

# 10<sup>TH</sup> EIB FORUM

WARSAW - 14-15 OCTOBER 2004

## Terence Brown

Director General  
for Lending Operations in Europe,  
European Investment Bank



Investing in the New Member States

## Introduction

First of all, I would like to thank the other speakers in this session on Innovative Financing for their valuable contribution to the discussion of this topic. While I will refer to some of the issues already mentioned, I would primarily like to focus in the next few minutes specifically on the EIB's role in the provision of innovative financing for European development and integration, in particular in the New Member States of the Union.

EIB is the largest long-term lender in Central and Eastern Europe, having committed since 1990 well over EUR 25 bn to the region, with more than EUR 7.5bn going to Poland alone. Now that enlargement has taken place, our overriding objective is to support the integration of the New Member States' economies with those of the rest of the EU, and we therefore consider lending to the region to be one of the Bank's major priorities.

There are three [four] particular areas on which I would like to focus in the context of innovative financing in the region, namely:

- Financing the **build-out of infrastructure** links with the rest of the EU and within the region itself;
- Financial solutions for the provision of public services involving the participation of the private sector – generally known as “**Public Private Partnerships**” or PPPs; and
- Support for the further **development of technology, innovation and human capital**;
- [Financing the **SME** sector – optional].

## Infrastructure build-out

Financing the build-out of infrastructure, both at the pan-European and regional level, has been one of the Bank's key tasks since its creation 46 years ago and represents a crucial contribution to what we call the “enabling environment” - namely the entirety of physical, institutional and legal structures which determine the competitiveness of the economy both at country and EU level as well as long-term growth potential.

EIB has an unparalleled experience over the last 40 years in financing complex infrastructure projects, of very varied characteristics, across the entire EU, and in fact also in many countries outside the Union. EIB has been involved, in one way or another, in financing a large portion of European road, rail, aviation and energy infrastructure, much of it contributing to Trans European Networks (TENs). We will continue to draw upon this unique institutional knowledge base accumulated during these years in order to devise financing structures best suited to the requirements of future projects.

One particular feature of most infrastructure assets is their very long economic life, making it very difficult to match the maturity of these assets and related liabilities by resorting to financial markets – in most cases, the markets' time horizon is too short. For EIB, however, it is not unusual to lend for maturities exceeding 30 years, with long grace periods. For priority projects under the EIB's special TENs Investment Facility, we can also finance up to 75% of the total cost, which combined with the long maturities can have a fundamental impact on the economic profile and financing structure of the project. It is also worth noting that the Bank can provide funds in local currencies, including those of the new Member States such as PLN, CZK or HUF.

Our co-operation with the Commission in the area of co-financing, particularly in the New Member States (including ISPA grants before the accession and Structural & Cohesion funds since 1<sup>st</sup> May) is and will remain a key element in devising the most suitable financing structures for infrastructure development. In particular, for the programming period 2004-6, the Bank has adopted an approach consisting of providing framework loans to Governments, which are available to finance the national budgetary contribution to the programmes of the Structural Funds and the projects of the Cohesion Fund => this approach provides much appreciated financial support to prepare and start the implementation of the programmes (bridge financing element), but also implies an involvement of the Bank in the definition of the programme structures and procedures and an overall monitoring of their implementation. In Poland we have signed such a framework loan for EUR 500 m and other similar operations are in place, for example, in Slovenia, Slovakia and Hungary.

## PPPs

I would like now to touch upon the subject of PPPs and the EIB's experience in financing such structures.

The EIB has always dedicated a significant part of its support to projects aimed at providing high quality, efficient public services, one of the key pre-requisites to achieving economic growth. Traditionally, such services were implemented and operated within public structures and financed by public money, with a limited role of the private sector. Over the past 20 years, however, challenged by a growing demand for modern, efficient and safe public services, and confronted with increasingly constrained public finances, many national governments have started to develop new methods of procurement. PPPs are one amongst them.

Here, I cannot escape the difficult task of trying to give a definition of PPPs. There are indeed many different and sometimes conflicting interpretations of this generic concept. Their common features seem to be:

- the notion of substantial risk-sharing between public and private sectors;
- the long-term relationship between the different parties; and
- the public authority being the arbiter of services required, but the responsibility for delivery resting with the partnership.

The logic behind PPPs is that, through its "rigour", the availability of resources and "expertise", the private sector brings efficiency in the design, financing, risk management, implementation and operation of projects in a manner that will benefit the society as a whole. As PPPs are long-term contracts for services and not just a procurement of assets, they allow a shift from input to output specifications. When properly designed, PPP contracts give the right incentives to perform well, i.e. improve the quality of public services and optimise life-cycle costs of assets. However, unless real value-added can be achieved – i.e. if the private sector can provide same (better) service/outcome at a lower (same) cost and risk – there is no rationale to resort to a PPP.

Accounting treatment of PPPs (as confirmed in the February 2004 Eurostat clarification of ESA95 rules on Government Deficits) is also an important issue, since these structures can provide a possible way to reduce both the public deficit and public debt. I would nevertheless add some words of caution: in the long-term, the main substantiated rationale to develop PPPs should remain efficiency and value for money for the Public Sector, not short term budgetary and accounting benefits.

Over the years, the Bank has observed and contributed to the launch and development of PPPs in many of the EU Member States and the EIB is already a substantial financier of PPP projects. Since the late 1980s, more than EUR 20bn euros have been committed by the Bank to finance some 100 PPP projects in the EU. Examples of EIB-financed PPP projects include London Underground refurbishment, the new Athens Airport, Tagus Bridge in Lisbon and Metro in Malaga. Outside Europe, the EIB has financed PPPs in Asian and Latin American countries and in Southern Africa. PPPs now account for a fairly significant part of our lending support to the improvement of public services. So far, the vast majority of EIB PPP portfolio is concentrated in the transport sector, with health/education and water & sewerage projects accounting for much of the remainder.

In practice, the characteristics of PPPs vary a lot according to the objective of the partnership. There is a huge range of possible structures, depending on allocation of the risks, sources of the operational revenue, proportion of the initial investment to the total expenditure over the life of assets etc. PPP structures vary also a lot also from one country to another, due to very different legal and historical backgrounds, as well as across sectors.

I would like to stress that our primary focus in PPP projects is usually to support the public side of these transactions. As a public sector bank, operating on a non-profit basis, we are well suited to understand and support governments and municipalities with our extensive experience and financial resources. Particularly important in the case of these sometimes extremely complex projects is the provision by the EIB not only of the best suited financial solution, but also of independent technical and economic advice. For example, a thorough review of the procurement procedure, which is crucial for achievement of a competitive tendering process, is an essential part of our appraisal process.

From our experience, we have seen that PPPs are not a quick solution for infrastructure and financing constraints. They involve rigorous appraisal of the project and of its operational and financial risks. They also require a change in mindset both in the public and private sectors as their respective roles in the due diligence, construction and operational phases of the infrastructure project change. A partnership has to be

---

developed based on a good understanding of respective positions and constraints. Countries embarking on PPPs or expanding the use of PPPs to new sectors climb a steep learning curve, as they need to identify or adapt the PPP models that meet their specific requirements. In Europe we have observed that adoption of PPPs has different speeds in various countries: whilst the UK, Spain, Portugal and Greece have been using such structures for some time now, other EU countries continue to use predominantly traditional procurement tools.

In order to achieve the conditions needed to implement successful PPPs, substantial modifications to the legal and institutional frameworks, (which include budget, fiscal and procurement legislation), still require implementation in most of the new Member States. We have nevertheless seen significant progress in this area, such as the pending PPP law in Poland. In Hungary also, the government recently confirmed its intention to complete the necessary changes to allow the financing of most motorway projects from 2005 under PPP structures. EIB will certainly be one of the key supporters of the New Member States in this important process, providing its knowledge and resources as appropriate.

## **Development of Technology and Innovation**

[And finally] I would like to move to our support for research and innovation in Europe, which has become one of the EIB's primary objectives since the late 1990s. For this purpose, the Bank has established a dedicated programme called i2i ("Innovation 2010 Initiative") under which we are contributing to the EU's Lisbon process as well as to its "European Action for Growth" agenda.

These different European initiatives have recognised the crucial role of R&D and innovation in closing the competitiveness gap between Europe and the US / Japan. They have set the ambitious target of increasing overall spending on R&D and innovation in the Union to a level of some 3% of GDP by 2010.

The Bank's ultimate goal under its i2i initiative is to enhance the links between knowledge creation and the market. Under i2i, the Bank intends to reach all phases in a continuous process from knowledge to innovation and subsequently to productivity and competitiveness gains. Reinforcing this full cycle is essential to sustain and improve growth, income and employment.

The EIB's i2i programme therefore covers three different areas: (i) education and training; (ii) research and development (R&D), including downstream investment; (iii) information and communication technology (ICT)

- I. Education and training comprises investments by the public and private sector (e.g. lifelong learning in industry and the service sector), integration of research into tertiary education projects, digital literacy and e-learning (eEurope), and, last but not least, the development and dissemination of knowledge via new media.
- II. The second concerns a broad spectrum of public and private-sector R&D projects, ranging from large-scale cutting edge R&D by leading European companies to financing incubator structures for young and technology-oriented companies as well as support to public research facilities.
- III. ICT relates to the creation and dissemination of information and communication technologies.

The i2i programme comprises the following financial instruments:

- Medium and long-term loans, partly in the form of risk-sharing or structured loans. Let me underline here that provision of debt for R&D is far from standard in the corporate sector, which traditionally sees this as an expense to be carried by its own resources. Attracting third parties to fund and particularly to share in the risk could significantly strengthen investment in this field. In this context, I should also emphasise that the EIB will itself increasingly support the role of commercial banks in future by assuming more direct risk when financing i2i projects.
- Equity participations and counter-guarantees through the European Investment Fund (EIF, our venture capital subsidiary) designed to stimulate the creation and development of small business by providing equity in the form of venture capital or facilitating access to bank credit.

So far, our "Innovation 2010 Initiative" has been a clear success, particularly due to the flexible approach taken when defining projects : cumulative lending under i2i has reached more than EUR 23bn since 2000. The current i2i programme runs from mid-2003 to 2010 and foresees an indicative lending volume of EUR 20bn for the period 2003-2006. Up to the end of the decade we expect our support for i2i projects to reach well over EUR 50bn. The EIF's venture capital operations could amount to around EUR 1bn and its guarantee operations in favour of SMEs to over EUR 3bn by the end of 2006.

### **[SME Financing – optional]**

[As a motor of employment growth and innovation, the local SME sector and its development are critical to long-term industrial health, and access to appropriate financing therefore needs to be strengthened.

Access to EIB funds for SMEs is normally provided through the network of the local banking community via global loans. EIB financing is channelled to viable projects promoted by smaller companies, which often lack adequate access to LMT debt to support investments. Global loans are already successful in funding numerous smaller FDI projects in the region, as well as investments promoted by local SMEs.

Furthermore, the EIB is participating in the SME Finance Facility funded by the European Commission – this offers grants to incentivise banks to provide LMT debt to smaller companies through the use of EIB funds channelled via global loans. ]

### **Conclusion**

In conclusion, it is clear that the increasing sophistication of financial markets in the New Member States is fuelling demand for more innovative funding structures from institutions such as EIB. I trust that these brief remarks have shown that we are committed to continue supporting European development and integration through an evolving spectrum of financial products to match this demand.

Thank you for your attention.