European Investment Bank

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"Innovation 2000 Initiative"

EIB to focus on knowledge-based economy

The European Investment Bank is to place special emphasis on projects that support innovation in the European Union.

This reorientation of the Bank's activities is a follow-up to the strategy established by the Lisbon EU Summit in March emphasising the need for Europe to develop a more competitive and dynamic knowledge-based economy.

The EIB Board of Governors - the EU Ministers of Finance - at its annual meeting in June endorsed the Bank's "Innovation 2000 Initiative" to support investments promoting the information society, research and development, innovation and competitiveness as well as human capital.

A lending programme of EUR 12 to 15 billion over the next three years will be dedicated to this purpose. The Board of Governors also decided to double the scope of the EIB's venture capital operations for small and medium-sized companies to EUR 2 billion.

In his statement to the Governors, EIB President Philippe Maystadt stressed that successful implementation of the programme will require close co-operation with national and local authorities, the Bank's partners in the financial sector and the EU Commission.

The "Innovation 2000 Initiative"

Under this initiative, the Governors approved a set of operational principles designed to channel EIB financing into the following five areas:

- **human capital formation**: by financing the provision of schools, colleges and universities with computing equipment and lending in support of IT training centres;
- **research and development**: by co-financing public or private-sector research programmes, corporate investment in R&D, research infrastructure, centres of excellence and measures enabling SMEs to obtain access to research programmes;
- **information and communications technology networks**: by financing trans-European broadband and multimedia networks and physical or virtual infrastructure providing local access to such networks, especially in the Union's less advanced regions. The Bank will focus its lending in this field on innovative technology projects such as ASDSL, xDSL and UMTS;
- **diffusion of innovation**: by financing "online healthcare" services and the use of information technologies to bring Europe's citizens closer to local authorities and public services; by helping to equip companies, especially SMEs, with advanced information technologies;
- **development of SMEs and entrepreneurship**: by strengthening venture capital support for the development of innovative SMEs, fostering science parks and company incubators and launching new products tailored to the business needs of very small enterprises.

Support for these new areas of EIB activity will be provided under a **dedicated lending programme of EUR 12 to 15 billion over the next three years**. More than simply an increase in the Bank's lending volume, this will represent a qualitative reorientation of the EIB's traditional operations towards sectors with high technological value added having a positive impact on the economy. To this end, the Bank will both broaden the range of its financial instruments and reach out to new partners and customers, especially to take account of the extension of its financing operations to include intangible investment. ■

Venture Capital and reform of the EIF

A key element of the "Innovation 2000 Initiative" is the expansion of Bank activity in support of venture capital financing for SMEs.

The Governors have increased the reserve set up to hedge the risk attaching to such operations from EUR 1 to 2 billion. Funded from the EIB's operating surpluses, this reserve is already endowed with EUR 1 billion drawn from the profit for 1996, 1997 and 1998. It has now been allocated an additional EUR 500 million from the 1999 surplus, and the balance will be drawn from the profits for the years 2000 to 2002 according to needs.

The Governors have also authorised the reform of the European Investment Fund with a view to turning this institution into the EIB Group's specialist venture capital arm. While maintaining the tripartite nature of the Fund (whose capital is jointly owned by the EIB, the European Commission and commercial banks), the aim of this reform is to make the EIB the majority shareholder, with a stake of over 50%, and operator of the institution.

Concentrating all the EIB Group's venture capital activities (EUR 1.2 billion committed) in the hands of the EIF will substantially enhance the Fund's financial and operational capacity and make it possible to target operations in this highly specialised field more effectively. This new form of relations between the EIB and the EIF will also encourage productive melding of expertise between the Bank and the Fund through the introduction of additional financial instruments to support SMEs and will boost the catalytic effect of the EIB Group's actions within Europe's banking and financial community.

At the EIB Board of Governors' meeting on 5 June in Luxembourg: EIB President Philippe Maystadt and the Chairman of the Governors, Gordon Brown, Chancellor of the Exchequer, United Kingdom.

EU Finance Ministers discussed EIB's top priorities

In his statement to the EIB Governors, Philippe Maystadt highlighted the Innovation 2000 Initiative and financing in candidate countries as top priorities:

"The Lisbon European Council conclusions include a clear endorsement of the Bank's Innovation 2000 Initiative in the following five areas: human capital, SMEs and entrepreneurship, research and development, information and communication technology networks and diffusion of innovation.

An essential component of the Innovation 2000 Initiative concerns the proposal to make available another billion euro, out of the Bank's surpluses for venture capital for SMEs. This proposal is timely, as the Bank has already committed, either directly or through the ETF mandate given to the EIF, the whole of the original billion you approved in 1997.

"Mini Marshall plan"

The Bank's financing in Central and Eastern Europe will amount in total to more than EUR 17 billion over the next years to prepare these countries for accession to the Union.

I would not like to overstate the importance of this commitment, but I note that some observers have already compared it to a "mini Marshall Plan" for our Eastern neighbours. I would also like to point out that half of this amount, EUR 8.5 billion over the period 2000-2003 will be advanced at the Bank's own risk. The remainder, i.e. EUR 8.7 billion for the period 2000-2007, will come from the new lending mandate given to the Bank by the Council.

Of course, I am fully aware that good use of this huge amount of resources is one of the biggest challenges for the Bank for the years ahead and I can assure you that the monitoring of this programme will be one of our top priorities.

This is why the Management Committee has just decided a major restructuring of the Bank's operational services. The new structure, will bring together Accession Countries and Member States, making it easier to transpose procedures and practices, to transfer know-how and to accelerate the linkage of the Accession Countries to the European Union. (see also pages 16-19)

EIB in 1999

(EUR million)

	1999	1998
Loans signed	31 800	29 526
- within the EU	27 765	25 116
- outside the EU	4 035	4 410
Borrowings	28 355	30 098
Outstanding loans	178 775	155 333
Own funds	20 494	19 306
Net profit	1 067	1 195
Balance sheet total	201 104	176 544
Subscribed capital (at 31 Dec.)	100 000	62 013

Philippe Maystadt on:

Lending

"Within the EU, I would like to point out the activity in support of SMEs, through global loans with our financial partners (EUR 2.8 billion) or through participations in venture capital funds (EUR 470 million approved in 1999). The Bank has also stepped up its efforts in favour of Trans-European Networks in transport, energy transmission and telecommunication (with more than EUR 10 billion financing provided).

The bulk of our activity outside the European Union has been in the candidate countries of Central and Eastern Europe and Cyprus. In Central and Eastern Europe, the Bank is by far the foremost multilateral financial institution".

Borrowings

"Our borrowings in euro represented 41% of our total borrowings in 1999, half of them falling within our EARN -Euro Area Reference Note- programme. The aim of the Bank is to provide a first class complement to sovereign borrowers, and we believe that we have made significant progress towards this. Our issues in GBP and USD represented approximately half of our total borrowings last year".

Balance sheet

"The gross operating surplus last year was EUR 1 187 million, representing a return on own funds of 5.8%. The decrease in gross result compared to 1998 (EUR 1 345 million) can be explained by a combination of reduced gross treasury revenues and reduced net interest margin. Gross administrative expenditure increased by 12.4% compared to 1998. The main reason behind this is the contribution of EUR 10 million to the HIPC initiative (see page 22) and exceptional contributions for earthquakes in Turkey and Greece as well as a donation for Kosovo (EUR 2.6 million in total)".

Our activity in the candidate countries will follow the same eligibility criteria as in the Union and our aim is to increase the proportion of total lending for environmental projects to 25%.

To ensure a maximum impact, close co-operation will continue with the Commission and its new ISPA programme as well as with the multilateral institutions operating in the region.

Finance Ministers at the EIB: Didier Reynders, Belgium (who now takes over Chairmanship of the EIB Board of Governors) and Laurent Fabius, France.

Following the decision at the Helsinki summit to recognise Turkey as a country candidate for accession, the Bank will naturally include Turkey in the list of countries under its Pre-Accession Facility.

As for all other candidate countries, operations under the Pre-accession facility will depend on our usual criteria, in particular as far as security arrangements are concerned." ■

EU versus US and Japan : catching up - but still a lot to do

Innovation and the Information Society

The Lisbon EU Summit in March decided on action to ensure that Europe should become a globally competitive and dynamic knowledge-based economy. Where does the European Union stand today with regard to innovation, research and development and the information society compared to the United States and Japan? Two background papers produced by the EIB's Projects Directorate elucidate the present situation.

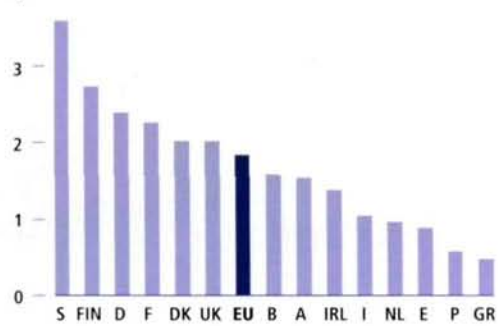
EU private sector must spend more on R&D

Technological innovation is the engine for growth and most innovations are the outcome of deliberate economic decisions concerning resources to be devoted to the production of knowledge.

Europe devotes relatively little resources to generation of knowledge, in particular for research and development (R&D), compared to the main international competitors (US and Japan). The R&D expenditure in Europe is equivalent to 1.8% of GDP. This compares with 2.8% for the US and 2.9% for Japan. There is little evidence that Europe is catching up with them over time. Moreover, there is a huge disparity (of the order of 7:1) in the R&D/GDP ratio across EU countries. *(Fig. I)*

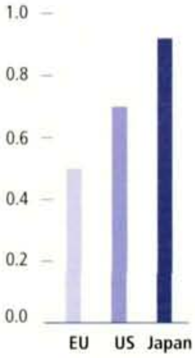
Because of the combination of forces intrinsic to innovative activity (i.e. for this to be successful, both

I. The R&D/GDP ratio (as a %) across EU countries



Source: OECD

II. Number of researchers in the business sector as a % of total workforce



Source: OECD

appropriate research infrastructure and other attractive incentives for those conducting research are needed), there is a risk of increasing technological differences between regions across Europe. Countervailing policy measures are necessary to raise the technology absorption capacity of less developed regions.

Whereas the resources devoted to basic research and that performed by governmental institutions in the EU are in line with the US, there are large differences when it comes to R&D carried out by the business sector.

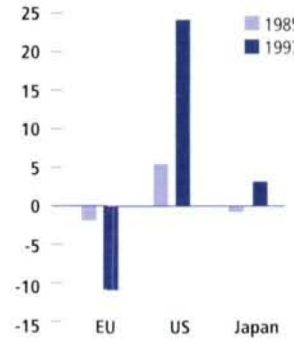
European private industry performs much less R&D than US and Japanese industry. There are also fewer human resources devoted to R&D in Europe: 5 employees out of 1 000 are researchers in Europe, whereas the figures are 7 and 9 for the US and Japan. For the shift to a knowledge-based economy, Europe is thus less well endowed with human capital than the US and Japan. *(Fig. II)*

The issue is not so much to increase funding for research performed by public institutions, but rather to induce the private sector to spend more on R&D. Nevertheless, there is also considerable scope for raising the efficiency of public R&D in the EU, particularly by improving coordination of public R&D expenditure in Member Countries. This would help to avoid unnecessary duplication and to enhance synergies.

Of privately funded R&D in Europe, about 80% is provided by large companies and 20% by SMEs. In comparison, the SME share is lower in the US (15%) and Japan (6%). Thus, innovation in the EU is proportionally more dependent on SMEs than elsewhere. Innovation performance of SMEs therefore becomes important. SMEs have less ready access to government funds than large companies, since only 9% of R&D spent by SMEs is financed by the government, compared to 13% of R&D spent by large companies. Making it easier for SMEs to gain access to innovation financing would therefore help to increase significantly the innovation performance of European industry.

There is evidence that Europeans do not adequately protect the results of their innovative activity through patents. European firms have a relatively low propensity to patent compared to firms in

III. The technological balance of payments (in € bn)



Source: OECD

the US and Japan. This results in a deteriorating technological balance of payments (which includes income from licensing, patents, know-how etc.). The balance is positive for the US and Japan. To reverse this negative trend, European inventors (universities, companies, private research institutions) should be encouraged to patent more of their discoveries and intellectual property. *(Fig. III)*

The venture capital industry is an increasingly important source of finance for innovation and helps new ideas to become a business success. This industry has got off to a later start in Europe compared with the US and hence the European market is less developed. Venture capital in Europe is still strongly biased toward the later stage in the so-called venture capital cycle. Early stage and start-up financing account for only a tiny part of venture capital financing in Europe. It is this portion that provides the bulk of innovative business ideas and therefore needs to be supported. ■

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Need for public action within the EU information society

The Information Society (IS) is developing apace in the EU (1), as shown, for instance, by the explosion in Internet subscribers since 1995. The EU seems to be catching up with the United States in this field, although the IS is still much less developed in the EU than in the US: total expenditure on Information and Communication Technologies (ICT) now represent about 6% of GDP for the EU as a whole, while this proportion is 7.5% in the US and 7.4% in Japan.

The expansion of ICT within the market place is not proceeding at the same speed in the different countries or regions, in particular during the early phase of market penetration. In 1998 there were substantial differences between EU countries in the number of PCs per 100 inhabitants, ranging from 10 to more than 50, and the same happened with Internet penetration: the number of Internet hosts varied from fewer than 5 to more than 90. The spread of ICTs also differs between social groups, depending mainly on their income level, and between economic sectors inside the various countries.

There is a risk that the lower income groups and the less developed regions of the Union will fail to adopt the new technologies, with severe consequences for their future economic development - or if they succeed in adopting these technologies, that they will be only passive actors in the process, with the majority of benefits harvested by individuals, firms and institutions in core regions, in which the barriers to IS participation could be lower.

In the EU, it is estimated that "information society industries" already contribute around 15% to GDP growth and create 25% of new jobs in the European economy (2). Following the US experience, it has become clear in the EU that the economy is experiencing acceleration in innovation. This should increase productivity and output over the long term, accompanied by an unprecedented wave of restructuring and emergence of new companies. Of course, innovation is not confined to information technologies, and technical advances are also found in many sectors, but information technology is a significant factor of this productivity and economic growth process. However, the impact of new technologies on economic performance depends substantially on how flexible the economy is to adapt to changes, and some of the EU economies still present substantial rigidities.

The Internet has reinforced the historical trend towards rapid expansion of data traffic over the telecom network. At worldwide level, the evolution of the Internet is driven by two main factors: a dramatic increase in the number of users and an expansion in **data-intensive internet applications**. This implies that, increasingly, access to high-speed services at affordable prices (flat tariffs in particular) is a key issue for the development of the Information Society.

Dramatic change in telecoms

Data will very soon become the predominant traffic in telecom networks, marginalising voice traffic. Some analysts believe that by 2005, as much as 90% of total traffic may be linked to data, while voice traffic may represent just 10%. This implies a dramatic change in every aspect of the telecom business, from organisation of the industry, pricing policy and network configuration to investment strategies.

The expansion in Internet and other data traffic is increasing the demand for high-speed transmission or higher bandwidth. The limited capacity of the majority of the local loops of telecommunications networks is a major bottleneck to expansion of data services. To contend with this situation, two major initiatives are under way with a view, on the one hand, to upgrading of existing conventional telephone lines and cable networks, and on the other, to upgra-

(1) The term "Information Society" here is defined as "the society currently being put in place, where low-cost information and data-storage and transmission technologies are in general use" (EC DG V, 1997).

(2) European Commission, the 1999 Communications review

There is a risk that the lower income groups and the less developed regions of the Union will fail to adopt the new technologies

ding of wireless networks, in particular mobile cellular networks.

These trends, combined with the entry of new players into the market, are the driving force for an increase in investment in the telecom sector. The new investment cycle will be driven by capital necessary to maintain, upgrade and expand the networks, as well as meeting demand for higher speed. Capital investment related to accommodating the future expansion of data and high-speed services will represent the bulk of overall future investment. The development of the IS is also driving the rapid expansion of new ICT businesses, particularly those related to Internet.

Transition to the IS - a top priority

The expansion of the usage of ICTs often implies changing working practices, organisation of enterprises and lifestyle. Although people's perception of the benefits of these technologies is changing very fast, still a large proportion of consumers and small businesses cannot see the benefit of using ICT.

Strong public action is needed to face up to the barriers to the development of ICT, in particular for the lower incomes and in the less developed regions of the EU. In line with this, the majority of the ten priority actions of the e-Europe initiative are related to similar measures, for instance the following:

- Education and training has to be overhauled to match the ICT revolution, so that people are aware of the possibilities of the new technologies and are able to use them. Learning institutions have to fulfil the ICT needs of business and industry.
- Action has to be taken to expand the adoption of Information and Communication Technologies in SMEs.
- The public sector, in general, has to be supported to enable it to adopt ICTs swiftly and to adapt to the new re-organised working methods.

Market liberalisation is the main policy measure to develop the telecom and related sectors in Europe and thus facilitate the expansion of the IS. However, the transition to competition is far from complete. The established operators will retain a dominant position in the communication market for many years to come. Therefore, regulation must ensure that dominant players do not abuse their market power, and should encourage competition. Regulation will be reduced as markets become more competitive.

The liberalisation of the EU telecommunications market since 1 January 1998 has dramatically transformed the traditional telecom sector into a dynamic one, able to adapt quickly to the new challenges at national and global level. The rapid development of competition can be illustrated by falling prices, growth of new innovative services and greater choices. Prices in the international and domestic long-distance markets have gone down substantially: about 70% since liberalisation in some EU countries. However competition on local markets has remained very limited in the EU. This is why competition in the telecom sector needs to be reinforced, particularly at the local level. In this respect, the Commission is proposing to use its powers to encourage local loop unbundling throughout the EU.

New players and innovative/broadband service providers will first address the optimum segments of the market. These segments are essentially in the most developed regions and in the clusters of high telecom consumers. Deployment in the less attractive segments of the market will follow later. This puts small businesses, low-income residential consumers and, in general, less developed regions at a disadvantage. Therefore the issue of providing equal access to broadband services needs to be addressed (as, for instance, through the recent Swedish initiative).

Public action related to new ICT business has to be seen in the context of the strategy to support the development of innovation in general.

The previous points illustrate the significant economic and social impacts of the IS. It stands as an opportunity to improve living standards, but could threaten progress, if the Union does not succeed in adopting the new technologies in a timely manner. ■

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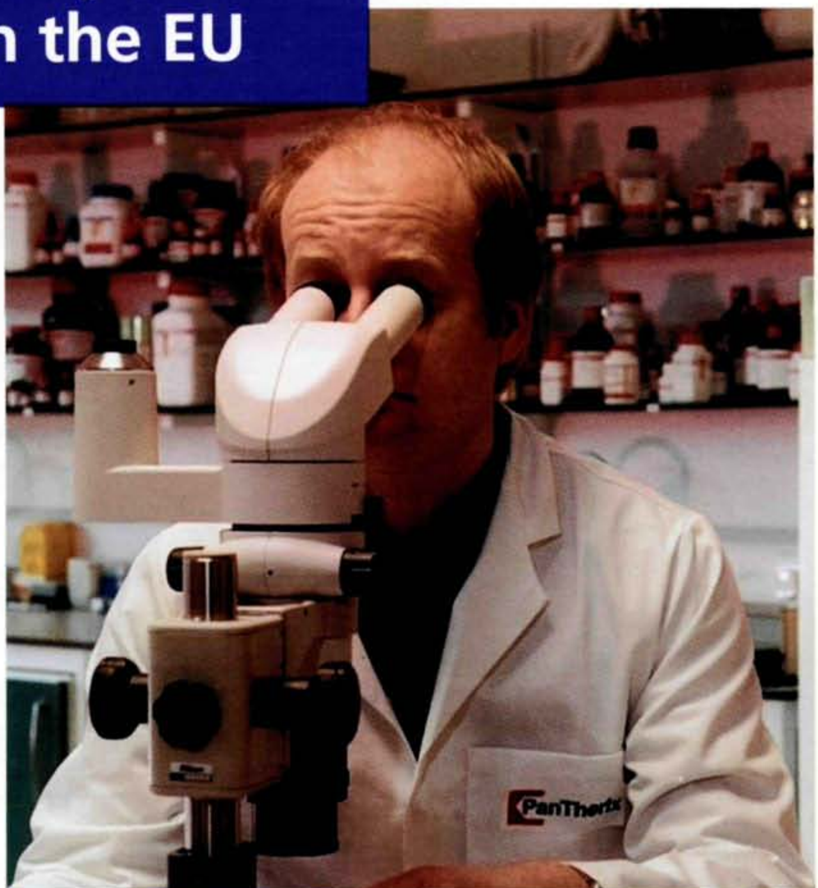
EIB venture capital operations in the EU

Within three years the EIB has become a key public-sector player in the European venture capital market

It is generally acknowledged that jobs in tomorrow's world will be generated among recently created small and medium-sized enterprises in new, technology-driven industrial and service sectors. Alert to this situation, the EIB has taken forward its initiative to promote high-growth SMEs, largely dependent on injections of equity capital for their development.

Since this initiative was endorsed by the Amsterdam European Council, in its Resolution on Growth and Employment, on 16 June 1997, the EIB has channelled either directly or under mandate via its sister institution - the European Investment Fund (EIF) - more than one billion euro into a broad range of venture capital funds, becoming in the process a major public-sector player on this market in Europe.

On the basis of these very encouraging results, the special European Council in Lisbon, in March 2000, invited the Bank to expand its ven-



EUR 50 million for pan-European biosciences fund

The EIB has concluded a EUR 50 million (GB£ 33 million) agreement with Merlin European Biosciences Fund to provide equity capital for leading European bioscience companies.

The Merlin Fund will be managed and advised by Cambridge-based Merlin Biosciences, a leading European venture capital group specialising in investing in bioscience enterprises.

The EIB sees the bioscience sector as of strategic importance in helping to underpin European competitiveness. The new biotechnology industry is growing rapidly in Europe and has great potential for creating growth and employment.

The EIB and Westdeutsche Landesbank (WestLB) are cornerstone investors in the Fund, which has a funding target of EUR 250 million (GBP 160 million). The Fund will focus on taking minority equity or equity-related stakes in some 20-35 unlisted ventures with proven track records in pharmaceutical, healthcare, food, beverage and chemical process industries.

ture capital operations, emphasising the positive role played by this instrument in "preparing the transition to a competitive, dynamic and knowledge-based economy".

A dynamic market

Europe's venture capital industry experienced soaring growth in the period 1998-1999, years in which funds raised climbed to record levels (close on EUR 21 billion in 1998). This swift rise has gone hand in hand with development of the "new markets" emerging on European stock exchanges in recent years and offering investors advantageous exit conditions as well as the possibility to reinvest gains generated.

Nonetheless, the industry remains focused on large-scale transactions, especially management buyouts (MBOs). The share of investment in technology, although on a constant upward curve, remains modest in Europe at about a third of the total compared with the United States, where it stands at two thirds. Moreover, the level of development of the major European venture capital markets varies enormously from one country to another: in terms of volume, Germany, Italy and France together combined have a market only half the size of that in the United Kingdom alone. But here the accent is on large transactions, chiefly MBOs, with only very small sums going to high-tech investment (less than 5% of the total). In contrast, investment in technology-oriented start-ups is attracting considerable sums in Germany, Scandinavia and Finland.

The relatively less developed markets in Greece, Portugal and Spain, for example, are displaying encouraging signs of taking off and new fund management talent is emerging. Another positive aspect is the appearance of an ever-growing number of pan-European funds, frequently targeting investment in technology-based SMEs; they are aiming to achieve a critical mass comparable with the major American funds. The latter are becoming increasingly active in Europe, thereby making beneficial contributions in terms of co-investment or transfer of expertise.

The main bottleneck in the European market remains the shortage of investment professionals with relevant experience. Their scarcity relative to investment opportunities - in this very new area - justifies support for development of high-quality teams or a transfer of know-how between foreign managers and newly-established European teams.

EIB strategy

The EIB is seeking to impact as effectively as possible on this constantly changing market, directing its activity as best it can towards those segments where it can bring the most value added. The Bank is looking to act as a catalyst in its financing operations, by backing funds which, without it, would not have been able to get up and going so rapidly, on the same scale

EIB-financed broadband network to connect Nordic countries

The Swedish data and telecoms operator Utfors is setting up a Nordic Internet Protocol- based broadband network. The broadband network will provide high-speed communications services to companies and private customers.

In 2001, Utfors will be completing the 6 000 km broadband network for data and telephony connecting 75 of the largest cities in Sweden as well as Oslo, Copenhagen and Helsinki.

The EIB is supporting the financing of this broadband network through its participations in two Nordic venture capital funds, which have invested in the company. These funds are managed by Swedish Litorina Capital Management and the Helsinki-based CapMan Capital Management. EIB investments in the funds total EUR 11 million and EUR 64 million, respectively.

Utfors is also taking part in the construction of a 1 100 km broadband network along the coast of northern Sweden. In addition, the company is planning to connect the Swedish optical fibre network with other European and American networks.

or with the same degree of success. In the light of its remit, the EIB also seeks to anticipate market developments: it endeavours to operate in areas where a dearth of equity is hampering the establishment of an efficient and balanced European venture capital market. Such shortcomings may show through in the scale of investment schemes, their location or the sector in question. EIB financing is designed to counteract these weak points. This calls for innovative and attractive instruments likely to encourage private investment.

The Bank must therefore remain extremely flexible, since the market is constantly evolving. E-commerce, for example, which as little as three years ago was not being sufficiently funded, has recently seen a massive surge in investor interest. The EIB, which was actively investing in this sector two or three years ago, has quickly adapted its strategy to take account of this shift. Conversely, a sector of such strategic importance to Europe as biotechnology is still not attracting enough support from investors, who consider it too risky: so the EIB has stepped up its involvement in this area.

Hence, for its investment strategy to have a multiplier effect in keeping with its role as the Union's financing institution, the Bank must remain both highly versatile and adaptable.

Financing in excess of one billion euro by end-1999

The table on page 12 details operations launched by the Bank and its sister institution the EIF since the introduction of the "SME Window" in mid-1997. These were concluded either directly by the EIB with funds or financial intermediaries or indirectly via mandates entrusted to the EIF in the form of two tranches of 125 million euro each for funding the European Technology Facility (ETF).

Since the end of 1997, the Bank has mounted 30 equity or quasi-equity operations totalling more than 600 million euro, plus the 250 million contribution to the European Technology Facility (ETF) managed by the EIF. A further 257 million under 12 other operations has been approved and is awaiting signature. Thus, less than three years after the EIB commenced its activity in this field, total equity and quasi-equity commitments throughout the Member States exceed 1.1 billion euro.

These operations have predominantly centred on the launch or joint financing of venture capital companies chiefly geared to making equity capital available to high-tech SMEs. The EIB has placed the accent on promoting regional funds, especially in the United Kingdom (the HSBC Enterprise Funds channel resources into 10 regional funds) and Germany (including the new Länder).

Another objective has been to set up new venture capital facilities in countries in which the market is less developed than in the rest of the Union, such as Greece, Spain, Portugal and Ireland. The Bank has provided substantial support (to the tune of a total 152 million) for development of the Italian market, participating in 1999 in 5 funds newly created by banks and venture capital companies.

In France, the Bank has been involved in State efforts to promote innovative SMEs. It has also made a highly important contribution in Finland by backing two funds doing major business financing SMEs in the IT and telecoms sectors.

Finally, the EIB has likewise helped to create a number of pan-European funds and lent its support to the formation of new fund management teams. It has also made available its financial know-how for the establishment of regional funds.

The EIF, for its part, has so far signed 20 operations under the European Technology Facility (ETF) for an aggregate amount of 98 million euro, in addition to which a further 35 million euro has been approved for operations awaiting signature. In keeping with the guidelines of the mandate framed by the EIB, the EIF has focused ETF support on the venture capital segment providing equity for fledgling high-tech companies. Partly thanks to this successful start, the EIF, which manages a cocktail of its own resources and funds from the ETF and the "ETF-Start-Up Facility" (an instrument managed by the EIF and financed from EU budgetary resources) has established itself as

Resources deployed by the Bank

The EIB shares the risks associated with these operations with its partner funds. The risk incurred under the "SME Window" is covered by scoring against the Bank's operating surpluses built up from the EIB's standard long-term lending operations. In 1997, the Governors approved the assignment of one billion euro to guarantee investment up to 2000. They recently authorised a further one billion to be drawn from the operating surpluses for 1999 to 2002, 500 million euro having been set aside in 1999.

SME WINDOW - risk-sharing operations managed by the EIB (situation as at 31 March 2000)

Title of operation	Amount signed (EUR million)	Location of managers
IMI Risk Sharing	26	I
ICO-Axis Risk Sharing Loan	9	E
Sofaris Technological Development	15	F
SNCI SME Development	9	L
LTH-SME Venture Capital Fund	20	D
ABN AMRO Causeway Mezzanine P.	25	UK
BPI Venture Capital	10	P
Allied Capital Germany Fund	51	D
Litorina Development Capital	11	S
Cajas/ING Barings Risk Sharing	30	E
HSBC Enterprise Funds	18	UK
CDC Fonds Capital-Risque	34	F
ACT 99 Venture Capital Fund	15	IRL
ICC 98 Venture Capital Fund	13	IRL
The Baring Growth Funds	46	UK
ES Venture Capital	2	P
CapMan Finnmezzanine Fund	17	FIN
DVCG Venture Capital Fund	15	D
Innov.-fonds Schlesw-Holst./Hamb.	7	D
Invest Equity Beteiligungs-AG	15	A
Arca Venture Capital Fund	21.8	I
Euromobiliare Venture Capital Fund	15	I
Retevisión Venture Capital	8	E
Retevisión Venture Capital Funds	20	E
Mediobanca Venture Capital Fund	40	I
Dresdner KB Venture Capital Fund	25	I
Eqvitec Technology Mezzanine Fund	17	FIN
The Merlin European Biosciences Fund	37.5	UK
CapMan Finnventure V Fund	17	FIN
The ICC Privte Equity Fund II	13	IRL
TOTAL (excl. ETF managed by the EIF : 250 M)	**601.3**	

European Technology Facility (managed by the EIF) (situation as at 31 March 2000)

Fund	Amount of ETF participation (EUR million)	Location of managers
Advent Private Equity Fund	29.2	UK
Amadeus	15.0	UK
Auriga Ventures	14.7	F
Banexi Ventures	24.6	F
Baring European Private Equity Fund L.P.	9.5	UK
Elderstreet Capital Partners	4.5	UK
Enabling Technology Limited Partnership	4.9	D
Eqvitec Technology Fund I L.P.	3.0	FIN
Galileo	24.6	F
Horizonte Technologiefonds Österreich B.V.	2.2	A
IT Partners N.V.	4.5	B
Kennet I Limited Partnership	5.0	UK
Kiwi Venture Partners	17.0	I
NeSBIC CTE Fund B.V.	2.3	NL
SFK99 Technology Fund Ky	5.5	FIN
Sofinnova Capital	34.6	F
SPEF Pre IPO European Investment Fund	2.0	F
TEC Plus III	5.5	E
Technostart	2.6	D
Trinity Venture Fund 1A	1.9	IRL
Vision Capital L.P.	5.2	UK
TOTAL	**98.1**	

a major European institutional investor in this sector. It plays an important catalytic role in raising start-up funds, and its input speeds up and lends weight to the launch of venture capital companies operating in leading-edge sectors such as IT, telecoms and biotechnology.

The way forward

To meet the Lisbon objectives and keep pace with market trends, the EIB and EIF will continue to concentrate their activity on funds specialising in start-up and early-stage companies, preferably with a high technology content. As in the past, priority will be given to backing pan-European and regional funds.

Under the "Innovation 2000 Initiative", moreover, the accent should in future be placed on developing synergies between research, the diffusion of innovation and enterprise creation. In this connection, productive links between universities and new companies will be explored and particular attention will be paid to fostering structures such as "company incubators" and "science parks". These developments are likely to result in the Bank and the EIF providing support for new management teams.

In organisational terms, strengthening the operational ties between the EIB and EIF (by establishing a unified structure specialising in equity and quasi-equity operations) will make it possible to enhance the interaction between the range of venture capital instruments available in the European Union with the aim of growth and job creation. ■

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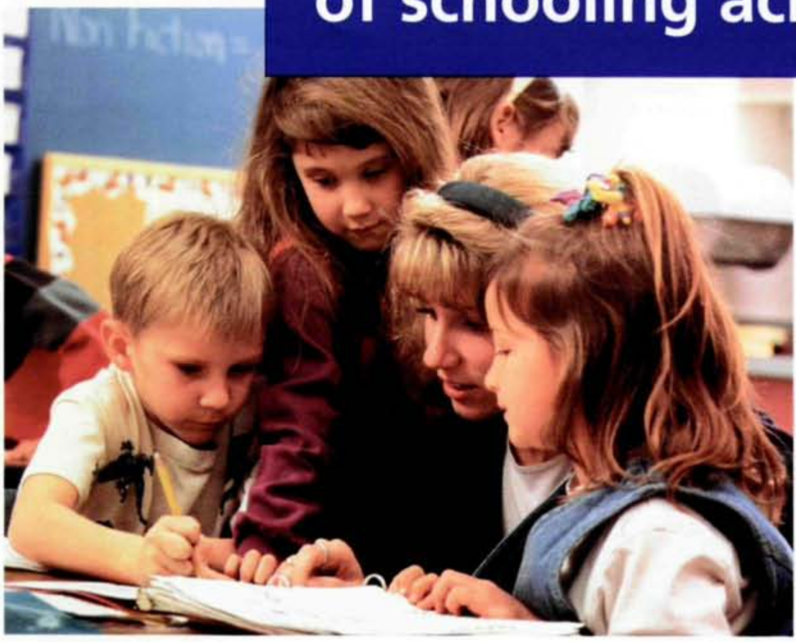
Improving the quality of schooling across Europe



In the European Union there is a serious backlog in the maintenance and refurbishment of school buildings and an urgent need for new educational facilities. More widespread development of the knowledge society needs additional investment to bring school/university buildings up to standard in terms of computer facilities and Internet access. At the same time, many European countries have reduced public expenditure and their scope for injecting new funds into their education systems.

EIB involvement in the education sector is now a core activity and is being extended to the candidate countries

The EIB's activities in the education sector significantly expanded under a mandate called for by the Amsterdam Summit of Heads of State in June 1997. Following the recommendations of the Cologne Summit in July 1999, the Bank's educational mandate was made permanent and extended to the candidate countries. The Lisbon Summit in March 2000 further emphasised this remit, highlighting education, along with information and communications technologies, as tools for creating a society based on innovation and knowledge.

As a result, the EIB is now prepared to finance a wide range of education infrastructure and investment, from modernisation or construction of schools and universities (general or vocational), to more fundamental educational investment, including the introduction of information and communications technology, training programmes and support for research and development.

Facilities and student performance

The benefits of education are well known. Higher levels of educational attainment are associated with better labour market integration and higher revenues over the working life. In addition, the creation of knowledge, skills and abilities affects not only performance at work but also social behaviour, such as for example, better health, lower crime, increased environmental consciousness, improved parenting, and higher political and community participation. Access to life-long learning and an active participation in the labour market are thus important conditions for a coherent social fabric and economic development.

But what are the factors which determine the effectiveness of an educational system, and what is the contribution of investment in educational facilities to delivering these benefits?

The link between the level of education and income is well established. However, the main factors affecting pupil achievement at schools are less well understood but crucially important.

There is evidence that the performance of students is affected by the quality of the schooling environment. Indeed, investing in school resources (e.g., school spending, teacher-pupil ratio), the quality of educational buildings and school design (e.g., class size, conditions of the buildings) have an impact on the performance of pupils and students.

There is evidence that student performance is affected by the quality of the academic environment

The effect that buildings can have on educational performance has been researched. There are two major routes through which there can be an impact. One is through additional and improved facilities, including for example the laboratories and modern teaching tools such as information and communications technology. And the other is through the learning environment to ensure the best surroundings to enhance pupil and student aspirations.

Some 90 % of the educational projects financed by the EIB are situated in assisted areas

Improvement in buildings affects positively pupil achievement (measured by test scores) and student behaviour (measured by attendance and exclusion). As regards school design, attending a small class in the early grades is associated with somewhat higher performance on tests, in particular for pupils from minority or poor socio-economic backgrounds. In France, studies have demonstrated the negative effects inappropriate design of the educational buildings can have on pupil performance.

Class overcrowding affects the ability of teachers to provide quality teaching, and correspondingly reductions in class sizes allow improvement in the quality of classroom activities. Hence, the buildings by their appearance and through the school teaching environment can affect both teacher and pupil behaviour and consequently educational attainment.

School size may also play a role, as well as class size. In the UK, studies on the relationship between school size and examination performance in secondary schools have shown that exam performance increases with school size but at a decreasing rate. As a consequence, school reorganisation is important.

Hence to raise education performance there is a need both for labour input, that is, teaching and management ability, proper curricula etc., and also for the provision of good capital input. Taking also into account the rapid pace of technological innovations and the growing impact of the knowledge society, there is a role for the EIB in helping to meet these growing educational needs.

Project appraisal

The Bank evaluates educational projects from a system- or country-wide perspective. Projects have to demonstrate economic value if they are to be considered for financing. An essential part of the analysis of an investment is to consider its implication for the functioning of the education system and its appropriateness in terms of the priorities or objectives defined at national or regional level. Because education is an intangible asset, there are great challenges in the appraisal of educational projects. (1)

Therefore an appropriate "road map" to decide whether a project is economically and socially acceptable or not is crucial.(2) Recourse to the private sector has recently been considered in some countries as a means of alleviating the constraint on allocating available public funds to finance new investment in educational facilities. The involvment of private partners allows risk-sharing between the different players and the development of innovative solutions in the construction or renovation of educational buildings.

EIB education operations

So far cumulative direct investment in educational projects financed by the EIB has totalled some EUR 2.3 billion. Projects in education are relatively small compared to other infrastructure projects. Of the projects financed since 1997, around 90 % are situated in assisted areas. Hence there is a combination of regional, urban and skill development taking place as a result of the Bank's intervention.

(1) The major economic evaluation routes are through cost-benefit or cost effectiveness analysis. In its appraisal, the Bank identifies the benefits and costs associated with the project and separates those that can be valued in monetary terms. Data do not always allow estimation of an Economic Rate of Return (ERR).

(2) The appraisal of an educational project has also to consider the different financing options available. Financing options might include: public budget, loans, finance leases, operational leases, contracting out or private finance initiatives.

In terms of the breakdown between the different levels of education, about two thirds of the projects financed have been in higher education, for example universities in Spain, Italy and Greece. In fact, they embrace both universities and vocational higher education institutions.

Recently, the Bank has begun to finance an increasing number of primary and secondary school projects. These have included schemes to reduce maintenance backlogs, modernise school infrastructure and bring into schools the latest information and communications technology (ICT) tools. Some of these projects are being implemented via public-private partnership agreements which seek to harness the abilities of the private sector to contribute to raising design, suitability and flexibility standards in response to changing curriculum and social needs. Projects for developing libraries and academies of art are also currently under appraisal.

It should not be forgotten that in a life-long learning society there is also scope to support training for teachers, managers, employees, etc., inside and outside the traditional teaching institutions. The link between the education and the labour market can be further fostered by investment in research and development, along with complementary development in areas which support private sector innovation, such as in technology-based small and medium-sized enterprises, science parks, and so on. Hence, improvement in education levels will have a wider knock-on effect.

Conclusion

The "New economy" has generated new expectations for the educational system, requiring innovative investment in facilities and services and the development of new teaching practices. The delivery of high-quality educational standards by schools and universities remains a cause of concern for public authorities, parents and their children.

Capital investment has a role to play with regard to education infrastructure, such as buildings equipment and tools needed for running and managing schools, universities and other educational facilities. Under its extended education mandate, the EIB can make a significant contribution to building new educational facilities for Europe. ■

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"The Appraisal of Investments in Educational Facilities", a book recently published by the EIB and the OECD, investigates in particular the impact of investment in school facilities on pupil performance and the economic rate of return of educational investment.

In addition, there are a number of other factors which affect educational performance including social factors, of which family background, traditions and aspirations all play an important role.

Loans for the education sector in Spain

Spain provides three good examples of EIB-financed educational projects, totalling EUR 314 million, addressing clearly defined educational problems. In a decentralised educational system, regional authorities - Comunidades Autonomas - are particularly aware of the crucial role that education has to play in the development of their region. Investment projects form part of multi-annual comprehensive programmes, within a long-term strategy.

In Galicia, a disadvantaged region in north-western Spain, some 160 secondary education institutes are benefiting from investment to modernise facilities, reduce class size, cater for the introduction of new subjects and train schoolteachers. Improvements will affect around 250 000 pupils ranging from 10 to 16 years of age.

Capital investment in higher education will improve facilities in the Universities of Alicante, Castellón, Elche, Valencia, Almería, Cadiz, Granada, Huelva, Malaga and Seville, in the regions of Valencia and Andalucía. Both technical colleges and universities will benefit from new or upgraded buildings, including lecture halls, libraries, administrative buildings and laboratories, as well as the acquisition of equipment. Priority has been given to academic areas focusing on training professionals for industry and to catering for R&D requirements within industry.

Western Europe	Central Europe	Partner Countries
UK Ireland Scandinavia/Finland	Germany Austria	Maghreb-Mashreq Middle East, the Balkans Turkey
Spain Portugal	Central and Eastern Europe & the Baltic States	Africa, Caribbean and Pacific /South Africa
France Benelux	Italy Greece/Malta/Cyprus	Asia and Latin America

EIB tailors its operational structures to its new remits

As the Union's financing institution, the Bank regularly adjusts its modus operandi and departmental organisation with a view to pursuing its economic and lending priorities to maximum effect in furtherance of the Union's objectives.

The Bank has just restructured its departments to take account of the guidelines handed down by the Helsinki (December 1999) and Lisbon (March 2000) European Councils, which place the emphasis on preparing for enlargement and developing a knowledge-based, innovation-led society, the driving force for growth in Europe. These changes are reflected in the EIB's new organisation chart, which is regularly updated on the Bank's website at www.eib.org

Reorganisation of lending activity

In order to pave the way for the candidate countries' accession to the Union and, by amalgamating operational procedures, meet the demand of the Bank's partners and customers for similar loan products both within and outside the Union, the EIB's lending departments have been regrouped under a single "Directorate for Lending Operations", a tripartite structure founded on the pillars of the following complementary operational zones:

- "Western Europe" (the Nordic countries, the United Kingdom, Ireland, the Benelux countries, France, Spain and Portugal);
- "Central Europe" (Germany, Austria, Greece, Italy, the candidate countries of Central and Eastern Europe, Cyprus and Malta);
- the Mediterranean "Partner Countries", the Balkans (reconstruction aid), Africa, the Caribbean and the Pacific, Asia and Latin America.

This new distribution of activity reflects the Bank's strong desire to integrate the candidate countries swiftly by adopting uniform operating procedures for mainstream lending and project selection. Indeed, one of the EIB's principal objectives in these countries is to promote the transfer of Community regulatory practices through Bank operations not only under EU mandate but also under the "Pre-Accession Facility", set up at the EIB's own risk for an indicative amount of EUR 8.5 billion for the period 2000-2003. The new structure likewise testifies to the steady growth in operations in non-member countries with the support of European industrial or banking partners.

This restructuring will also facilitate exchange of know-how between integrated expert teams combining disciplines and responsibilities covering every area of EIB lending, e.g. introduction of new products, project finance, loan monitoring, etc.

A single Coordination Department for all three pillars of the Directorate for Lending Operations will manage common functions in terms of operational support for the Bank's customers, coordination with other directorates, loan monitoring and deployment of budgetary and human resources. In cooperation with the existing Coordination Department in the Projects Directorate, the new Coordination Department under the Directorate for Lending Operations will also liaise with the European Commission and international financial institutions. Hence, the new structures underscore the firm wish to engage in comprehensive dialogue at a practical day-to-day level with the Bank's European and international institutional partners in order to achieve maximum synergy between the EIB's operations and those of the Union and other players in the international community.

The Projects Directorate: project appraisal expertise

The Projects Directorate is responsible for economic, technical and environmental appraisal of projects submitted for Bank financing. It employs some 75 engineers and economists working in close cooperation with the Lending Directorate's teams.

The Directorate is divided into three departments dealing respectively with the following sectors: transport, water supply, sewerage and sewage disposal infrastructure; energy, telecommunications and solid waste processing; and industry and services. This sectoral approach, dovetailing with the geographical approach adopted by the Directorate for Lending Operations, facilitates the exchange of know-how between economists and engineers responsible in their respective fields for appraising projects both within and outside the Union.

Through its financing decisions, the EIB contributes to turning EU policies into economic reality. The Directorate is therefore also responsible for cross-sectoral consistency, a task which it entrusts to a Coordination Department under the direct authority of the Director General. The focus, in particular, is on environmental and regional development policies as well as on methodological issues. This department is also responsible for coordinating the Bank's actions with those of the Commission and national authorities in implementing EU policies.

The new structure places particular emphasis on the form and manner of project appraisal in relation to the environment. An environmental coordinator reporting directly to the Director General is charged with defining corresponding strategy, criteria and methods, as well as with ensuring that these factors are duly taken into account, during project appraisal, by engineers and economists in the different sectoral departments. The coordinator and his assistant have link persons in the various departments, who ensure that the latter are equipped with the necessary state-of-the-art analytical, design and technical tools. The coordinator also briefs the Bank's management on environmental issues.

The combined know-how of the Projects Directorate enables the EIB to maximise its support for project promoters in defining, implementing and monitoring investment projects, notably in the Union's less developed regions and the candidate countries.

Strengthened control structures

In parallel to reform of the EIB's project finance and appraisal structures, the Bank's internal financial and audit controls are constantly adapted to mirror best banking practice.

The EIB's independent Financial Comptroller reports directly to the President of the Bank. Assisted by services with full access to information on the EIB's financial flows, he is responsible for drawing up and vetting the financial statements, as well as for keeping the Bank's general accounts and sustaining analytical development. On this basis, he analyses the Bank's performance in relation to objectives and puts forward recommendations for optimising results. He also helps to monitor the Bank's financial management and to formulate financial policies by expressing reasoned opinions on strategic options in areas such as lending, credit risk, treasury operations, borrowings, asset/liability management and the budget.

The Financial Comptroller coordinates his activities with those of the external auditors (currently Ernst & Young) in order to submit to the Bank's Audit Committee financial statements drawn up and audited in accordance with the highest standards of transparency. He therefore acts as a key liaison officer vis-à-vis the Audit Committee, which is composed of three independent persons appointed by the Board of Governors.

The Financial Comptroller's activities complement the work carried out by the Internal Audit Unit entrusted with conducting objective and independent assessments of the EIB's control systems and procedures. This unit adheres strictly to the standards laid down by the International Institute of Internal Auditors and is answerable directly to the President. ■

Appointments

As part of the restructuring of operational departments described above and the renewal of certain Senior Cadre posts, the following appointments have been made:

- The three pillars of the Directorate for Lending Operations have been placed under the authority of Mr Michel Deleau ("Western Europe"), Mr Terence Brown ("Central Europe") and Mr Jean-Louis Biancarelli ("Partner Countries"), Directors General. Mr Jos van Kaam, Director, is to be responsible for the joint Coordination Department, under the authority of Mr Deleau.
- Mr Eberhard Uhlmann has been appointed General Counsel of the Legal Affairs Directorate.
- Mr Walter Cernoia has been appointed Chief Executive of the European Investment Fund (EIF), the EIB Group's specialist vehicle for venture capital operations.
- Mr Emanuel Maravic has been appointed Director of the Department for Lending Operations in Central and Eastern Europe.
- Mr Dominique de Crayencour has been appointed Director of the EIB's Representative Office in Brussels.
- Mr Constantin Christofidis has been appointed Director of the Industry and Services Department within the Projects Directorate.
- Mr Patrice Géraud is to head the Coordination Department of the Projects Directorate with the title of Deputy Director.
- Mr Andreas Verykios has been appointed Director of the Human Resources Department.
- Mr Per Jedefors has taken up the duties of Deputy Director, Operations and Infrastructure in the Credit Risk Department.

Michel Deleau

Economist, graduate of the École Polytechnique, Civil Engineer; career in research, teaching and economic appraisal, notably at the Ministry of Economic Affairs in Paris; joined the EIB in 1986 as Director of the Department for Economic Studies within the Union; Director General of the Directorate for Lending Operations outside the Union (1994), then Director General of Directorate 2 of the Directorates for Lending Operations in the Union (1995).

Emanuel Maravic

Lawyer; joined the EIB in 1996, following the accession of Austria, Finland and Sweden, as Director of the Department for Lending Operations in Germany and Austria; previous career path: with Austria's Creditanstalt in London and New York, then with Deutsche Bank in Hong Kong, Sydney and Manila.

Terence Brown

First-class honours degree in Commerce, Master of Business Studies (Hons.); joined the EIB in 1978 as loan officer in the Directorate for Lending Operations outside the Union; Head of Coordination Division (1983), then Head of Division for Lending Operations in the Mediterranean non-member countries (1986). In 1990, launched the Bank's operations in Central and Eastern Europe; in 1992, appointed Director of that Department; 1991-1996, Director of the EBRD; in 1996, entrusted with setting up an independent Credit Risk Department.

Dominique de Crayencour

Economist; following career with World Bank then Morgan Guaranty Trust, joined the EIB in 1980 as loan officer; Head of EIB's Lisbon Office (1986), then Head of Organisation and Methods Division (1990); moved to Credit and Monitoring Department in 1993; in 1997, appointed Director of Information Technology Department.

Jean-Louis Biancarelli

Economist, graduate in Political Sciences; joined the EIB in 1977 following career at World Bank (1973); loan officer, then Head of Division for Lending Operations in West Africa (1983) and Head of Division for Lending Operations in France (1986); Director of Department for Lending Operations in Africa (1992), the ACP Countries (1994) and then the Mediterranean non-member countries (1996).

Constantin Christofidis

Chemical engineer; following career in private-sector industry in Greece, joined the Bank's Technical Advisory Service in 1983 as an expert in the chemicals industry; as Head of Division within the Industry Department (1992), responsible notably for appraisal of projects in the oil, petrochemical and pharmaceutical sectors.

Jos van Kaam

Economist; joined the EIB in 1971; career path within the Directorate for Lending Operations in the Union, notably as Head of Division for Lending Operations in the United Kingdom (1983), then Spain (1993); since 1 January 2000, has headed the Coordination Department of the Directorate for Lending Operations in the Union.

Patrice Géraud

Graduate in mathematics and economics; joined the EIB in 1977 as economist specialising in transport and telecommunications, becoming Head of the Infrastructure Division in the Research Directorate in 1986, then Head of the General Policy Division; in 1995, appointed Head of the Coordination Division in the Projects Directorate.

Eberhard Uhlmann

Lawyer, graduate of ENA as a foreign student; following professional specialisation in the banking sector, joined the EIB in 1979 to follow a career path within the Finance Directorate, firstly as treasury officer in the Treasury Department, then as Head of the Planning and Control Division (1983), and subsequently, since 1 January 1996, as Director of the Planning and Settlement of Operations Department.

Andreas Verykios

Economist and graduate of INSEAD (Fontainebleau); following a private-sector career in the United Kingdom and Greece, joined the EIB in 1981 as Head of Division for Lending Operations in the United Kingdom; since 1996, Director of the Bank's Representative Office in Brussels.

Walter Cernoia

Graduate in Business Administration; career in banking sector in Milan and London; joined the EIB in 1982 as loan officer for East Africa and the Indian Ocean, then Head of Division for Lending Operations in Spain (1986) and Head of Division for Lending Operations in Poland, Hungary, former Yugoslavia and the Baltic States (1992); since 1996, Director of the Department for Lending Operations in Central and Eastern Europe.

Per Jedefors

Mr Jedefors joined the EIB in March 2000 after having been based at the World Bank as Program Manager for Korea. He joined the World Bank on secondment from Skandinaviska Enskilda Banken where he held the positions of Head of Group EMU, Global Head of Credits, Relationship Manager and Chief Financial Officer. Before joining SE-Banken he was an Associate with McKinsey & Company and worked in New York in a private company for several years.

The new ACP-EU Partnership Agreement

Significant changes and a larger role for the EIB

Cotonou, 23 June 2000. The economic capital of Benin was chosen for the signature of the new ACP-EU Partnership Agreement, that will give continuity to 25 years of successive Lomé Conventions. Some 400 delegates, representing 71 African, Caribbean and Pacific (ACP) States, the 15 EU Member States, the European Commission, the EIB, amongst others, made the occasion a great event. The new Agreement is the outcome of lengthy negotiations that started officially in September 1998 and ended in early February 2000.

The EIB to manage the new Investment Facility

The new ACP-EU Partnership Agreement is built on the experience of previous Lomé Conventions, that produced positive, though on occasions less than expected, results. It takes into account today's global economic and trade environment, demographic developments, environmental consciousness, and the increasing gap in growth trends between most ACP countries and the rest of the developing world.

As a result, the Partnership introduces a different approach to development co-operation: while the main focus remains on economic development, the Agreement contains a strengthening of the political dimension.

A strategy for economic development

The central objective of the Partnership is to reduce and eventually eradicate poverty. This objective is to underpin all strategies promoting sustainable development *"centred on the human person"*. The Agreement clearly sets out that ACP States shall be sovereign in determining the models of, and the strategies for their economies, but it stresses the need for an integrated approach in establishing specific strategies, taking into account the political, economic, social, cultural and environmental aspects of development.

The underlying philosophy includes a number of new elements: the recognition of a basic role for the private sector in any development strategy, the need for greater involvement of civil society, and the application of market economy principles.

Accordingly, developing the private sector, improving access to productive and financial resources, increasing employment, respecting the rights of the individual and meeting basic needs, promoting social development and setting up the conditions for *"an equitable distribution of the fruits of growth"*, are explicitly referred to as key components of such an approach.

In addition, support for economic and institutional reforms should help to create an enabling environment for private-sector investment and financial-sector development.

Strengthening the political dimension

The new Agreement provides for a clear strengthening of the political dimension, reflected in the long duration of the Agreement - 20 years. It now includes a policy dialogue on the promotion of peace and the prevention of conflicts, and re-enforcement of essential elements such as respect for human rights, democratic principles, the rule of law and good governance, now defined as integral parts of sustainable development. All partners have committed themselves to respect and promote these principles and to take joint action in serious cases of corruption, even where no EU funding is directly involved.

This is an integrated approach, in which economic, cultural and social development is seen as a means of contributing to peace and security and promoting a stable and democratic political environment, which in turn will provide the framework for development strategies.

Financial co-operation

As in previous Conventions, the EIB is given a key role in implementing the financial co-operation aspects of the Agreement. The Financial Protocol established for the first five years (2001-2005) envisages financial aid for a total of up to EUR 15.2 billion, of which loans from the Bank's own resources (1) amount to up to EUR 1.7 billion and EUR 2.2 billion are for the new Investment Facility to be managed by the EIB. These figures represent a substantial increase in the funds available under Lomé IV (2).

Financial co-operation instruments from budgetary resources have been rationalised to two: one envelope providing grants (EUR 11.3 billion for the period 2001-2005) managed by the European Commission, and a new Investment Facility to provide risk capital and loans to the private sector. The Investment Facility represents an important shift from previous risk capital operations, not only because of its size (EUR 2.2 billion for the first five years vs. EUR 1 billion under Lomé IV, Second Financial Protocol), but also because of its focus and modus operandi.

(1) Raised on the international capital markets.
(2) EUR 3.9 billion vs. EUR 2.25 billion under Lomé IV, First Financial Protocol and EUR 2.658 billion under Lomé IV, Second Financial Protocol.

EIB to provide up to EUR 3.9 billion in the first five years

The Investment Facility is designed to finance private-sector development and commercially-run public-sector entities. Operations will be on market-related terms, and structured so as to avoid displacing private sources of finance, but at the same time to create a catalytic effect by encouraging mobilisation of long-term local resources and attracting foreign private investors and lenders.

The Facility will be managed as a *revolving fund*, in which the returns from operations will flow back to the Facility. In other words, after some time no replenishment of the Facility from budgetary funds should be necessary. The Facility is furthermore expected to be financially sustainable in the long run.

At present, the Member States, the European Commission and the EIB are defining the framework for management and operation of the Investment Facility. Although many details are still under consideration, the management arrangements will take into account the need to cater effectively for the requirements of the private sector.

Lending from the Bank's own resources under the new framework was approved by the EIB's Board of Governors and incorporated into the Agreement. In doing so, the EIB confirmed its continued commitment to supporting the EU's development aid policies in the ACPs. Own resources financing will go to support capital investment projects meeting the Bank's normal lending criteria. ■

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Highly Indebted Poor Countries (HIPC) initiative

The EIB recently approved a contribution to provide debt relief under the enhanced framework of the Highly Indebted Poor Countries debt initiative (HIPC Initiative), further to an initial amount approved in 1998. This brings the Bank's contribution to the Initiative to a total of EUR 70 million. The EIB's funds will provide HIPC-eligible countries with grant aid from which to prepay certain loans extended by the EU. The Bank's contribution has been calculated so as to be equivalent to the share of loans from its own resources in the overall debt to be relieved.

The HIPC Initiative was launched, in September 1996, by the World Bank and the IMF, to deal with the problem of excessive indebtedness constituting a major obstacle to the development of a number of poor countries. Under the Initiative, to be eligible for debt relief and have it delivered, countries have to meet certain performance criteria.

In September 1999, the Governors of the IMF and the World Bank, with the lead of many from the EU, agreed to an enhanced framework for the HIPC Initiative to provide broader and faster debt relief. Under the initial HIPC framework, debt relief was to be delivered at the completion point, i.e. once certain performance criteria had been met. Under the enhanced framework, donors, including the Bank, will be able to offer early relief on debt service between the decision point (the moment when creditors approve a very detailed programme of economic reforms presented by the highly indebted countries, including attainment of specific targets with respect, in particular, to poverty alleviation) and the completion point (when these targets are actually attained).

Focus on regional convergence: *"More is not always better"*

The 2000 EIB conference on Economics & Finance in January was devoted to regional development policies

No institution can afford not to reflect from time to time upon the way in which the goals defined in its mission statement are best achieved. The EIB is in this respect no different. Quality control in the form of theory-underpinned (re) thinking has indeed become one of the President's top priorities.

The EIB's raison d'être is written down in the Treaty of Rome, and has been reconfirmed during the Maastricht and Amsterdam summits. Oiling the cogwheels of regional convergence will continue to be the main mission of the Bank.

Unfortunately, the broad picture of Europe suggests that fifty years of costly regional policies have led to not much more than the status quo. Over the most recent decades, for instance, income inequality among European regions has remained rather constant from an aggregate point of view. Some economists are taking this now as the natural or at least global-capitalist order of things: the rich are getting richer, and so are the poor, but without ever catching up.

To believe that the productivity gaps are immutable is, however, a mistake.

Given the complex dynamics of catching up and falling behind, it was therefore time to take stock of what we know about regional development policies. This took place in January within the annual

Lessons from twin stories

In any country there are regions that seemed similar to start with, but nonetheless have grown at very different rates. Clearly, it is a complex matter to try to identify the reasons why. One approach is to look at what actually happened in a number of case studies to see if any common features can be identified. Three papers provided such case studies for regions in Greece, Italy and Spain. Each study included a region that has performed well (in national terms) and another that is lagging behind.

Our twin stories highlighted three broad messages. Firstly, industrial structure is important. Large factories coming to the region must use technologies that encourage the development of economic activities by local subcontractors. The chances for this are increased if local human resources, particularly those employed by SMEs, have a matching set of skills.

Secondly, the quality of regional government is critical if development programs are to be sufficiently fine-tuned to local conditions. Some degree of conditionality, or at least firm guidance, to prevent misallocation of funds might therefore be desirable. For instance, technical and economic assistance, and training of local administrators, can easily be imposed.

Thirdly, more infrastructure investment does not necessarily imply faster convergence, and a uniform approach towards regional development policy is mostly ineffective.

Developing effective policies

It has been emphasised that the traditional "fundamentals" for judging projects - rate of return and geographical eligibility - are necessary, but far from sufficient, to guarantee an impact on regional development. A relatively objective assessment within the context of a more general framework that goes beyond the traditional cost-benefit analysis should become standard. The list of issues to be considered should at least include:

- Does the project fit into a coherent strategy to develop a region's comparative advantage? In particular, large-scale public investments should be motivated within such a framework
- Does the project stimulate demand for local sub-contractors? Are associated policies needed to support the development of such companies?
- Is project implementation well thought out given its particular characteristics? As delays are endemic in some lagging regions, project appraisal should assess the complete list of stakeholders, and the associated threats to the project. Public support could be contingent on external project audits for those projects that become excessively delayed or exceed their budget.
- Does the availability of public support actually change location decision, or would the promoter(s) have implemented the project anyway? If so, then the likelihood that the grants will affect regional development is rather low.
- And, finally, is the project economically attractive in its own terms? Forecasting is difficult because policies may significantly change the local economic environment. Still, good forecasting should be able to capture coordination problems, and projects should be economically sound against this background.

conference on Economics & Finance, organised by the Chief Economist's Department. Such occasions give the Bank's staff intellectually challenging food for thought and allow the Bank to complement its internal reflections with inputs from major field players.

In his opening speech, EIB President ***Philippe Maystadt*** formulated clear-cut questions for the forum to answer. Firstly, what kinds of market failures lie behind regional divergence, and what levels of inequality should we be willing to accept? Secondly, he pointed out that the role of governments has evolved in recent years, with states withdrawing from direct involvement in a number of activities - privatisation of public activities being one example. In terms of the debate on regional development, the question henceforth is when spending on investment is best done by the government itself, and when public funds should be used to support investment by the private sector.

The rich are getting richer, and so are the poor, but without ever catching up

Mr Maystadt also stressed that spending by itself is not enough, as it is quality, not quantity that is important. Public funding certainly needs to be integrated into appropriate packages of policy interventions, but what can we conclude from regional successes and failures about the measures needed to complement investment? And last, but far from least, can project selection criteria be developed to help ensure that regional growth is actually achieved by a particular investment?

A review of economic theory set the framework for the day. Professor ***Angel de la Fuente***, Instituto de Análisis Economica in Barcelona, explained that in the past, the consensus was that regional policies could support growth and that convergence would come about as a virtually automatic side effect. Reducing inequality and economic growth were considered to go hand in hand. However, recent developments in economic theory have led a number of authors to argue that there are strong market forces that lead to divergence between regions.

Daniel Moucque, Directorate-General for Regional Policy at the European Commission, subsequently confirmed that socio-economic disparity among EU regions is rather persistent and does not show a tendency to decline. He stressed that the levels of regional imbalances are currently still about twice as high as in the United States, but conjectured that this value might have been even higher without the considerable efforts undertaken by the European Commission and the EIB.

Has EU policy been badly designed then? Professor ***Philippe Martin*** (Ecole Nationale des Ponts et Chaussées, Paris) raised the fundamental question of the desirability of policy interference. His main point was that public aid may increase the level of income per capita in lagging regions, but may possibly come at a rather high opportunity cost. To be more precise, the net result of public aid may simply be a transfer

of income from rich to poor without affecting productivity. This may lead to lower overall prosperity if these transfers drain resources from those wealthy and innovative regions that are the main engines of economic growth in the country. If this is the case we unavoidably face a trade-off between equality and growth.

Martin's argument was, at least partially, confirmed by the in-house empirical study by the Chief Economist's Department. The initial observation in this presentation was that very few economists would deny *per se* that fostering economic growth is the key to convergence. At the same time, it is hard to imagine any growth mechanism that does not work through an increase of the capital stock in one way or another. A pragmatic policy question then is: does fixed capital formation by the government - building roads, schools, hospitals, ports and airports etc. - play a major role or should public funds rather be used to stimulate private investment such as equipment and machinery?

To believe that productivity gaps are immutable is nonetheless a mistake

The results showed that at both the national and regional level there are good reasons to believe that fixed capital formation by the business sector and increases in the level of human capital (schooling) boost the economy's potential to catch up. In addition, and without doubt, key strategic infrastructure is essential. There appear to be well-documented cases in which better communications infrastructure, for example, can help shift-ing economic geography to a new equilibrium. However, this certainly does not apply in a general way to public investment. In fact, it was documented that public investment has been an instrument of regional redistribution rather than a substantial force behind productivity gains.

Regions often compete with one another to have the largest quantity of publicly provided capital...more is not always better

Nonetheless, a battery of public-sector projects surely must have had a positive impact on regional development and would survive a rigorous *ex post* cost-benefit analysis. ***Bertrand Rossert*** from the EIB Evaluation Department, explained that this has been the case, but that not all projects can be expected to be equally effective in generating regional economic activity. It depends, among other factors, upon the range of stakeholders involved, and how well negotiations with these stakeholders are managed. An investigation of various case studies by the Evaluation Department revealed, moreover, that heavy public sector involvement in projects for administrative reasons leads towards substantial inefficiencies, which dampens the potential impact of the project on regional development.

Finally, Professor ***Jacques Thisse*** (Université Catholique de Louvain) posed a provocative question: why are regional imbalances (not) bad for people's well-being? He pointed out that there are market failures that may lead towards persistent spatial concentration and analysed what their sources are. In fact, he argued that the drastic reduction in transport and trade costs over the past decades, together with imperfect labour mobility, have been important factors in the emergence of clusters and regional imbalances. He stressed that the efficiency and quality of local institutions, as well as the availability of technological infrastructure - local networks of specialized providers of technological services and the like - are striking determinants in success stories. In this respect, he added the consideration that, in certain cases, it would therefore help regions to impose conditions - or at least firm guidance - on the provision of loans and grants.

Professor Thisse also criticised the fact that regions often compete with one another for the largest quantity of publicly provided capital. He clarified that if regions want to exploit their comparative advantages they may not need the same type of infrastructure at all. Policy makers should therefore focus on what type of public capital benefits the region's economic activity best. Put differently: more is not always better. Thisse's theoretical assessment clearly reinforced the lessons from the twin stories that were presented earlier. ■

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Interested readers can find more detailed information in the latest two volumes, 5 (1&2), of the EIB-Papers in which the studies mentioned here are published. The EIB-Papers are available free of charge from the Chief Economist's Department (Fax: +352 4379 3492)

Regional Development - Making Efficient Use of Financial Resources

BEI/EIB FORUM

2000 BREMEN

The annual EIB Forum is to be held in Bremen on 19-20 October

Supporting balanced regional development by financing sound investment is the EIB's core activity. In some Member States, EU regional policy as well as the Bank's pro-active input have helped regions to catch up economically. In others, success is less obvious. But even where Member States have caught up successfully, divergence among regions within one and the same country has not necessarily narrowed. Therefore, the central questions to be raised at this year's EIB Forum are "what has worked" and "what went wrong" and, even more important, "what are the lessons to be learnt"?

This is all the more important as Europe faces new challenges. New technologies and the emerging information society may benefit above all already highly developed regions. Dynamic regions may resist being burdened too heavily with transferring payments to regions lagging behind as this could undermine their own competitive position in international markets.

Furthermore, we face the enlargement of the Union to Central and Eastern Europe. With enlargement, regional divergence will rise to unprecedented levels. Inevitably, the question will be raised as to what extent divergence can be tolerated and to what extent others can be expected mutually to assist new members in the catching-up process.

Financial resources for assisting disadvantaged regions may become scarcer. Hence, it will be all the more important to make the best possible use of available resources, whether grants or loans, in order to enhance regional development.

"Factors for Success"

Regional success has many ingredients: in addition to financial resources, quite a number of factors such as functioning administrations, proper development planning, autonomy in decision-making combined with political accountability of decision-makers, the availability of entrepreneurial people and a skilled workforce. Last but not least, there is a need for general economic policies that set the right incentives for structural change, economic growth and job creation. The subject is a complex one but it might, nevertheless, be possible to identify the most important factors for successful regional development.

"Lessons from Experience"

On the second day, the Forum will discuss the factors contributing to regional success in more detail. The speakers represent experience in the field within regional development, regional policy planning and financing investment projects.

A first sub-session, "Lessons from Regional Policy Experience", will focus on the assessment of strengths and weaknesses of regions and discuss the need for a balanced development policy, i.e. conventional comprehensive planning covering infrastructure, human resources development and incentives for SMEs.

"Financing Regional Development"

A first question to answer during this session is whether the introduction of the euro and the ongoing integration of financial markets within the euro zone have improved the access of SMEs and regional/local authorities to finance, as this would strongly contribute to regional development.

A second issue is whether we should expect the present budgetary constraints in Europe to continue and stimulate the demand for alternative models for building, financing and operating infrastructure, particularly private-public partnerships. The Forum will discuss to what extent such models could be applied to Central and Eastern Europe. Also the role of regional venture capital companies will be examined.

Günter Grass - after-dinner speaker

The EIB has made a tradition of inviting to its fora an after-dinner speaker presenting views on a subject that does not figure on the

daily agenda of its guests. This year, we are particularly honoured to have Günter Grass, last year's winner of the Nobel Prize for literature, with us. It has also become a tradition to close the Forum with a speech by the EIB Governor of the host country: this year Hans Eichel, Federal Minister of Finance. ■

Programme

BEI/EIB FORUM 2000 BREMEN

19 October 2000

15:00: OPENING OF THE FORUM :
Philippe Maystadt, President of the EIB

SESSION I : *"Regional Development Policies - Factors for Success"*
Chairperson : **Wolfgang Roth**, EIB Vice-President

Speakers :
Kajo Schommer, Minister of Economic Affairs, Saxony
Charles McCreevy, Minister for Finance, Ireland
Leczek Balcerowicz, Vice-Prime Minister and Minister of Finance, Poland *
Jack McConnall, MSP, Minister of Finance, Scottish Executive
Michel Barnier, EU Commissioner for Regional Policy *

GALA DINNER
Welcoming address **Hartmut Perschau**, Mayor of Bremen
Guest speaker **Günter Grass**, winner of the 1999 Nobel Prize for Literature

20 October 2000

Introduction to SESSION II : *"Experiences with Regional Policy and Financing"*
Alfred Steinherr, Chief Economist, EIB

SUB-SESSION 1 : *"Lessons from Regional Policy Experience"*

Speakers :
Henning Christophersen, President of Øresund Regional Council, Denmark *
Brigitte Ederer, Councellor in charge of Finance, City of Vienna
Pierre Mayet, Président, Groupe de Coordination Interministériel Sofia Antipolis, France
Pasquale Pistorio, CEO, ST Microelectronics, Agrate Brianza, Italy *
Ramon Marimon, Secretary of State, Ministry of Education and Technology, Spain

SUB-SESSION 2 : *"Financing Regional Development"*

Speakers :
Jacques Guerber, CEO, Dexia Crédit local de France
Ingrid Matthäus-Mayer, Board Member, Kreditanstalt für Wiederaufbau, Germany
Rinnooy Kan, Member of Executive Board, ING, the Netherlands
Ari Tolppanen, President and Partner of CapMan Partners, Finland, Chairman of EVCA (European Private Equity and Venture Capital Association)

CLOSING OF THE FORUM
Hans Eichel, Minister of Finance and EIB Governor for Germany

** unconfirmed as at 15 June 2000*

For further information on the EIB Forum 2000, please contact the EIB's Information Department; Yvonne Berghorst +352 4379 3154, E-mail: y.berghorst@eib.org

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First targeted EARN e-bond

The EIB joined forces in February with Caboto, the Investment Bank of the Intesa Group, to launch its first Targeted EARN e-bond.

The EUR 500 million bond issue with maturity 15 October 2002, has a coupon of 4.625%. It is the EIB's first issue to be distributed electronically. Caboto, acting as the sole lead-manager, through its RetLots system, makes the issue available to its most important institutional clients in Italy and abroad through the Internet and Bloomberg.

This issue represents a key building block in developing the EIB's Internet funding strategy, started in June 1999 with a euro debt exchange offer entirely executed via the Internet. ■

EIB donation to Mozambique

The EIB donated EUR 500 000 in March to the Republic of Mozambique for relief assistance to victims of the devastating floods.

The funds were channelled through the EU's Delegation in Maputo, which identified the uses for the emergency funds.

In recent years, the EIB has provided humanitarian grant aid to countries or regions severely hit by disasters, such as Honduras and Nicaragua in 1998, Kosovo, Turkey and the Athens area in Greece in 1999.

The EIB has been active in Mozambique for some time and its financing has been stepped up since 1992 with the ending of Mozambique's long civil conflict. Loans, approved under the framework of the 4th Lomé Convention, have helped to upgrade the country's electricity system and supported investment in industrial production of some of Mozambique's natural resources (graphite, aluminium, cashew nuts, shrimp farming, sugar). ■

Berlin office opened

In late May, the EIB opened its new office in Berlin. The main tasks of the office are to support expansion of the Bank's financing operations, particularly in Berlin and the new Länder and to strengthen further relations with investors and partner banks.

The Berlin office will chiefly be responsible for maintaining contacts with the Federal Government and Länder Governments and keeping abreast of debates in Germany on lending issues, such as those currently under way on new techniques for financing public infrastructure.

Since 1990, the EIB has increased the annual volume of its lending in Germany sixfold, to reach EUR 5.5 billion in 1999, making this country the leading recipient of EIB funds.

German unification was a determining factor behind this surge in the EIB's activity. Of the EUR 30.7 billion advanced in Germany as a whole during the last ten years, about half was deployed in the new Länder.

Berlin has become a particular focal point for the EIB. Since 1990, a total of some EUR 4 billion has been channelled into 18 major infrastructure projects, including modernisation of gas, district heating and water supply facilities, construction work in the Potsdamer Platz and upgrading of hospitals in east Berlin. ■

German Finance Minister Hans Eichel (to the right) and EIB Vice-President Wolfgang Roth at the opening ceremony.