such gains is obviously limited with projects of sophisticated corporations. The technical and economic evaluation of projects of reputed corporations in the EU is therefore much more limited and in certain cases virtually absent.

Borrowers outside the EU benefit from an EU guarantee as the EIB is carrying out lending outside the EU on the basis of an EU mandate. Therefore there is a subsidy but provided by the EU.

D. Financial Solidity of the Bank

The authors of the Bank's statutes had a clear vision of the mission of the Bank and the means to accomplish this mission. These views obviously reflected the financial knowledge and market conditions of the 1950s and are increasingly required to be interpreted flexibly.

One compelling argument was to make the Bank financially as strong as possible. This was rightly seen to have two advantages: first, a low likelihood of recourse to shareholder money. Second, a low cost of funding from capital markets for the benefit of the projects funded by the Bank. In the terminogy of economics, this is a coordination gain.

The first step to financial solidity is a generous endowment with own funds. The Bank has a gearing ratio between outstanding loans and signed capital of 250 %. The World Bank, in comparison, has 100 %. The conservative nature of the EIB's gearing ratio becomes apparent from the second quality feature. Furthermore, 10 % of the signed capital has to be paid in and the unpaid 90 % are a contingent capital guarantee of shareholders. Should a shareholder be unable to pay up then all others are solidarily liable. This is a very strong capital backing.

The EIB was set up in 1958 with a subscribed capital of € 1 billion. After its last capital increase and before enlargement on 1 May 2004 its *subscribed capital* stood at € 150 billion and its paid-in capital at € 7.5 billion. Reserves stood at € 18,5 billion to bring own funds up to € 25,9 billion. After 1 May 2004 the subscriptions of new members led to an increase to over € 163 billion. The very prudent management of the Bank is also evidenced by the high level of provisions in relation to modest past loan losses. See Appendix 2 for key balance-sheet data for 2003.

The third qualitative feature is on the assets side. All loans need to be adequately guaranteed by a first-class third party. For a long time, guarantees were mainly provided by governments. This was the case when EIB lending was mainly concentrated on the public sector. Over time, the share of lending to the private sector steadily increased. Third-party guarantees were provided by first-class banks (meaning banks with at least a single-A rating).

A test of the contribution of the asset quality to the Bank's solidity is provided by a computation of the Basle I capital adequacy ratio. Although the Bank is not subject to the Basle framework, such a computation is suggestive. Until the early 1990s, more than half of the outstanding loans enjoyed a government guarantee and hence a zero risk weighting. The remainder of the loan book was supported by bank guarantees with a 20 % risk weighting. It comes therefore as no surprise that the Bank's capital adequacy ratio exceeded 100 %, far in excess of the minimum requirement of international commercial banks of 8 %. Over time, with a rising share of lending to the private sector, the capital adequacy ratio declined gradually, but is still very comfortable at over 30% in 2003.

The need for third-party guarantees became increasingly recognized as problematic and overly conservative. Problematic, because the Bank in line with a growing role of the private sector sought to lend increasingly to the private sector, but to maintain very high quality. Focussing on top borrowers and insisting on third-party guarantees turned out to be both contradictory and not market conform. The commercial cost of a third-party guarantee, added to the Bank's lending rate made the package unattractive for borrowers with a top standing and hence access to the capital market.

To make its loans more attractive to prime lenders the Bank introduced "single signature" loans, that is, loans without a third-party guarantee. This is unlike loans with a third-party guarantee which are priced on the basis of the Bank's "opportunity" refinancing cost[8] (that is, what the Bank would pay if it had to refinance on capital markets on the day of fixing the lending rate for a loan). With the hedging techniques available, this "opportunity" rate corresponds, on average, to the Bank's actual cost of refinancing plus a mark-up to cover administrative costs (see below), a risk premium is added to single signature loans. This risk premium is computed by the Bank using advanced financial models and as input external ratings. Additional securities such as mortgages or revenue pledges are accepted by the Bank and reflected in the size of the risk premium.

As a result of the very prudent and conservative approach of the Bank to lending, it has not lent to weaker economic actors without strong securities or third-party guarantees. Loan performance therefore has been exceptionally good and the Bank lost little money

[8] Until the late 1980s lending rates were set on the basis of actual borrowing costs. The change to "opportunity" cost was a response to market developments.

from its lending activity. As only few loans have been non performing over its existence of 46 years also the Bank's recourse to guarantors has been modest. The reverse side of the coin is that borrowers of excellent credit standing and equipped with high-quality guarantees also could find money elsewhere.

As pointed above, one of the key aims of the EIB was and is to contribute to convergence of poorer regions and countries by concentrating lending to them. Griffith-Jones et. al. (1992) deflated total allocations of EIB lending by country, by years of membership and by population, for the 1959-90 period. It found that amongst the countries obtaining highest loans from the EIB during that period (per capita and per year of membership) were Ireland, Portugal, Greece and Spain. These were then the poorest countries in the Community (Denmark, not so poor, was the only outlier, also obtaining high levels per capita and per year of membership). This provides strong indicative evidence that the EIB did perform an important redistributive role.

Table 4

EIB Lending, Deflated by Time of Membership and Population (1959-90)

Member country	Indicator
Belgium	0.4
Denmark	4.2
Germany	0.2
Greece	2.9
Spain	2.9
France	0.7
Ireland	5.5
Italy	1.9
Luxembourg	0.5
Netherlands	0.2
Portugal	5.5
United Kingdom	1.4

Source: Griffith-Jones et al (2002)

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E. Pricing

The EIB is not for profit and therefore prices its loans with the aim to cover costs. Given its very high financial solidity (see below) it enjoys triple-A rating and, if quadruple-A existed, it would have it. It therefore borrows at the finest terms, with only a slight spread over triple-A rated government debt. To this cost of funding a mark-up is added reflecting administrative costs. Given the high lending volume per employee (personnel costs account for 80 % of total administrative costs) the total administrative costs are small. Over time and in line with increased outstanding loans per employee, the cost covering mark-up declined to 15 basis points in the early 1990s.

The mark-up calculation was then changed to reflect more directly costs incurred per project. A major problem is that the administrative cost is concentrated on origination and therefore not related to loan maturity. It would therefore be best to compute a unique up-front fee. For a variety of reasons a mark-up embodied in the interest rate is preferred and therefore a modulation of the mark-up for very long maturities was introduced. In addition, the administrative cost of a € 1 billion loan is not hundred times the administrative cost of a € 10 million loan. Repeat loans also generate lower costs of assessing the creditworthiness of the borrower. Modulation now generates mark-ups in the range of 5 to 15 basis points. The combination of a low financial cost with a very low administrative mark up means that the Bank's lending conditions are extremely attractive for borrowers, even when compared to other international financial institutions like the World Bank or the EBRD.

As this description of EIB pricing made clear there is no explicit subsidy in EIB lending. Rather, the strong financial backing of the Bank minimizes the cost of resources to the Bank, an advantage passed on to customers. There is, however, an implicit subsidy. All members of the EU are treated as equal. Therefore the lending to governments is priced equally without a risk premium and independently of country ratings. These ratings vary in the EU from triple-B to triple-A.

F. Historical Evolution

Activity of the EIB was fairly slow to develop (see Table 5 and Graph 2 for details)[9]. During the first ten years of operations, the total of loans granted amounted to only € 1,137 billion, compared to € 42.3 billion in 2003 alone[10]. Agriculture never received much support and global loans were modest during the first two decades. The public sector was the predominant borrower to finance infrastructures, energy and capital-intensive state industry (airlines, electricity generation and distribution, telephone systems etc).

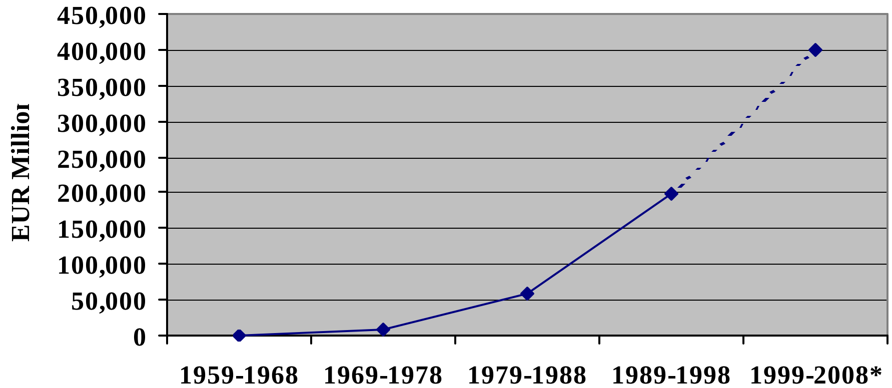
Table 5. Total EIB Lending by Sector (Euro Millions)*

	Agriculture, fisheries, forestry	Energy	Global loans; grouped loans	Health, education	Industry	Infrastructure	Services	Total
1959-1968	1	177	10	0	440	509	0	1,137
1969-1978	14	2,914	760	2	2,163	3,689	26	9,568
1979-1988	375	17,173	14,493	102	6,206	21,441	258	60,048
1989-1998	458	30,486	48,921	1,346	20,178	94,210	1,918	197,517
1999-2008	504	35,126	126,828	20,440	30,844	176,056	8,524	398,322
Total	1,352	85,876	191,012	21,890	59,831	295,905	10,726	666,592

* The data from 2004 to 2008 were estimated based on historical trends
Source: Authors' own elaboration, based on EIB data.

[9] See Appendix 1 for more details.
[10] All values are in nominal terms

Graph 2. Total EIB Lending



* The data from 2004 to 2008 were estimated based on historical trends

Source: Authors' own elaboration, based on EIB data.

During the next decade from 1969 to 1978 the total lending volume increased to € 9,560 million. Although nine times higher than during the first decade it still represented less than one-fourth of lending in the single year 2003. This increase was due to more lending in the Community of six and to an expansion of the Community. Whilst Italy remained by far the largest borrower, the United Kingdom became the EIB's second largest borrower. Lending outside of Europe amounted to less than 10 % of total. As a result of the first oil shock energy lending came close to 30% of total lending. And global loans became modestly significant and reached 8 % of total lending.

During 1979-1988 the EIB became a bank with a recognized role in Europe. Total lending for the decade increased sixfold and exceeded confortably the single year lending of 2003. Global loans continued their march to greater significance reaching over 20% of total lending. Countries outside of Europe received a regressive 7 % of total.

The total for the next decade 1989-1998 is € 197,516 million. Germany and former socialist countries became major borrowers. Two sectors dominated: infrastructures accounted for nearly 50% of total lending and global loans for 25%. Remarkable is that global loans accounted for nearly 50 % of lending to France and Germany, two countries which are not generally considered underrepresented in retail banking and whose numerous savings banks have exactly the task to lend to SMEs.

During the five years 1999-2004 the lending volume of the decade 1989-1998 was already surpassed and the Bank became a global name. For the first time since 1958 Italy lost its top borrower position to Germany and Spain nearly caught up. As accession countries were treated as if they had already joined the Community, the lending outside the Community exceeded 19 % of total. As to the sectoral distribution, energy declined strongly, global loans exceeded 30 %, health and education took of.

This very slow evolution of the Bank's lending during the first 20 years and the explosion of activity during the last 20 years are all the more remarkable, as the very reason for the creation of the EIB, namely capital controls and an underdeveloped capital market, disappeared with the reforms of the late 1980s/early 1990s in preparation of EMU. To put it more provocatively, the EIB only started to flourish when its original raison d'être vanished. Why?

There are no convincing reasons for the slow start taking decades. Surely, it was wise to build up operations slowly, to gain experience on the terrain, and to focus on economically promising projects within a narrow range. As a new bank the EIB had to establish first a solid reputation. In addition, the underdeveloped, split-up European capital market put constraints on the refinancing capability of the Bank, a constraint that has disappeared with the development of the European capital market. Most of the lending took place in European currencies as borrowers preferred not to take an exchange risk. Financial markets in Europe were still national markets and not yet sufficiently developed to allow borrowing in the more mature US market and swap the proceeds into European currencies.

The data on the evolution of the Bank's lending discussed till now are in nominal terms. As inflation in most European countries was still quite high until the creation of European Monetary Union , the nominal data exaggerate quite significantly the growth of EIB activity in real terms. Using the EU GDP deflator with base 100 in 1995, the deflator had a value of 14 in 1960 and 119 in 2003. At constant prices of 1960 the lending level of 2003 of over € 40 billion represents therefore only € 6 billion. Still a very high increase but not spectacular any longer. In terms of growth of lending adjusted for price increases the highest growth rates were achieved between 1965-1973 with an annual growth rate of 20 % (neglecting the set-up period during which growth rates are meaningless). During 1974-1985 the average annual real growth rate declined to 15 %, and since 1985 it has been around 8 %. Even during the last years, between 1995 and 2003 the growth rate was maintained at 7%. This is still a very high growth rate, much higher than real GDP growth in the EU.

Beyond the initial period growth of EIB lending was mainly driven by four factors.

First, the successive enlargement of the EC automatically expanded the lending volume. To gain a quantification of the impact of Community expansion out of the total of lending of € 199, 160 million during 1999-2003 € 154,451 million were granted in the EU-12 and € 86,530 million to the EU-6. If we further assume that Germany had maintained the share of lending in the EU-6 it had before unification, namely 8 % during 1979-1988, then lending in the EU-6 would have been € 58,283 million. Therefore, expansion accounted for over 70 % of activity.

Second, the expansion of eligible projects for EIB financing. Among the most significant decisions figures the decision to increase lending in health and education in recognition of the importance of such investments for economic growth. During 1999-2003 health and education accounted for 5.14 % of total lending and services for 2.14 %. Remarkable is the volume of global loans accounting for 31.85 %, and the very low share of industry with 7.75%. If global loans, services and health and education were subtracted from the adjusted EU-6 lending of € 58,283 above, then lending in the EU-6 would have dropped to some € 30,000 million or only 15% of the total. Hence, new lending activities outside of the initial EU-6 and in sectors that initially played no or only a modest role accounted for 85 % of the expansion of EIB lending.

Third, a growing mandate to support the political objectives of the EC outside of the European Union. The first lending mission outside the EC concerned projects in ACP countries. In the early 1990s Latin America and poorer countries in Asia became eligible. Of course, the biggest impact on EIB lending outside of the EU came from the opening up of former socialist countries in Eastern Europe, where the EIB is by far the largest lender. In 2003 the EIB lent in Eastern Europe more than € 4 billion or about the amount of its total lending in 1985. Also lending to Mediterranean countries picked up for geo-political symmetry.

Until the turn of the century the Bank limited its lending outside the EU to 10 % of its overall lending. In 2003, lending outside the EU represented 19.26 %. Of that lending, 10.85% went to Acceding and Accession Countries and 8.41% to partner countries in the rest of the world. A large part of that lending has become internal with the expansion of the EU on 1 May 2004 so that lending outside of the EU is again close to 10 % of total.

Fourth, the favorably evolving financial situation. Both own funds and borrowed resources benefited from a positive evolution. The EIB is a non-profit organization. But it invests its own funds and the returns generate a surplus, as all projects funded with borrowed resources must be cost-covering. This surplus (technically not a profit because it only remunerates the factor of production capital) is added to the Bank's reserves and allows to augment capital by converting reserves into paid-in capital without cash payments by existing shareholders.

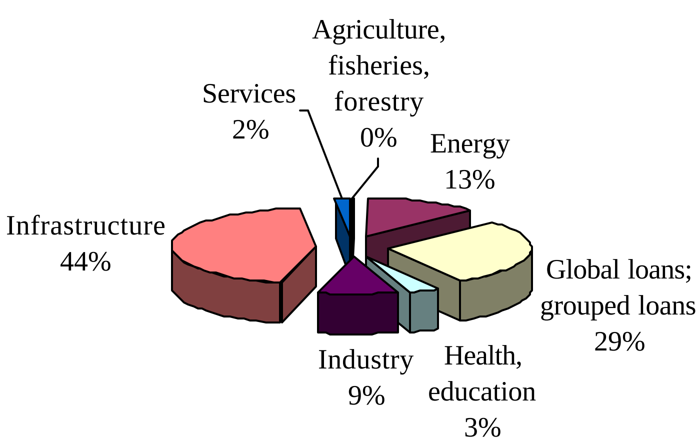
For example, if the average return on loans outstanding and on financial investments is x percent, then own funds of the Bank will grow at x percent p.a. as the EIB pays no dividend and retains all earnings. Operations could then grow at x percent and keep the ratio outstanding loans/own funds constant. Of course, the gearing ratio of the EIB is defined in terms of signed capital. But as 5 % of signed capital must be paid-in, there is an implicit relation with paid-in capital. The Bank then can satisfy this constraint by transferring inside of own funds from reserves to paid-in capital.

Since 1991 all capital increases of the EIB were in this way self-financed. This makes it obviously easier to increase capital. On the external refinancing side, the return to convertibility of member countries eased the access of the Bank to borrowed resources. A big jump was achieved with EMU representing for the Bank a significant ease in funding through large issues in just one currency, the Euro. Progressing financial sophistication made the management of the Bank's asset liability position and its currency risk easier. Today it has become standard to borrow in currencies for which the Bank has no direct use but for which funding costs are interesting and to swap the proceeds into Euros. At present, the Bank, in short, has virtually no compelling, immediate financial constraint for expansion.

G. Key areas of operation

To avoid undue details the scale and scope of lending priorities are illustrated with operations in 2003. The shares of the sectors concerned have been roughly comparable in preceding years. For a summary of sectoral distribution in the EIB's lending by decades, please see again Table 5 (above). For the overall sectoral distribution of the EIB lending for the whole period 1959-2008, see Graph 3.

Graph 3. Distribution of EIB Lending per Sector



Source: Authors' own elaboration, based on EIB data.

The following description allows an overview not just of the scale, but also of the diversity of EIB lending and other activities, including some very innovative aspects, where interesting lessons can be drawn for developing economies.

a) Regional development, -lending to poorer regions

In 2003, the Bank granted individual loans totaling nearly 16.3 billion Euro in the 15-member Union for projects to assist regions lagging behind in their economic development or grappling with structural difficulties. This amount makes up some 70% of aggregate individual loans. The main beneficiaries were the Cohesion Countries Spain, Portugal, Ireland and Greece (7.1 billion Euro), Italy's Mezzogiorno (3.2 billion Euro) and Germany's eastern Länder (2.7 billion Euro). Cohesion countries, a concept created by the Maastricht Treaty in 1993, are those poor countries who had joined in the early 1990's, -Spain, Portugal, Ireland and Greece. The concept and the setting up of the Cohesion Fund were negotiated by Spain to assist the poorer countries of the Union to adjust to the Single Market.

Attracting more than 35% of loans, transport is the main sector supported. The projects financed are helping to mitigate the effects of geographical isolation and improve internal services, so promoting the physical integration of outlying regions. This facilitates trade integration. Upgrading of urban infrastructure accounted for over 19.5% of operations, while loans for the energy sector totaled 14.4% and those for industry and services 13.7%. Lastly, the health and education sectors saw their share of loans rise markedly to 10% (7% in 2002), confirming the Bank's commitment to fostering equal access for the people of the Union to the most advanced educational and healthcare facilities.

Global loans ran to around Euro 6.5 billion, bringing total lending in the EU-15 under the regional development heading to over Euro 22.8 billion in 2003 (67%).

A project is considered to fall into the category regional development if it is located in an Objective 1 area as defined by the Community Structural Funds measures, or in Objectives 2 and 5 (b) areas (areas in need of industrial conversion or rural development) or Objective 6 (Arctic areas). Needless to say, such a bureaucratic criterion has shortcomings.

One is in terms of target definition. For example, Ireland is an Objective 1 area. New policies and Community financial support, including sustained strong financing from the EIB have transformed one of Europe's classic poverty houses into one of the most prosperous and dynamic countries of the EU. But certain areas along the Northern and Western border have remained less developed. To continue qualifying for the EU's regional support a new region was created, the BMW region (Border, Midlands, West), which still will qualify for Objective 1 treatment.

Another difficulty is the economics of regional development. Location is the key criterion and not whether there is employment creation, positive or negative knock-on effects, agglomeration effects and the like. For example, a motorway or fast train connecting, say, Berlin with Warsaw is considered a regional development project. Whether this project will create or destroy jobs in Eastern Germany or Western Poland is an open question.

b) Financing Trans-European Networks

Efficient communications, energy transfer and information networks will be a vital factor in the economic integration of the Member States of the enlarged European Union.

Since 1993, in response to the various Community initiatives identifying Trans-European Networks (TENs) in the Union, and more recently in the new Member States, the Bank has vastly scaled up its TENs lending.

As the leading source of bank finance for these major networks in the enlarged EU, the EIB is supporting twelve of the fourteen priority transport projects and seven of the ten priority energy projects pinpointed by the Essen European Council in December 1994, as well as the main large-scale telecommunications projects. Over a period of 10 years (1993-2003), loans amounting to Euro 56 billion have been signed for transport TENs, Euro 6.7 billion for energy TENs and Euro 19 billion for telecommunications TENs. For 2003, signed loans in support of TENs projects in the enlarged Union totaled Euro 6.9 billion.

The Bank contributes real value added to these projects. It has the financial clout to:

- mobilise on the keenest terms the huge sums necessary to build this infrastructure;
- offer maturities (up to 30 years and longer) tailored to the scale of the schemes concerned;
- where appropriate, provide structured finance as an adjunct to commercial bank and capital market funding.

The catalytic effect of the Bank's input is especially illustrated by the growing number of public-private partnerships (PPPs) supported by the EIB, which combine the inherent advantages of both sectors in the creation of such infrastructure. In 2003, the Bank approved loans totaling Euro 2.8 billion for PPP projects and financial contracts for a similar amount were signed in support of key schemes such as improvements to the London Underground and the Barcelona tram network, and the construction of motorways in Spain, the United Kingdom and Ireland, and a major bridge in Greece.

Under the *European Action for Growth* approved by the European Council in December 2003, the EIB will increase its contribution to TENs financing, notably by introducing a priority lending facility endowed with Euro 50 billion up to 2010.

Furthermore, the Bank will improve the range of its financial instruments with a view to boosting the proportion of private-sector investment in TENs financing. In particular, it will offer loans with very long maturities (up to 35 years) and appropriate grace periods which in certain cases may cover up to 75% of the investment cost; provide guarantees for investment-grade projects during their construction phase; and create securitisation funds.

Finally, the Bank will implement, in cooperation with the Commission and the Council, a “quick-start” programme focusing on projects’ importance for the integration of the internal market in the enlarged EU, along with their degree of maturity, economic and financial viability, impact on growth and leverage effect on private capital.

In the new Member States, where infrastructure development and rehabilitation needs are immense, signatures for transport TENs projects amounted to close to Euro 1.5 billion in 2003. These countries benefited from schemes to upgrade roads and motorways, port and airport infrastructure and rail transport.

c) EIB Group support for SMEs

The EIB Group is able to provide both medium and long-term financing via its global loans and equity through venture capital financing. This covers the spectrum of resources necessary for the development of SMEs in a changing economy.

Over the past five years, the EIB Group’s support for SMEs in the enlarged 25-member Union has been distributed as follows:

- Almost half of the Euro 56.2 billion signed in global loans to over 200 partner banks;
- Euro 2.5 billion in equity participations in 189 operations;
- Euro 6.4 billion in portfolio guarantees set up through 120 specialised banks.

EIB global loans

Global loans are credit lines that the EIB grants to an intermediary – a bank or other financial institution – which deploys the proceeds to support small-scale investment projects. Global loans signed by the Bank in 2003 in the enlarged 25-member Union amounted to Euro 11.2 billion, of which nearly half is destined to benefit SMEs. Of this amount, the Central and Eastern European Countries that have recently joined the EU received Euro 635 million.

The Bank pressed ahead with its policy of diversifying intermediary banks in order to create a competitive environment favourable to SMEs and spread the use of global loans, particularly in regional development areas.

SME Finance Facility in the new Member States

In the framework of the EIB/European Commission partnership (the SME Finance Facility), Euro 300 million was allocated to financing some 335 small and medium-scale projects under existing global loans in the new Member States. Following the success of this concept and its implementation, the EIB again joined forces with the Commission to set up the Municipal Infrastructure Facility (MIF). With the Commission's support, this Facility aims to speed up the development of small-scale local infrastructure projects in regions of the new Member States bordering the EU-15.

The European Investment Fund

The EIF, in which the Bank is lead shareholder (almost 60%) alongside the Commission (30%) and a cluster of banks and financial institutions, specialises in venture capital financing and SME guarantees.

Since 2000 and in light of the Lisbon Summit conclusions, the EIF has been responsible for all the EIB Group's investment in venture capital funds. Previously, it had also provided guarantees for Trans-European Netwrok financing of infrastructure. It also manages budgetary resources mobilised by the European Commission under the Multiannual Programme for Enterprise (MAP) 2001-2005, which mainly consists of a seed and start-up capital instrument and a SME guarantee facility.

The EIF's business is geared to a twofold objective: supporting EU policies while obtaining a financial return. Total venture capital and guarantee operations currently amount to Euro 2.5 billion and Euro 6.4 billion respectively.

EIF venture capital operations

The EIF's investment strategy rests on three main pillars:

- support for European high technology (biotechnology, new materials, life sciences, etc.);
- participation in funds furthering the Union's regional development objective;
- backing for funds operating on a pan-European scale.

Despite a market environment beset by investor wariness, the EIF's investments in 2003 reached Euro 135 million spread over 16 operations. Five of the venture capital funds involved focus exclusively on companies in their seed and start-up phases, with two targeting new technology-based firms that are either university spin-offs or benefit from a strategic partnership with a university.

EIF SME guarantees

The second branch of the EIF's activity is the provision of guarantees for the SME portfolios of financial institutions or public guarantee bodies. Under this heading, the EIF works with over 120 financial intermediaries. It offers two main product lines for its guarantee activity: credit enhancement (securitisation) and credit insurance/re-insurance. The EIF only covers operational lending risks.

In 2003, the EIF concluded 31 guarantee transactions totaling over Euro 2.2 billion, an increase of 80% compared to the previous year. The first three EIF guarantee operations were signed in Eastern Europe. The EIF guarantee portfolio totals Euro 6.4 billion. To date, <u>over 250 000 SMEs have benefited indirectly from EIF guarantees</u>.

In response to growing demand, the EIF is strengthening its advisory services for the structuring of guarantee and venture capital funds. These are designed to support the creation, growth and development of SMEs by enhancing their access to finance. This is accomplished through the provision – for a fee – of strategic and technical advice on the design, implementation and evaluation of SME finance policies, projects and structures to a range of counterparties, e.g. governments, local authorities and regional development agencies, as well as the European Commission.

An interesting possibility would be to extend these advisory services, -or provide technical assistance for the <u>creation of such services in developing country regions undertaking integration processes.</u>

d) Protecting the environment and improving the quality of life

Protecting and improving the environment ranks among the EIB's top priorities. Accordingly, the Bank has set itself the goal of devoting between 30% and 35% of all its individual loans within the enlarged European Union to projects safeguarding and enhancing the environment. The figures for 2003 meet this goal.

The Bank also hit its target of doubling the financing of renewable energy projects as a proportion of its total energy sector funding (from 7% in 2002 to 15% in 2003). In 2003, EIB individual loans for environmental projects within the 15-member European Union amounted to 10.7 billion.). The EIB provided reconstruction financing to counter damage caused by natural disasters in various countries.

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e) Cooperation with the Commission

Synergies between EIB loans and EU grant financing are crucial for an effective and efficient transfer of funds. The Bank and the European Commission are operational partners in the environmental sector, combining their funds particularly in the new Member States of the Union, the Mediterranean Partner Countries and the ACP Countries. The Bank also acts as an adviser to the Commission in the appraisal of Cohesion Fund and ISPA (Instrument for Structural Policies for Pre-Accession) projects.

Furthermore, the Bank is supporting the EU Water and Renewable Energy Initiatives to help achieve the UN Millennium Development Goals. It also plays a part in various European regional environmental initiatives in the Baltic, Mediterranean, Danube and Black Sea regions. Also important is its role in helping co-ordinate and accelerate the implementation of environmental aspects of nuclear projects in Europe's northern region, in particular in North West Russia.

African, Caribbean, Pacific (ACP) States and OCT

Since 2 June 2003, the Bank's operations in the ACP countries have been carried out under the new Cotonou ACP-EU Partnership Agreement and project financing under the expired Fourth Lomé Convention has been phased out.

In this framework, the Member States have entrusted the Bank with managing, over the next five years, an Investment Facility endowed with Euro 2.2 billion, plus Euro 1.7 billion in EIB own resource lending. As the prime objective is poverty reduction, priority will be given to small-scale private-sector investment and schemes in the health and education sectors. The Investment Facility will operate as a revolving fund, meaning that the proceeds of repayments will be ploughed back into financing new projects. In 2003, the EIB granted loans totaling 463 million in the ACP countries, including close on 286 million from the Member States' budgetary resources.

Western Balkans

In 2003 the EIB pressed ahead with its operations in this region, lending some Euro 372 million. Its business was characterised by diversification into new sectors such as health and local authority financing.

Asia and Latin America (ALA)

In 2003, lending amounted to Euro 254 million in Latin America and Euro 94 million in Asia, or Euro 348 million overall. Since it began its operations in the ALA countries in 1993, the EIB has signed 73 loans totaling Euro 3 298.4 million. EIB activity is aimed at strengthening the international presence of European companies and banks by supporting projects of mutual benefit.

H. Recent Policy Initiatives

a) The 2000 Initiative

The Innovation 2000 Initiative (i2i) was set up by the EIB Group to underpin the "Lisbon Strategy", as charted by the European Council, for building a European economy based on knowledge and innovation. In 2003, i2i was renewed, confirming the priority accorded by the EIB Group to financing innovation up to 2010.

Since the launch of i2i, over Euro 17 billion has been advanced in support of capital projects under this initiative, including Euro 6.2 billion in 2003. Focusing on five economic sectors, i2i operates through:

- medium and long-term EIB financing (where appropriate in the form of risk-sharing or structured loans) and
- EIF participations in venture capital funds (VCFs) that provide SMEs with equity resources in the form of venture capital.

Research and Development (R&D)

In 2003, the EIB ploughed over Euro 2 billion into 18 R&D projects, most of which mounted by the private sector in the fields of nanotechnology, optics, biotechnology and telecommunications. These loans brought the EIB's R&D financing since 2000 to a total of almost Euro 6 billion. A notable example of such projects is the Helsinki Science Park, where laboratory and office space is made available to start-up companies in the biotechnology sector.

Development of SMEs and entrepreneurship

The EIB supports SMEs through its global loans, from which part of the allocations serve i2i objectives. The EIB Group's operations in 2003 include the activities of its specialised subsidiary, the EIF.

The EIF continues to concentrate on financing funds downstream of R&D, and especially technology transfer and investment companies promoting the exploitation and commercialisation of university research results.

In addition, the European Commission's Research Directorate-General has entrusted the EIF with carrying out a feasibility study on the introduction of a new type of investment and technology transfer vehicle built around centres of excellence and universities. This study is geared particularly towards the creation of a pan-European instrument bridging the gap between research and its commercialisation.

Technology networks

As essential vehicles for the diffusion of innovation and data exchange between companies, in 2003 information and communications technology (ICT) networks attracted Euro 1.4 billion in EIB loans.

b) The Euro-Mediterranean financial partnership (FEMIP)

In 2003, the first full year of activity since the launch of the Facility for Euro-Mediterranean Investment and Partnership (FEMIP), lending in the 10 Mediterranean Partner Countries (MPC) reached the record figure of almost Euro 2.1 billion, confirming the Bank's position as a major player in fostering the region's economic development and stability.

Focus on the private sector and infrastructure

- EIB activity in the Mediterranean region reflects the high priority accorded to FEMIP's objectives: more than one third of operations directly promoted the growth of private businesses, through support for foreign direct investment (Turkey, Tunisia) or joint ventures resulting from cooperation between MPC promoters (Algeria), or through SME financing via creation of a regional venture capital fund.

- Loans also targeted infrastructure projects, including in the energy and environment sectors, underpinning private sector development in Morocco, Algeria, Egypt, Lebanon and Syria.

FEMIP represents a major step forward in economic and financial cooperation between the Union and the MPC. Its priorities include:

- Extensive involvement of the MPC in FEMIP policy-making through the holding of ministerial-level meetings (Policy Dialogue and Coordination Committee – PDCC) and opening of regional offices;
- Development of the private sector;
- Promotion of investment in human capital;
- Greater technical assistance;
- Deployment of innovative financial products and risk capital;
- Gradual increase in the annual volume of EIB lending in the region.

In December 2003, the Brussels European Council decided to augment FEMIP, by means of a number of measures in support of private sector development:

- Allocation of a maximum of 200 million from the Bank's reserves to the expansion of risk-sharing operations up to 1 billion, and better structuring of lending to mitigate private sector risks (special FEMIP envelope);
- Improved dialogue on the structural reform process to enhance the environment for private sector activity.

A decision on whether to incorporate an EIB majority-owned subsidiary dedicated to the Mediterranean Partner Countries will be taken in December 2006 on the basis of an evaluation of the reinforced FEMIP's performance and taking account of the outcome of consultations with the Barcelona Process partners.

I. Policy issues

The EIB was created at a time when large market imperfections gave a strong backing for a public bank. Market imperfections still prevail in developing countries and provide justifications for the creation of public banks. Also the creation of integrated economic spaces such as *Mercosur* justifies a regional public bank with the mission to support an integrated infrastructure and assistance to lagging regions.

The remarkable feature of the evolution of EIB activity is that when market imperfections prevailed lending of the Bank was relatively small and rising fairly slowly. When a well performing capital market developed activities of the Bank grew more rapidly (of course, at the same time the EU enlarged, eligibility was widened, and external mandates multiplied). The question therefore is what would be the optimal mandate of the Bank in a performing financial market environment? Or, otherwise said, what are remaining market imperfections?

For the classic reasons of asymmetric information problems, the risk market is still tainted with major imperfections, particularly for non-rated companies for which credit derivatives are still underdeveloped. Commercial banks are charged with a capital cost when taking risk under the Basle capital requirements. It could therefore be argued that in such an environment the role for a public bank might more pertinently be seen in assuming risk rather than the flow of funds.

The actual situation is broadly the opposite. The EIB provides funds but usually without assuming the risks which are borne by the guarantors of a loan. If a commercial bank provides the guarantee it has to back it up with the same amount of capital as when it makes the loan. As the EIB is very capital rich, the present role distribution should be put on its head: banks provide funds and the EIB assumes the risk. This could also be a more useful role for public sector banks in developing countries.

Of course, the EIB has taken important steps to recognize the changes in the financial environment. It assumes already the risk in single signature loans. It also is examining ways to securitise parts of its loan book. Above all it has promoted the creation of the European Investment Fund, of which it is the major shareholder. The EIF's role is to provide guarantees, to take equity participations, and to support venture capital funds.

An unresolved issue is subsidiarity. This is less of a problem in financially constrained economies where even for perfectly sound projects funding may not be available at any cost. When funding is available at some cost it may be useful to define benchmarks to settle the subsidiarity applicability.

Use of a well endowed public bank as a special refinancing vehicle with a triple-A standing may be useful in many circumstances. This goal is already successfully pursued by institutions like the African Development Bank which, thanks to its triple-A rating, can borrow on international markets at much better conditions than African States can.

Even on internal markets borrowings by a well recognized regional bank with a triple-A rating may make significant contributions to the development of internal bond markets. The EIB played a significant role in this respect during the 1990s in the capital markets of Greece, Portugal and Spain and later in the emerging markets of Central Europe.

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Annex 1

Present Structure of Governance of EIB

The **Board of Governors** consists of Ministers designated by each of the 25 Member States, usually Finance Ministers. It lays down credit policy guidelines, approves the annual accounts and balance sheet, decides on the Bank's participation in financing operations outside the European Union as well as on capital increases. It appoints the members of the Board of Directors, the Management Committee and the Audit Committee.

The **Board of Directors** has sole power to take decisions in respect of loans, guarantees and borrowings. As well as seeing that the Bank is properly run, it ensures that the Bank is managed in keeping with the provisions of the Treaty and the Statute and with the general directives laid down by the Governors. Its members are appointed by the Governors for a renewable period of five years following nomination by the Member States and are responsible solely to the Bank.

The Board of Directors consists of 26 Directors, with one Director nominated by each Member State and one by the European Commission. There are 16 Alternates, meaning that some of these positions will be shared by groupings of States.

Furthermore, in order to broaden the Board of Directors' professional expertise in certain fields, the Board will be able to co-opt a maximum of 6 experts (3 Directors and 3 Alternates), who will participate in the Board meetings in an advisory capacity, without voting rights.

Since 1 May 2004, decisions have been taken by a majority consisting of at least one third of members entitled to vote and representing at least 50% of the subscribed capital.

The **Management Committee** is the Bank's permanent collegiate executive body. It has nine members. Under the authority of the President and the supervision of the Board of

Directors, it oversees day-to-day running of the EIB, prepares decisions for Directors and ensures that these are implemented. The President chairs the meetings of the Board of Directors. The members of the Management Committee are responsible solely to the Bank; they are appointed by the Board of Governors, on a proposal from the Board of Directors, for a renewable period of six years. The President of the Bank is also a non-voting member of the Ecofin Council and thus part of the preparatory process for the Bank's mission.

The **Audit Committee** is an independent body answerable directly to the Board of Governors and responsible for verifying that the operations of the Bank have been conducted and its books kept in a proper manner. It reports to the Board of Governors and, at the time of approval by the Governors of the Annual Report of the Board of Directors, issues a statement on the audits carried out.

The Audit Committee is composed of three members and three observers, appointed by the Governors for a term of office of three years.

Annex 2

Lending by sectors and countries 1959-2003 (in million Euros)

1959-1968

Country	Agriculture, fisheries, forestry	Energy	Global loans; grouped loans	Industry	Infrastructures	Sum:
Belgium				5	26	31
France	1	31		45	76	154
Germany		32		24	49	105
Greece		6		16	47	69
Italy		57	10	258	272	597
Luxembourg		4			4	8
ACP/OCTStates	0	4	0	38	9	51
Turkey		42		54	26	122
Sum:	1	177	10	440	509	1,137

1969-1978

	Agriculture, fisheries, forestry	Energy	Global loans; grouped loans	Health, education	Industry	Infrastructures	Services	Sum:
Austria		52						52
Belgium		118	18		6			142
Denmark		72	28		24	67		191
France		559	100		138	863		1,661
Germany	5	302	43		174	22		545
Greece			28		13	26		67
Ireland		33	27		80	240		380
Italy		716	291	2	910	1,508	10	3,436
Luxembourg						1		1
Netherlands		55			18	8	3	84
Portugal		55	24		55	51		185
Slovenia		4				4		8
United Kingdom		680	99		456	699		1,934
Norway		68						68
Mediterranean countries		3						3
ACP/OCTStates	9	81	60	0	231	103	14	496
Balkans	0	21	0	0	0	21	0	42
Turkey		95	43		58	78		273
Sum:	14	2,914	760	2	2,163	3,689	26	9,569

1979-1988

	Agriculture, fisheries, forestry	Energy	Global loans; grouped loans	Health, education	Industry	Infrastructures	Services	Sum:
Austria		73						73
Belgium		532	42		86			660
Cyprus		15				43		58
Denmark		1,853	323		9	452	16	2,653
France		1,363	3,602		404	2,369		7,738
Germany		942	422		108	207	1	1,680
Greece	10	476	649	31	254	1,234		2,655
Ireland	246	653	195	65	205	1,337	3	2,705
Italy	35	5,572	6,338	7	3,046	9,071	78	24,148
Luxembourg						36		36
Malta					3	37		40
Netherlands			43		305	97		445
Portugal	18	391	451		210	591	19	1,681
Slovenia						152		152
Spain		173	1,209		166	1,137		2,685
United Kingdom		3,867	408		581	3,721	61	8,638
Austria		103						103
Mediterranean countries	56	330	388	0	78	396	0	1246
ACP/OCTStates	0	510	364	0	732	312	80	1991
Balkans	0	68	0	0	0	251	0	318
Turkey	10	256	60		20			346
Sum:	375	17,173	14,493	102	6,206	21,441	258	60,049

1989-1998

	Agriculture, fisheries, forestry	Energy	Global loans; grouped loans	Health, education	Industry	Infrastructures	Services	Sum:
Austria		278	313		489	515	50	1,645
Belgium		361	1,998		172	2,586		5,117
Cyprus		30	133			84	1	248
Czech Republic		355	97		114	1,250		1,816
Denmark		1,118	525		228	5,103	87	7,060
Estonia		7	20			61		88
Finland		121	145		140	1,012		1,417
France		157	10,756	23	2,641	9,010	182	22,768
Germany		2,591	11,064	567	2,076	6,241	923	23,463
Greece		1,130	1,210	81	4	2,525		4,949
Hungary		105	365		125	687		1,282
Ireland	85	540	730	103	42	1,096		2,596
Italy	11	8,268	10,537	7	5,174	12,990	297	37,283
Latvia		6	20			69		95
Lithuania		10	10			128		148
Luxembourg			14		102	247		363
Malta			6			38		44
Netherlands		317	961		272	2,034		3,584
Poland	13	230	298		140	1,795		2,476
Portugal	121	1,855	879	126	1,265	7,383	125	11,754
Slovakia		236	78			352		666
Slovenia			10			366		376

Spain	176	2,481	4,158	383	2,538	17,311	20	27,066
Sweden		461	135		154	1,947		2,697
United Kingdom		5,231	2,416	56	2,897	13,318	154	24,072
Article 18	0	1193	16	0	0	387	0	1596
Bulgaria		45	30		100	396		571
Romania		170	40		47	795		1,052
Mediterranean countries	28	1370	731	0	691	2501	38	5357
ACP/OCTStates	16	1011	834	0	569	760	44	3226
ALA	10	567	40	0	198	577	0	1392
South Africa		101	304			45		450
Balkans	0	12	5	0	0	320	0	337
Turkey		134	50			283		467
Sum:	458	30,486	48,921	1,346	20,178	94,210	1,918	197,516

1999-2003

	Agriculture, fisheries, forestry	Energy	Global loans; grouped loans	Health, education	Industry	Infrastructures	Services	Sum:
Austria		211	1,957	617	610	1,096	35	4,526
Belgium		70	1,114		74	1,140		2,398
Cyprus		300		315		255	70	940
Czech Republic			350	95	688	2,027		3,160
Denmark		644	429	349	140	3,502	391	5,454
Estonia		80	160			32		272
Finland		37	725	815	1,008	1,068	123	3,777
France			11,905	979	1,954	5,473	86	20,397
Germany		777	16,412	3,083	4,198	7,489	605	32,564
Greece		664	227	424	150	5,790	156	7,411
Hungary		282	635	164	230	1,349	174	2,834
Ireland		717	707	68		603		2,094
Italy	75	4,375	10,323	207	716	11,168	1,282	28,146
Latvia		80	70			126		276
Lithuania			40			209		249
Luxembourg		80			130	424		634
Malta			25					25
Netherlands			1,050		66	1,275		2,391
Poland		30	825	225		3,943		5,023
Portugal		847	1,700		276	6,128	141	9,092
Slovakia			180	14	264	466	50	975
Slovenia		1	190			858		1,049
Spain	25	2,105	7,976	902	1,185	15,431	293	27,917
Sweden		328	306	381	402	2,392	145	3,954
United Kingdom		2,314	2,830	959	1,514	8,199	137	15,953
Article 18	0	410	100	0	0	280	300	1090
Bulgaria		60	90			455		605
Romania		104	92	243	35	1,722	8	2,204
Russian Federation						25		25
Mediterranean countries	90	1433	516	280	544	1987	51	4901
ACP/OCTStates	29	482	646	0	281	517	211	2164
ALA	33	651	349	0	506	443	0	1980
South Africa		107	475		25	145		752
Balkans	0	285	116	50	25	1010	0	1486
Turkey		90	897	50	400	1,003	6	2,446
Sum:	252	17,563	63,414	10,220	15,422	88,028	4,262	199,160

Annex 3

	(Euro million)
European Investment Bank	
Activity in 2003	
Loans signed	**42 332**
European Union	**34 187**
Acceding and Accession Countries	4 589
Partner Countries	3 556
Loans approved	46 614
European Union	37 273
Acceding and Accession Countries	5 731
Partner Countries	3 610
Loans disbursed	**35 672**
From the Bank's resources	35 414
From budgetary resources	258
Resources raised (after swaps)	**41 911**
Community currencies	30 983
Non-Community currencies	10 928
Situation as at 31.12.2003	
Outstandings	
Loans from the Bank's resources	247 600

Guarantees provided	392
Financing from budgetary resources	2 497
Short, medium and long-term borrowings	194 505
Own funds	**25 984**
Balance sheet total	**234 078**
Net profit for year	**1 424**
Subscribed capital	**150 000**
of which paid in	7 500

European Investment Fund	
Activity in 2003	
Venture capital (14 funds)	135
Guarantees (31 operations)	2 251
Situation as at 31.12.2003	
Venture capital (189 funds)	2 480
Guarantees (126 operations)	6 351
Subscribed capital	**2 000**
of which paid in	400
Net profit for year	**20**
Reserves and provisions	**178**

Annex 4

Cooperation with the banking sector

The EIB Group works in very close cooperation with the banking sector, both with respect to its borrowings on the capital markets and its lending, equity participation and guarantee activity. This provides an essential channel through which the EIB Group can:

- contribute funding to a raft of large-scale individual projects, where appropriate via intermediated financing;
- obtain adequate security for funding private-sector individual projects, with one third of guarantees made available to the EIB being furnished by banks or other financial institutions;
- on the strength of its experience in appraising long-term projects, act as a prime mover in arranging sound financing packages offering the keenest interest rate and maturity terms;
- help to finance municipalities and promoters of small and medium-scale infrastructure schemes by providing global loans;
- by way of its global loans and the operations of its subsidiary the EIF, underpin the activities of SMEs by enhancing their financial environment and acting as a catalyst for bank investment in this sphere.

In working together with the banking sector, the Group deploys a varied and effective range of financial products.

EIB global loans, an important means of fostering smaller-scale investment, are currently deployed through some 280 banks and other financial institutions both within and outside the EU. Apart from their impact on developing the local financial sector, they enable SMEs and local authorities to maintain close links with banks. The palette of global loans is being broadened to encompass regional banks (in response to the objective of supporting investment in less favoured areas) and more specialised intermediaries, for instance in the environmental, audiovisual and high-tech sectors.

The EIB also co-finances medium and larger-scale projects. Complementing the banking sector, EIB funding, predominantly long-term and sometimes taking the form of structured or intermediated financing, serves to diversify the sources and types of funding available to businesses, so optimising their development plans. As part of its endeavours to widen the gamut of its products to accommodate economic needs, the EIB, in cooperation with its partners in the European banking sector, is giving thought to devising a new form of financing tailored to intermediate-sized firms.

Lastly, operating both within and outside the Union, the EIB is well equipped to work in tandem with the banking sector in supporting the group strategies of major players by furthering their projects in the EU as well as their foreign direct investment in non-member countries.

The **EIF**, for its part, also operates in partnership with the financial and banking sector:

- either in channeling finance to venture capital funds, partly run by banking groups' specialist subsidiaries;
- or by providing guarantee facilities for banks' SME investment portfolios.

Annex 4

Projects eligible for financing by the EIB Group

Within the European Union and in the Accession Countries, projects considered for financing must contribute to one or more of the following objectives:

- strengthening economic and social cohesion: promoting business activity to foster the economic advancement of the less favoured regions;
- furthering investment contributing to the development of a knowledge-based and innovation-driven society;
- improving infrastructure and services in the health and education sectors, key contributors to human capital formation;
- developing transport, telecommunications and energy transfer infrastructure networks with a Community dimension;
- preserving the environment and improving the quality of life, notably by drawing on renewable or alternative energies;
- securing the energy supply through rational use, harnessing of indigenous resources and import diversification;
- assisting the development of SMEs by enhancing the financial environment in which they operate by means of:
    - medium and long-term EIB global loans;
    - EIF venture capital operations;
    - EIF SME guarantees.

In the Partner Countries, the Bank participates in implementing the Union's development aid and cooperation policies through long-term loans from own resources or subordinated loans and risk capital from EU or Member States' budgetary funds. It operates in:

- the non-member Mediterranean Countries by helping to attain the objectives of the Euro-Mediterranean Partnership with a view to the creation of a customs union by 2010;

- the African, Caribbean and Pacific States (ACP), South Africa and the OCT, where it promotes the development of basic infrastructure and the local private sector;
- Asia and Latin America where it supports certain types of project of mutual interest to the Union and the countries concerned;
- the Balkans where it contributes to the goals of the Stability Pact by directing its lending specifically towards not only reconstruction of basic infrastructure and projects with a regional dimension but also private sector development.