EUROPEAN INVESTMENT BANK

CA/238/89
12 December 1989

DRAFT

PV/89/13

BOARD OF DIRECTORS

Minutes of the meeting held in Luxembourg on Tuesday
7 November 1989 at 9.30 a.m.

[redacted]

10. THE ROLE OF THE BANK IN THE 1990s

The CHAIRMAN introduced Document 89/510 as a precursor to a paper proposing a further increase in the Bank's capital. The present paper explained the rôle of the Bank in the Community in helping to advance the objectives of Community policy, in particular those of economic and social cohesion and the completion of the internal market. The paper did not cover lending outside the Community nor purport to answer all questions in the area it covered. However, it incorporated questions and suggestions put forward in advance by some Directors. Questions submitted by Mr SAMUEL-LAJEUNESSE in a letter of 2 November covering three main topics (the Bank's operations in general, operations in the Community and operations outside the Community) had already been partially dealt with or would be covered during the discussion, which was only the first phase of the preparation of a future capital increase : the debate would continue, with further input from all concerned.

Mr SARCINELLI, initiating the discussion with a review of the entire text, found the report concise and clear and, although some points needed in-depth analysis, he considered that the Bank was heading in the right direction.

In his view, **balanced regional development** was one of the Bank's main objectives, which must not be undermined. He stressed the need not only to preserve, but also to improve **the environment** (quality of life) as another main objective of the Bank.

The prospective increase in the Bank's contribution to enhancing **competitiveness**, he added, should not clash with the private financial sector, particularly in industry. To that extent, he felt that a major field for action could be Eastern Europe, where not only infrastructure, but also industrial rehabilitation was needed. In that connection, and referring to President Mitterrand's recent mention of an all-Europe Investment Bank, he wondered why a new institution was needed when the Bank had already enough experience and expertise to assume such task.

As large firms would increasingly call on the financial markets, **SMEs** would, in his view, become more important customers of the Bank. Although that would be desirable, he signalled the possible need for additional staff having the requisite know-how.

The Bank could be considered as the operational arm of the Community in the field of providing services of selection, evaluation and monitoring of projects and, for that reason, he found the term "**value added**" to be misleading because it was a quantitative concept, used in national accounting and statistics, and not qualitative, which was preferable.

He favoured the techniques of non-price competition but stressed the need to pay attention to the use of **pricing** policy. It should be compatible with the special status the Bank enjoyed in the market and with its requirements. Flexibility was a vital element in this and other areas.

He preferred not to offer any specific remarks on the use of the **off-balance-sheet** mechanism until concrete proposals were made.

On the question of **guarantees**, he called for a flexible policy. If a minimum level was set, he said, every guarantee above that level should in principle be acceptable. The guarantee should be based on the balance sheet and the soundness of the company acting as guarantor, regardless of whether it was a subsidiary or not.

Mr DE VRIES considered the paper to be a useful basis for discussions in depth to precede proposals for the capital increase, whereafter the timing of those proposals could be more easily determined.

He noted that the question of **subsidiarity**, which did not cover the whole rôle of the Bank, had already arisen during the meeting. An institution providing non-reimbursable funds had to apply very strict standards, while if government funds were totally lacking it would be glad to accept every possible project : it depended on the degree of privilege, to which reference had already been made (Mr JONKHART, DSM Project, item 6.13). Hence he saw a close link between the subsidiarity question and the amount of capital to be paid in. If the Bank were to seek a high amount of paid-in capital, it would be much harder pressed to show that what it did could not be done by anyone else. It might even consider doing without a further increase in the paid in, given its strong position.

He did not feel that there was as close a link when it came to the subscribed capital. If more were sought, he would not be much concerned from the budgetary point of view, because the existing 25 billion Ecus (over and above the paid-in) could be considered sufficient for **guarantee** purposes. With all different kinds of banks, he suggested, paid-in was decreasing : they were relying less and less on budgetary resources and more and more only on guarantees and perhaps even increasing gearing ratios. The explicit need for subsidiarity was in his view decreasing as the Bank matured.

He recalled his previous suggestions that, to avoid the guarantee constructions that were proving difficult to implement for the Bank and difficult to understand for the recipient, provision might be made, in the context of **modifying the Statute** for the purposes of the capital increase, for removing this area of difficulty, through the appropriate wording.

He cautioned against seeing the mere fact of EIB financing for a company, or of cooperation with other banks or of its being approached for financing as proof that there was subsidiarity. At the same time, he felt there were projects in which the Bank's involvement was very hard to defend.

However, it was important for the Bank to maintain good profitability to show that it functioned with as little advantage as possible and could thus widen operations.

Subsidiarity was however not the only justification for EIB financing : there was also what he termed the **political justification**, e.g. for operations to support the **environment** or **regional development**. Here, the issue of subsidiarity became less and less important. It had also to be borne in mind that in such fields Bank intervention could prevent the provision of many more subsidies where they were not appropriate, for instance in favour of infrastructural investment showing a high rate of return. It was a valuable contribution of the Bank to ensure that there were alternative sources of finance, and this should continue to be the case.

As far as increasing the Bank's contribution to the Commmunity was concerned, Mr DE VRIES spoke in terms of the "**Brussels priorities**", which went beyond the Single Act, and included the questions of international **competitive bidding**, which many Board Members saw as a contribution, and support for small and medium-sized enterprises.

Similarly, he called for early Bank involvement in the project cycle and **early programme commitment** as mentioned in the document, which required further consideration. He saw the **off-balance-sheet mechanism** in this context as a means of achieving earlier Bank involvement in its existing lines of activity, for instance at the teething stage of very large projects of European interest.

He wished also for further examination of the concept of "**governments concerned**", viz. not only those in whose territory operations were located but also those to which projects might equally be of paramount importance : he counted on the Bank to make sure that it had their agreement in order to be seen as a truly European institution. With the scale of operations becoming more and more European and projects becoming more intertwined, it was necessary to get all governments concerned in line.

He was not immediately in favour of **differentiated pricing** as described in the paper, but felt it should be given serious consideration, especially if earlier involvement in projects were to come about : a charge could reflect this, given the higher average staff time that would be spent on projects in such a situation. He was not however in favour of fierce competition : the Bank could and should be able to concede more than one basis point, and from that perspective, differentiated pricing would not be necessary.

As regards Bank **operations outside the Community**, Mr DE VRIES reflected that Europe lacked an equivalent to such an institution as the IDA, with its strong conditionality. In order to place investments with comparable efficiency, the Community needed something similar. This he felt would also answer needs in Eastern Europe and possibly Latin America.

Mr MÜLLER-ENDERS stressed that the Bank, as a Community institution established to support Community policies, should continue to play an important role in investment financing. Its tasks would be increasing both inside and outside the Community, and he endorsed the previous speakers' comments on the priority objectives. However, he preferred private investment where possible. Advantages resulting from the Bank's privileged situation should be passed on to the final beneficiaries. The success of the Bank's cost-conscious and flexible work should be measured by its qualitative contribution, not by balance-sheet figures. He was of the opinion that, after 1992, commercial banks could become more competitive. He welcomed the possibility of consultancy services offered by the Bank whereas he had doubts as to equity participations.

The CHAIRMAN confirmed that, as mentioned in § 22, the Bank could be undercut by other financial institutions operating on different principles. After 1992, the Bank would not be able to compete, on a purely financial basis, with large commercial banks prepared to take a loss in order to get business, but in offering more service ("value added"), based on 30 years of experience, it could continue to assist its clients. This meant that, on a long-term basis, it might have to change its recruitment policy.

Mr O'CONNELL welcomed the report and expressed his intention to send, before the next Board meeting, a written response that would take into account initial discussions and would secure some emphasis on some new policies the Bank could apply to the regions. He agreed with the possibility of a reasonable increase in the Bank's capital, always on the understanding that due recognition was given to regional competence and disparities.

Mr EVANS welcomed the document and suggested three directions in which further analysis should go, prior to any consideration on a capital increase : a **quantitative analysis** of recent increases in Bank lending, a consideration of how far the Bank should continue to **finance an increasing share of investment** in the Community and, finally, the **size of the expansion of the Bank** so as to avoid its being driven by demand.

Rapid increases in Bank lending which had taken place the past two years, stemmed in his view directly from the factors cited in the report : accession of new Member Countries, widening of eligibility criteria, expectations of increases in interest rates, increases in financing certain areas and, finally, EIB competitiveness. On the question of **competitiveness** he took up the point made by Mr MÜLLER-ENDERS, adding that, although accepting the possibility of the Bank being undercut in terms of prices by financial intermediaries, that was not the general norm. The Bank was able to borrow, in general, on finer terms than the private sector.

This, in his view, led to the second direction in which further analysis should be taken for the Board of Directors and the Governors : the Bank's share of investment in the Community and, in particular, of private investment, in the context of the single financial area. He did not see a clear mechanism, on either the supply or the demand side, that could cause that share of investment to rise, stabilise or fall. Therefore a view should be taken on what share of investment in the Community should be financed by the Bank.

With regard to Mr SARCINELLI's comment on the rôle of the Bank in financing SMEs, he said that this was an area in which the Bank could clearly provide **value added** even if, in doing so, it had to disengage itself to some extent from financing larger firms which, thanks to the single financial area, would be in position to borrow increasingly from the capital markets.

He agreed with Mr SARCINELLI's view of the question of **pricing policy** and suggested that the Bank needed to make the terms of its loans more market-oriented. In that respect, he recalled Mr De Vries' suggestion on the possibility of linking the pricing policy with the value of the guarantee given by private borrowers to the Bank.

He shared Mr MÜLLER-ENDERS' caution on the question of the **off-balance-sheet** mechanism which, he thought, needed to be examined in detail at a later date.

He found very helpful Mr DE VRIES' analysis of **subsidiarity** which he related to that of **additionality** and asked for further analysis.

The information he requested covered recent increases in Bank lending, a comparison of the costs at which the Bank was able to borrow with those at which its private-sector borrowers were able to borrow, either from banks or from capital markets, and, looking to the future, an assessment of how far it was justified for the Bank to finance an increasing share of Community investment.

Accepting these proposals, the CHAIRMAN said that the Bank would go further and look also at regional differences in EIB growth.

Mr CONTHE welcomed the document but would have liked additional information on some of the subjects mentioned in it (e.g. off-balance-sheet mechanism). He stressed the importance of the **value added** of Bank activity, a concept that should be considered as the "trade mark" of the Bank, and felt it was closely related to that of **subsidiarity**. What the Bank could provide was the critical and technical appraisal of projects on an ex-ante basis. The Bank should try to avoid getting involved in viable parts of larger projects which were not feasible as a whole.

Several conclusions could, in his view, be drawn from the report. The first was that the Bank should not strive to keep pace with investment in the Community but rather stick to its basic goals. He stressed the importance of **regional development** as paramount objectives because it was there that the principle of subsidiarity could best be applied and because it was what really distinguished the Bank from other international financial institutions.

He considered the Bank to be justified in offering the best possible terms on its loans as a way to compensate for their higher conditionality. The Bank's privileged position (no distribution of dividends, tax exemption) could equally be justified on the basis of its tougher lending mechanism.

Bank policy on **guarantees** should, he felt, be subject to careful consideration since, unlike other international financial institutions, the Bank did not bear country risks in projects within the Community and, therefore, there would be an apparent contradiction between thorough project appraisal and a tight guarantee policy.

Although global loans were a good instrument to promote investments among SMEs, there was a clear risk of looser project evaluation since that task had to be delegated to the intermediary institution. This, he said, could offset the advantages of global loans. The Bank, he added, should monitor the financial intermediary so as to know what was the exact margin it obtained and whether it complied with Bank project evaluation policies.

Mr SAMUEL-LAJEUNESSE agreed with the three main objectives mentioned in the report and expressed the need of the Bank to maintain intervention in the **energy sector** to cope with potential tensions that might appear in the future.

In his view, **balanced regional development** and improvement of **environmental** conditions remained fundamental objectives of Bank activity, not only in themselves but also because the Bank had a sound expertise that could be used in other Community financing instruments, from both the micro- and the macroeconomic points of view.

Increasing **competitiveness** in general and that of Community industry in particular was seen as another main issue the Bank would have to deal with in the near future. In that sense, the promotion of SMEs was basic, and global loans seemed a perfect instrument not only to achieve that goal but also to assure a good and fluent cooperation with national financial institutions.

The **value added** by the Bank could and should be increased through wider intervention in certain areas such as Ecu promotion or sophisticated financial services. The Bank could also play an important rôle in the management of exchange and interest rate risks for its clients. He agreed with his colleagues on the fact that the Bank was the only Community financial institution with solid expertise in project financing.

He felt it would be very interesting and helpful to have an open discussion on the **off-balance-sheet** mechanism and, in that connection, he mentioned the possibility of securitising certain Bank loans in Ecus, perhaps making a new market, and enabling certain Bank operations to be funded without additional capital requirements.

He considered **competition** with the private financial sector to be helpful, both to the financial sector itself and to the Bank.

He highlighted the following points as essential for future analysis on that subject :

- a qualitative and quantitative forecast of Bank activity in the near future.

- the application of classical private financial ratios to the Bank, not to draw any conclusion but to see what the place of the Bank was in relation to other private financial institutions.

He agreed with previous speakers on the responsibility the Bank had towards East European countries. He recalled Mr SARCINELLI's remark on a possible "Development Bank for Eastern Europe", stressing that the Bank should at least participate in such an institution if not have its exclusivity. New complementary financial instruments should also be used in the Maghreb region, countries with large infrastructure and demographic imbalances.

The CHAIRMAN observed that various questions put by Mr SAMUEL-LAJEUNESSE in his letter had already been covered, but cautioned that not all his proposals could receive the simple answer "yes", for instance the notion that the Bank might provide fuller cover for borrowers' exchange risks. The Bank had to find a workable way forward through all the contributions to the debate.

Mr COSTA, welcoming the paper as a very good starting point for reflexion on the future of the Bank, suggested that two further elements were missing : the fact that the first stage of the **Monetary Union** would have commenced by the time the next capital increase was decided, and the **new developments** occurring in Europe, especially to the East. There were important changes forthcoming and the rôle of the Bank in that evolutionary process would have to be considered.

He welcomed the analysis of recent Bank growth in the document and the very good profits and reserves, which might even cover an increase in the capital without major paying-in on the part of governments. These, and other factors such as the continuing triple-A rating bore witness to good management but also to the support the Bank enjoyed in cooperating with other Community instruments (risk capital, budgetary guarantee, interest subsidies and EDF).

He also appreciated the references to new banking techniques, to financial advisory services and the adaptation of procedures to help firms compete in an increasingly sophisticated financial market.

In Mr COSTA's view, what the paper had omitted was consideration of the **structural changes** in the real economy that would be taking place in the European Community system, either because of spontaneous competition or because induced by policy : greater **economic convergence** ; greater flexibility in production activities (decreasing use of exchange-rate instruments), and greater **productivity**. In the last-named area, the Bank had a comparative advantage in facilitating productivity improvements in countries previously characterised by systemic or structurally higher inflation than others. Public deficits could also decline, with a downward pressure on demand, which would call for greater private-sector dynamism, wherein the Bank could have a rôle to play. However, Bank operations were already running at the equivalent of about one quarter of the Community budget, which was giving them something like a macro-economic dimension : such a volume of resource mobilisation might actually alleviate transitional costs during the first stage of monetary union.

Mr COSTA went on to cite two principles he considered could help guide the Bank in mapping its own strategy in the coming five years : **subsidiarity and flexibility**. The first he took to mean that an institution should not centralise activities that could be better managed elsewhere, i.e. the Bank should give lower priority to firms able to have direct access to the financial markets and higher priority to assisted areas and regional policy.

The promotion of regional development and **economic and social cohesion** were needed for the successful realisation of Stage One of Monetary Union, and the Bank had an essential part to play in the area of private investment serving that end : the transfer of public funds would not alone suffice.

As far as flexibility was concerned, he appreciated the idea of the Bank moving over to a régime of diversified lending conditions, but still more the switch to an alternative financing mechanism, i.e. the **off-balance-sheet entity**, for which he had a number of suggestions to put forward, whether the entity was to be a sister organisation or a subsidiary, which remained to be seen.

The first element should be flexibility in the management of the entity and in the matter of guarantees, bearing in mind for instance that the IFC was making a sound rate of return on assets, without guarantees of any sort. Secondly, he would prefer to see the entity as less of an investment bank and more of a development bank. Thirdly, it should be closely linked to national, regional and local development banks, so as to provide an element of subsidiarity where the need arose. Lastly, it was to be hoped that the entity would be able to raise funds in the financial markets, especially in the medium-term field.

He would like to explore the possibilities with other Board members, e.g. in the field of **risk capital**, with a view to the forthcoming Lomé Convention negotiations. The concept of risk capital should in his view be reassessed, more towards the sense of capital not fully securitised. This implied easing guarantee conditions accordingly.

Secondly, he saw a rôle for the new entity in the field of **soft loans**, along the lines of the IDA or IFC : such an entity within the Community would be helpful.

In providing help for SMEs, the Bank had had the impulsion of the erstwhile NCI, but it might be possible to envisage an NCI facility specifically tailored to the new entity, itself in turn tailored to the needs of SMEs.

Two other major sectoral activities were the environment and transport, for which the new entity might again be put to use.

Mr COSTA hoped that the elements under consideration could be put into a second paper with a view to enlarging the debate.

As regards developments outside the Community, Mr COSTA observed that the problem for the Commission in implementing its mandate from the Paris Summit to coordinate assistance to East European countries was no longer one of quantity but of quality and the identification of sectors for intervention and the nature of structural adjustment assistance. He hoped the Bank would become directly associated with Commission cooperation with the IMF and the World Bank, as it would be making available resources not far short in volume from those to be provided by the World Bank.

He took up a reference made by Mr SARCINELLI to the recent speech of Mr MITTERRAND and the idea of a new European Bank to help East European countries. At all events, he felt the EIB should move quickly, using the Community budgetary guarantee, to finance investment in Poland and Hungary and help the Commission in the definition of sectoral priorities and of structural adjustment needs, as well as promote the private sector there.

Mr VANORMELINGEN pointed to the way the Bank had been adapting its rôle to the changing economic and financial environment, which he said was linked to the main Community objectives : regional development, improvement of the environment, infrastructure development and industrial competitiveness.

He felt that the Bank should concentrate its activity within the Community and should not take over the specific rôle from the World Bank, IDA or other regional development banks. That, he said, should not prevent it from collaborating with those institutions via joint financing, both with its own resources and with funds under mandate from the Commission.

He stressed the concept of subsidiarity and the need to identify areas of intervention, in the light of the coming capital increase. He agreed with other speakers on the need for detailed analysis of the question of competition with private financial institutions, but considered that the Bank should play an active rôle, trying to pass on its advantages to its clients.

He agreed with previous speakers on the need for the Bank to get involved at an early stage in projects and apply its technical expertise, especially with growing operations in countries outside the Community in prospect.

He showed preference for a qualitative approach in Bank intervention and could associate himself with most of the remarks made concerning guarantees on bank operations.

Finally he observed that it was too early for him to take a position on the establishment of an off-balance-sheet mechanism, a proposal which needed further study and examination.

Mr ZACHARIADIS expressed his satisfaction with the document and agreed with the objectives set out in it, although he fully endorsed Mr COSTA's remarks on what he considered to have been omitted. He particularly welcomed the reference to **balanced regional development** as the most important objective in Bank lending policy and agreed with the observation that this was where the principle of **subsidiarity** could and should be best applied.

At the same time he spoke of the progressively reducing attractiveness of the Bank in certain Member Countries, notably Greece. He sought an explanation for the Bank's decreasing share in investments in that country. The qualitative value added by the Bank could, in his view, be a way of solving that situation through the provision of selection, evaluation and monitoring services.

Mr MORENO welcomed the document and considered the different ideas it contained as a basis for future discussions on the rôle of the Bank.

He noted with interest the concept of value added and the possibility of Bank support in the fields of financial planning and project preparation, using its valuable expertise to assist promoters and European investors. He had many doubts on the other hand about the use of differentiated interest rates as a way of covering the cost of such services. The application of identical interest rates without discrimination was one of the pillars of Bank policy.

He requested clarifications as to the medium-term financial commitments implied by Bank involvement in such services as financial planning and project preparation.

He stressed the importance of global loans in promoting SMEs. In his view, those firms would be of key economic importance, especially with the coming process of internationalization and industrial concentration.

He wished for further information on the idea of the so-called off-balance-sheet mechanism, which he found most important.

Mr BRANTNER requested more information about the off-balance-sheet mechanism, wondering if the creation of a European IDA or IFC was envisaged. He asked for figures presenting the advantages resulting from the Bank's privileged situation (not liable to taxation nor distribution of dividends) in comparison to commercial banks. He wondered if the Bank passed these advantages on to its clients and if the cost of the Bank's loans would rise, if it were obliged to compete on an equal footing.

In the absence of any further remarks, the CHAIRMAN thanked all concerned for their contributions to the debate, inviting Directors to put any other considerations in writing. These would be taken into account in the drafting of a further paper on the subject. As proposed by Mr ZACHARIADIS, the grounds for the next capital increase would be explored and figures put forward. The CHAIRMAN also accepted a suggestion from Mr DE VRIES that any written submissions by Directors be circulated, with their consent, to the other Members of the Board.