Dr. Werner Hoyer

President of the European Investment Bank

Center on Global Economic Governance

Ambassador Donald and Vera Blinken Lecture Series on Global Governance

"The Current Situation and Future Prospects for Europe's Economy"

(~40 minutes)

Columbia University, New York - 10 April 2017

Check Against Delivery

Seul le texte prononcé fait foi

Es gilt das gesprochene Wort

Ladies and Gentlemen,

I am honoured to be here today at the Center on Global Economic Governance of Columbia University, to deliver this speech as part of the Ambassador Donald and Vera Blinken Lecture Series on Global Governance.

It is a particular distinction to be a speaker for the lecture series dedicated to the Blinken family, who carried out a path-breaking work in international relations during their diplomatic mission in the mid-nineties to Hungary… only five years into the country's transformation towards democracy and market economy.

In addition, they also generously support academic research on international - chiefly European - affairs through donations to Blinken European Institute here at Columbia University, and also by providing funding to the Open Society Archives of the Central European University in Budapest, which is one of the key repositories for post-war European history.

We cannot be grateful enough for their example in generosity and humanity!

Introduction

This year we celebrate the 60th anniversary of the Treaty of Rome - which also marks the creation of the EIB, the EU Bank. This is a good time to reflect on Europe's history of these past 60 years, which represents a tremendous achievement in terms of institutional innovation, economic stability and multilateral cooperation that delivers peace, productivity and prosperity.

In spite of such achievements - or perhaps because they formed such a solid bedrock, today Europe faces considerable challenges. Chief among them is a destabilizing sense of uncertainty that has loomed over us since the beginning of the global financial and sovereign crisis. Initially uncertainty plagued the economic outlook, but over time spread to the realms of policy and politics.

Brexit confirmed the severity of the disenchantment and showed us that the EU's narrative of multilateralism and openness no longer connected with important parts of the population. Some European citizens may have taken for granted the Union and some of the values it represents.

Further destabilising are the challenges of migration linked to crises in the EU neighbourhood and beyond, and those posed by climate change.

As we know, the vicious circle between uncertainty and its harmful effect on economic activity can be persistent.

Our living standards depend on our ability to sustain stable, thriving and innovative economies. In turn, this ability rests on the capacity of both market forces and, when needed, public institutions to foster high quality investments - investments which, in turn, provide us with confidence in our prospects.

Against this background, I will cover three topics in my speech today.

First, I will talk about the macroeconomic outlook in Europe, and the key challenges that we are likely to face in the coming years.

Second, I will share some of my thoughts on the institutional turning point that the European Union is experiencing at the moment, and which has been the theme of the European Commission's White Paper on the Future of the Union recently.

Finally, I will elaborate on the role of investment, and explain how the European Investment Bank can contribute to the success and the prosperity of the citizens of Europe.

Economic outlook and challenges

Let me begin by providing a background on the macroeconomic situation and outlook for the EU.

The good news is that, after many years of stagnation and weak growth, the economic recovery in Europe looks ever healthier, as it firms and broadens, with domestic demand driving growth and labour markets continually improving.

External demand has been an important factor, especially in the early phase of the recovery, as crisis-hit economies complete their adjustment and improve their competitiveness.

Although the recent pick-up in global growth is still fairly modest by historical standards, we can finally say that the state of the global economy is not a barrier anymore for the recovery in Europe.

In recent years, emerging markets have picked up much of the slack in the global economy, notably China and India, which continue to grow at rates in excess of six and seven per cent. Further, a mild rise in energy prices has given some succour to some commodities exporters that had struggled until recently, such as Russia, Brazil, and South Africa.

That being said…

… the average growth rate of the World economy is projected to increase from below 3 to close to 3.5 per cent in the coming years, but it is still below the 4 per cent average of the pre-crisis decades.

… global trade continues to weaken, reflecting the fact that global value chains are developing much more slowly, if at all, than before the crisis.

As such, while I firmly believe that, going forward, an important factor will be global coordination and the strength of multilateral institutions, recent lack of commitment at G20 level to free trade can only add to concerns in this regard.

Indeed, this is an important factor to take into consideration when evaluating the impact of the widely expected expansionist US fiscal stance. Certainly, it is expected to stimulate domestic demand and, in particular, investment.

Yet, what it means for the globally economy is increasingly unclear!

If the US weakens its commitment to multilateralism and its institutions by seeking out bilateral agreements and enforcing protectionist measures, then this will make the global cake smaller, not larger. An agenda where protectionist measures, such as tariffs, are used to promote domestic investment would deal a severe blow to the progress made over recent decades. To us in the EU, which is based on multilateralism and freedom of movement, this is anathema.

Notwithstanding this mixed external picture, GDP growth in Europe is expected to strengthen… and most analysts project a growth rate of between 1.5 and 2 per cent for the next years, mainly fuelled by a robust growth in domestic demand.

Yet, despite the prevailing high-liquidity low-rate environment, investment - critical to potential growth, and competitiveness - has remained low and uneven across EU Member States, especially for SMEs, RDI, and infrastructures.

Even if real gross fixed capital formation has contributed 28% to EU real GDP growth since 2013, by end-2016 it remained roughly 6.5% below the 2008 level.

Many governments and households face fiscal constraints, while many banks remain constrained by legacy assets. Unsurprisingly then, the construction sector accounts for the largest share of the accumulated investment gap, with the lack of infrastructure investment a particularly important concern as it is the conduit for all of our interactions and the basis of our productivity and wealth.

On the other hand, with corporates leading the investment recovery… EIB survey data shows that firms continue to focus on rebuilding capital stocks, and that uncertainty and availability of staff are the main barriers to investment.

When it comes to RDI, Europe is still lagging behind and, although we intend to increase our spending to 3% of GDP, this will merely mean that we keep up with the US, Japan and emerging players like China and Korea.

At the EIB, we stand ready to address this issue with particular concern, as we recognise that innovative activities call for a financing mix that matches the risk and balance sheet profile, notably of young firms that are not rich in fixed assets.

Challenges

Against this background, let me highlight a few of the challenges that I believe we face, both globally and in the EU.

As I already mentioned, policy and political uncertainty is omnipresent these days.

We are not talking about the type of financial sector uncertainty that grabbed our minds over the past decade, as I believe we have now achieved a certain degree of financial stability.

Rather, it is something much deeper… a sense of disenchantment and disengagement with our institutions and their processes.

Indeed, perhaps it is the sense of having restored stability and even growth, but have overlooked at what cost for the common citizen.

We cannot champion competition and openness as enhancing global welfare unless we install mechanisms to ensure inclusiveness as well as protection of the weakest in society.

Looking ahead, in a world where technological frontiers are shifting swiftly, ensuring that the working-age population maintains adequate and up-to-date skillsets is as much an economic as a social challenge.

In fact, constant developments leave many members of western societies feeling left behind by economic growth.

A major challenge for European and, probably, global economies is thus to make economic growth more inclusive, ensuring equal opportunity and social mobility.

As I have already alluded to, the advent of populist and protectionist governments in western countries, capitalises on the lack of such opportunities and social mobility, and is therefore symptomatic of the misinformed global backlash against multilateral and open economies.

Well… at the EU we take this very seriously, as our history of the past 60 years is founded on the multilateral principle, on the belief of high international coordination and role of multilateral and global institutions… considering them fundamental to a functioning global economy.

Another challenge we will face in the coming months and years is the fact that a sustained period of unusually loose monetary policies appears to be coming to an end.

Although in itself this is rather welcome, it does entail risks… risks that will increase with the extent to which central banks to normalise monetary policies in an asynchronous manner.

An important question will therefore be the sequencing of tightening, while the manner in which unconventional monetary policies can be unwound, including the possibility of ad hoc measures, remains rather ill-defined.

Indeed, related to the previous point on multilateralism, the room for accidents with uncoordinated or even competitive strategies may be considerable; and economies that have loaded up on external debt, such as some European ones, are historically vulnerable in such circumstances.

The EU at crossroads

Ladies and gentlemen,

Let me now turn to the second theme of my speech, namely the historic crossroad where the EU is standing at the moment from an institutional viewpoint.

Let me start by stating that the European Union is an immensely successful and historic achievement. It is home to the World's largest single market, the second biggest currency union and it is the World's largest trade power.

The EU also remains extremely robust even when, or dare I say, especially when required to change with the times...

… when you think only about the last 20 years, transformation has advanced at a tremendous pace: the introduction of the euro, the integration of the Eastern Bloc countries, and then the rapid response to the crisis, with measures such as the Banking Union, to deepen and strengthen the euro area.

The EU also provides a lot to the daily life of its citizens…

… first and most important of all, it has been delivering peace, stability and freedom!

But it also delivers hassle-free movement through national borders for the 1.7 million people who commute from one country to another every day and for the hundreds of millions who travel for other purposes each year.

It allows European citizens to enjoy many benefits of the single market: cheaper goods, more reliable services, inter-connected and integrated transport and telecommunications systems.

Nevertheless, the aftermath of the financial crisis brought many dormant problems to the surface: the ageing of Europe's population, the growing inequality between various parts of the society, structural problems leading to long-term unemployment and high public debt, to name a few.

These developments led many citizens to raise doubts about the EU's ability to deliver on its promises and in many Member States we can observe signs of indifference, mistrust and growing discontent towards mainstream politics.

Exploiting these feelings, there is an emergence of populist and discriminatory rhetoric in the political field.

The process that led to Brexit showed how dangerous can it be when the EU is used as a scapegoat for all kind of troubles… and the European Union is indeed an easy target for finger-pointing!

However, if there is one lesson to be learned from it, it is that we can never take the citizens' unconditional support for Europe as granted.

I strongly believe that Europeans profoundly agree with the fundamental idea and principles of the Union. They strongly support the EU project, and see it as a cornerstone of stability.

Nevertheless, whether or how the EU can deliver on the promises and expectations is getting increasingly questioned, and these questions are often based on valid criticism.

Restoring trust in the institutional framework of the European Union must be our priority task at the moment… and it is also our greatest responsibility.

The task of restoring trust and laying the foundations for a successful and prospering Europe has to stand on three important pillars.

First, we have to provide alternatives!

In the past we have been making the mistake of assuming that we all want to take the exact same road, but it is important to give the possibility for the citizens of the European Union to have a real say in shaping the EU that they live in.

I believe the recently published White Paper by the European Commission has taken a very bold step in this direction, as it is very important to show that the EU we know is an EU of alternatives.

We also have to clarify what consequences our choices have: not only in the near future, but also on the long run.

And most importantly, we need to have ownership of these decisions… after all it is us, the European citizens, who have both the freedom and the responsibility to make the choices about our lives and our collective future.

Second, we have to find better ways to communicate between the Union and its citizens!

On one hand, we need to be able to explain better the often complex structures through which decision-making is happening in the EU.

When seen from Gdansk, San Sebastian, Manchester or Nicosia, decisions made in Brussels often seem very remote and disconnected from the daily life of the citizens and businesses they affect.

On the other hand, we also have to be able to explain our results better. I believe that we failed on many occasions to make our citizens recognise many of the achievements that the EU has brought into their lives. We cannot just let the fruits that the Union has given to Europe taken from granted.

Bringing new information to the people has never been easier than now, yet the accessibility and the abundance of information is also a challenge.

It is crucial for our success that the institutions of the EU learn to communicate quicker and more efficiently with the citizens of the Member States, and turn social media into a powerful tool of interaction and debate.

Third, we have to work harder than ever on delivering on our promises and on the expectations!

The EU has delivered a lot, but it is in the human nature to take results for granted, and highlight the deficiencies…

… and, on top of that, there are many areas where we have not delivered enough.

We have to make economic growth in the EU more robust. We have to find ways to increase our potential growth and economic competitiveness. We have to find ways to bring the benefits of economic prosperity to many more people, both across and within countries. We have to find answers to the problems of aging population, and climate change. The European Investment Bank - the EU Bank - is ready to contribute to this challenge.

How can the EU Bank contribute?

Let me now turn to the third major part of my speech today: the role of investment in strengthening Europe, and the contribution of the European Investment Bank to the solution for some of the challenges mentioned.

To prevail, the European Union - with its multilateral institutions and cooperative values - must recast a strong, persuasive and inspiring narrative that connects with our citizens and business community in a real, tangible and inclusive manner.

Investment is a cornerstone of this narrative: it is precisely because the decision to invest requires so much confidence that the very activity of investment projects confidence.

On the eve of its anniversary, the European Investment Bank, as the EU Bank, is doing just that!

The EIB is the EU Bank. We are the only bank owned by all Member States, representing and promoting their interests. With paid-in capital and reserves of 61 billion euros, a triple-A rating and a balance sheet of around 570 billion euros, we are the largest multilateral lender and borrower in the world.

As a public financial institution, we distribute our funding advantage throughout Europe… and, in fact, the world… in support of high-quality investment projects, typically with a long-term view, looking for public good and productivity-enhancing effects of investments, such as in the in areas like transport networks and R&D.

In 2016, the contribution of EIB Group activity to investment across Europe rose to 83.8 billion euros… which are supporting and mobilising well over a quarter of a trillion euros *[280 billion euros]* of total investment in a single year.

Over recent years, the effect on overall investment has been growing tremendously. This results from a smarter deployment of resources - combining EIB Group-financing with private capital, EU funds and grants, as well as advisory support from the EIB's experts - to maximise economic effect…

… and our investment makes a difference!

Recent modelling of the impact of EIB funding on Europe's economy for the 2013-2015 period confirms this.

The Bank's engagement in this period, which follows the Member State-financed capital increase granted in the summer of 2012, is expected to generate 830,000 new jobs and an additional 0.8% on Europe's GDP by 2017.

As a long-term investor, the measurable effects will continue to accumulate and by 2030 we calculate our 2015 investment will have brought 1.4 million additional European jobs and an increase in GDP by 1.1%.

The Investment Plan for Europe is another crucial element in this response and the EIB, playing the central role, is actively implementing it.

The Plan should facilitate deals by the European Investment Bank with companies and other entities whose profiles would probably not have crossed our radar screens before in such a scale and numbers… and, through this, it will allow the EU Bank to address a crucial investment gap in the European economy which I have already mentioned… innovation.

Reflecting the perceived investment needs in Europe but also reflecting its confidence in the EIB's capacity based on progress to date, the European Commission has proposed to expand the Plan to deliver investment of 500 billion euros by 2020.

Ladies and Gentlemen,

I already mentioned the EIB's approach to identify and filling investment gaps by crowding-in the private sector... but where are these gaps, and how do we identify and address them?

Take innovation… in terms of relative spending, Europe has its work cut out.

The EIB has always aimed to be the "innovation bank", as without innovation, Europe runs the risk of not remaining competitive. Hence, the EIB Group proactively promotes innovation, in terms of its approach, offer and portfolio of investments in order to ensure that Europe remains at the forefront of the next industrial and digital revolution.

Let me switch to the question of infrastructure.

Infrastructures, so essential to our quality of life and businesses, also exhibit glaring investment gaps notwithstanding low interest rates.

… and we must bear in mind that investment in innovation and infrastructures complement each other!

Fiscal consolidation - required in many Member States to ensure fiscal stability - has seen Member States slash infrastructure spending, especially in crisis-hit euro area countries.

Even in cohesion countries, where the economic recovery has been more dynamic, the cycle of European Structural Investment Funds has, for technical reasons, rendered a dynamic investment recovery into a stutter in 2016.

The perversion in this is, of course, that it undermines long-term competitiveness in already struggling economies.

With the support of EFSI, the EU budget guarantee of the Investment Plan for Europe, we now provide financing for smaller, new, higher risk projects, complementing many other facilities and initiatives run by the EIB and the EIF… namely in support of much-needed investment in innovation and infrastructure.

This is a public bridge over a critical financing gap as the market is notoriously risk averse when it comes to funding *de novo* infrastructures or the transfer of new concepts into the markets, even though there is strong need and demand.

With a view to limiting the impact of financing constraints, the EIB is also eager to engage with third parties, including national promotional institutions, and to provide advice and guidance on the, sometimes infamous, PPPs.

The European Investment Advisory Hub, one of the pillars of the Investment Plan for Europe, enhances project identification and augments local project implementation capacities, thus reducing risk and optimising inputs, including through the smarter and sometimes innovative use and combination of structural fund grant assistance and financial instruments, which leverage European Structural Funds, and potentially EFSI.

In this regard, the addition of cohesion is a useful extension of eligibility for the Juncker Plan and will enable the use of related higher-risk structured products which benefit from the EU guarantee to add to EIB's overall contribution to 'EU Cohesion' and therefore to the sustainable and inclusive growth of Europe's economy.

But let us also consider European corporate investment: sure, it leads the recovery. Yet, by historical standards it remains timid and low.

In order to identify market failures in this area and optimise its products and initiatives, the EIB's Economics Department has rolled out an unprecedented, extensive survey of corporate investment activities and financing needs.

This survey - covering over 12,500 companies, ranging from small to large, in all 28 Member States - shines a torch on conditions and needs as they are perceived on the ground.

It reveals that, though private sector investment is picking up gradually, a considerable share of European companies claims to have invested too little in recent years.

Accordingly, substantial investment gaps remain, particularly in qualitative terms: firms need to invest not only to expand output, but also to replenish their capital stock in order to absorb innovative technologies or for innovating in new products and services. In line with this, a significant share of productive assets is not considered state-of-the-art.

What these findings tell me once again is that much still needs to be done to address Europe’s corporate investment gap.

In what concerns SMEs in particular, as providers of employment and innovation, and critical to the fabric of the European economy, what we achieved during 2016 is extremely encouraging, and when I say “we”, I mean the EIB Group in collaboration with our partner banks, which intermediate our loans to SMEs.

Last year SMEs received 33 billion euros of support from the EIB Group. That is more than a third of our total activity!

In a similar vein, our research shows that firms with diversified financing are more resilient and agile. The financing mix is particularly important for small and innovative firms, whose needs reflect their balance sheet composition and risk profile.

At present, with liquidity and credit abundant, calls are increasingly strong for equity investment. For young and innovative enterprises this can be critical, as they are richer in intangible capital, something which is not easily collateralised.

Yet, while private equity has recovered since the crisis, I note that venture capital remains anaemic.

Indeed, in this period of constrained capital, the EIB Group is looking for ways to innovate and complement our traditional long-term financing to banks with a more diverse offer… such as capital relief products to trigger and support SMEs lending.

The European Investment Fund, in particular, increasingly provides equity and quasi-equity financing. It has a strong focus on innovation and innovative finance, and has made highly effective use of the EFSI, channelling financing to where it counts most, that is to say, into youth employment and innovative start-up companies.

Distinguished guests,

Earlier I mentioned the importance of prospects… well, the effect that this financing has on young people is a source of pride!

Since its launch in 2013, the EIB's "Skills and Jobs - Investing for Youth" programme has provided more than 37 billion euros to projects that support jobs and skills improvement for young people.

I am therefore delighted that the European Council is keeping youth employment on the agenda, and we look forward to working with European leaders and their governments to address this fundamental issue.

These are concrete results that show the impact of our work on Europe's future!

Every part of financing by the EU Bank is complementary to others… as the EU Bank is a crowding-in bank!

While the EIB naturally stands ready deploy its means to promote sustainable and inclusive growth… important aspects remain extraneous to the EIB's immediate field of influence.

First are barriers to investment, which the third pillar of the Investment Plan for Europe aims to reduce.

Indeed, in the above-mentioned survey, regulatory factors, together with the lack of skilled workers, are among the leading responses when firms state the barriers to their investment.

Second, as the EU economy remains a bank-based financial system, the health of the banking system and its ability to absorb and complement diverse financing needs is critical.

In this regard, completion of Banking Union and Capital Markets Union, the stability of regulatory regimes and a true common market, would ensure our joint effectiveness.

Conclusion

So, to summarise… yes, Europe faces fundamental challenges and more bold action will be needed to fully overcome them!

What gives me confidence is my belief in our common values and our institutions' ability to deliver on these… such that populist alternatives, appealing as they might seem after a long crisis, will lose their lustre.

The EU Bank will continue to work hard to step into the breach, be it to lend to Member States, companies and businesses in need of support, be it to adapt its offer to complement what the market provides and catalyse even more!

Thank you very much.