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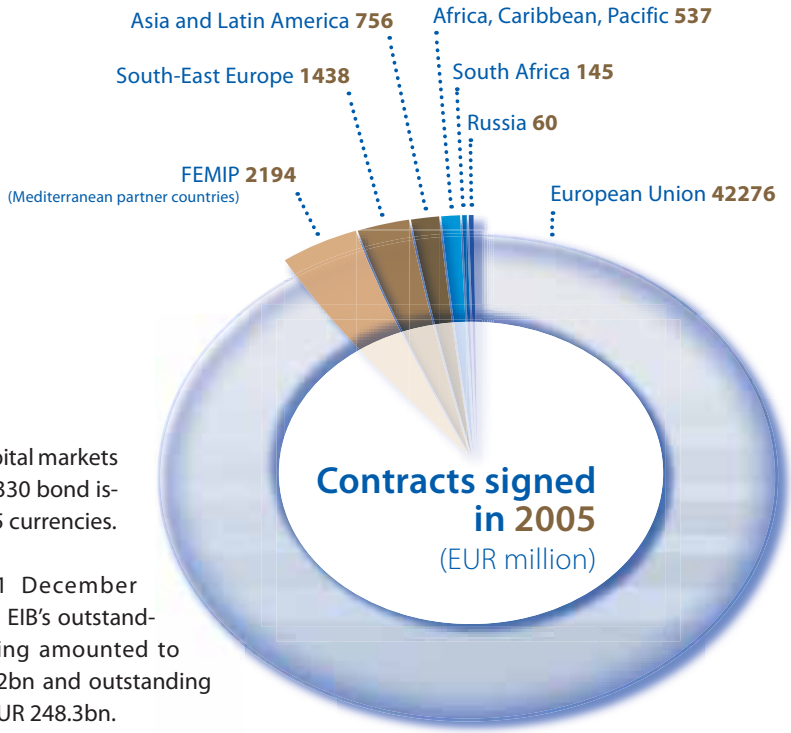
The European Investment Bank Group in 2005

In 2005, the European Investment Bank lent a total of EUR 47.4bn (2004: 43.2bn) for projects furthering the European Union's political objectives. Financing in the EU-25 Member States totalled EUR 42.3bn, of which EUR 5.8bn in the 10 new Member States. EUR 5.1bn was made available in non-EU countries, of which EUR 2 bn in the Acceding Countries (Bulgaria, Romania) and Accession Countries (Croatia, Turkey).

In 2005 the European Investment Fund (EIF) – the EIB Group's specialised venture capital arm and guarantee provider – invested EUR 368 million in venture capital funds, bringing its aggregate portfolio to EUR 3.1bn, and provided a total of EUR 1.7bn in guarantees for SME portfolios of financial intermediaries.

To fund its lending, the EIB raised an aggregate amount of EUR 49.8bn on the international capital markets through 330 bond issues in 15 currencies.

As at 31 December 2005, the EIB's outstanding lending amounted to EUR 294.2bn and outstanding debt to EUR 248.3bn.



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The Bank's lending in 2005 was focused on five core areas: economic and social cohesion, the Innovation 2010 Initiative, environmental protection, the development of Trans-European Networks, and support for the EU's development and cooperation policies. What follows below is a summary of key figures and salient characteristics for the EIB in 2005.

Examples

- *Paper production machine for Kvarnsveden Mill in the Norra region, Sweden*
- *Construction and upgrading of hydroelectric power plants in Lapland, Finland*
- *Water and wastewater infrastructure In the City of Poznan, Poland*

Economic and social cohesion in the enlarged EU (EUR 34bn)

Within the EU-25, individual loans (loans for individual projects and programmes appraised by the Bank) worth EUR 28bn were granted in 2005 for investment contributing to the strengthening of the economic potential of these regions. A further EUR 6bn was made available as credit lines (global loans) to partner banks for the financing of SMEs and smaller-scale public investment. The total lending of EUR 34bn for regional development represented about 80% of the EIB's aggregate lending within the EU-25.

The cooperation with the European Commission's Regional Policy Directorate-General has been further intensified. Two new initiatives have been developed. Firstly, JASPERS aims at offering technical assistance to countries and regions to ensure that the Cohesion Funds available in 2007-2013 are used for the best investments in terms of stimulating economic growth and job creation. JASPERS is managed by the EIB; experts of the EIB, the Commission and EBRD will join forces to assist national authorities of the recipient

countries in the preparation and implementation of investment projects that are suitable for co-financing by grant money from the Commission. Secondly, JEREMIE, which is managed by the European Investment Fund, will use European Regional Development Fund money provided, on a voluntary basis, by recipient countries to transform it into new financial products, such as regional venture capital funds, guarantees for SME loan portfolios or global loans for micro finance institutions with the objective of improving, in regional development areas, SMEs' access to finance.

Innovative and knowledge-based European economy (EUR 10.7bn)

Through its "Innovation 2010 Initiative" ("i2i"), the EIB supports the EU's Lisbon Strategy for an information and knowledge-based economy. The EIB's target is to mobilise EUR 50bn by the end of the decade to increase the EU's innovative capacity and enhance its longer-term competitiveness.

Since the start of "i2i" in 2000, the EIB has advanced loans for innovative investment worth EUR 34.8bn, of which EUR 10.7bn in 2005 alone. The EIB's lending is concentrated on three main areas: (1) research, development and innovation (RDI), with projects ranging from fundamental research undertaken by universities/research centres to applied research done principally by private sector businesses (45% of individual loans provided since 2000); (2) education and training for furthering employability, with the bulk of the Bank's financing being directed to the enhancement and technological upgrading of higher education facilities (30%); and (3) development of information and communication technologies and networks, such as broadband, and dissemination of their use throughout society (25%).

The EIB has made an effort to distribute its financing of "i2i" projects throughout the EU-25. About two thirds of total "i2i" lending so far has been within regional development areas, in order to help bring these less developed regions into the knowledge-based economic fold. In 2005 alone, 84% of i2i lending benefited the regions.

The European Investment Fund (EIF) strongly supports the Innovation 2010 Initiative, mostly by taking equity stakes in venture capital funds. In 2005, the EIF invested EUR 368 million in venture capital funds (2004: EUR 358 million), expanding its portfolio of participations to EUR 3.1bn, spread over some 217 funds operating in the EU-25. The EIF operates as a fund of funds, with a bias (two thirds of its portfolio) towards funds specialising in early-stage financing (primarily information and communication technologies and life sciences). It is now one of Europe's largest venture capital providers in this segment. Last year, the EIF further broadened its investment policy to include also mid and later-stage funds.

Examples

- *Construction of new launch pad at Guyana Space Centre and adaptation of Soyuz rocket launcher, France*
- *Public sector basic research of Deutsche Forschungsgemeinschaft, Max-Planck-, Fraunhofer-, Leibnitz-Gesellschaft, Germany*
- *Student loan scheme, Hungary*
- *Development of broadband telecommunications network in southern Italy*
- *Upgrading of academic and research facilities of Milan technical university and University of Trento, Italy*

Environmental protection (EUR 12.3bn)

In 2005, the EIB signed individual loans for environmental projects totalling EUR 12.3bn, of which EUR 1.4bn outside the EU-25. The EIB's target of devoting 30-35% of its individual loans in the EU-25 to projects aimed at protecting or improving the natural or urban environment has therefore been attained. Over 60% of this lending in the EU-25 was directed to the urban environment (i.e. public transport and urban renewal) and 20% to water supply and sanitation projects and the reduction of industrial pollution. Most of the remaining 20% went on investments in energy efficiency and renewable energy.

Examples

- *Wastewater treatment plants, collectors and sewerage systems, Belgium*
- *Construction and equipment of metro line connecting Buda and Pest, Hungary*

The EIB had, in 2004, undertaken to increase renewable energy's share of total new electricity generation capacity financed by the Bank in the EU from some 15% to 50% by 2010. In 2005, a share of 64% was attained. In support of the EU's Lisbon Agenda, the EIB has also started to fund renewable energy projects involving new and innovative technologies that, although not meeting the Bank's standard criteria for economic viability, can demonstrate that they have the potential to become economically viable within a reasonable timeframe.

Examples

- *High-speed rail line Madrid-Barcelona-French border, Spain*
- *Motorway between Prague and Dresden in Pan-European Corridor IV (Berlin/ Istanbul), Czech Republic*
- *Construction and operation (PPP model) of Motorway E18 (priority TEN), Finland*

Trans-European Networks (EUR 8.2bn)

Efficient transport and energy networks are vital for the economic integration of the enlarged EU and for secure energy supplies. Hence Trans-European Networks (TENs) are another priority activity of the EIB. In 2005, signed loans in support of TEN projects within the EU-25 totalled EUR 7.7bn, with a further EUR 550 million signed in Romania.

In order to step up its support for TENs, the EIB also introduced new financial instruments, such as the Structured Finance Facility for financing higher-risk TEN projects, and proposed an EU TENs Guarantee Instrument, which is still under consideration, covering risks in the early years of a project when the flow of revenues may be below expectations.

Support for EU development and cooperation policies (EUR 3.6bn)

FEMIP aims to develop the private sector and social and economic infrastructure in the Mediterranean partner countries. In 2005, lending under FEMIP totalled EUR 2.2bn, split between four key fields: the private sector (49%), transport infrastructure (34%), energy (13%) and the environment (4%). FEMIP provides the regional business

Partner countries

Examples

- *Construction of natural gas liquefaction train, Egypt*
- *Creation of five regional technology parks for research, training and production, Tunisia*
- *Construction of cement plant, Nigeria*

community (including foreign investors) with access to financial products that are not easily available in the region (long-term loans, risk-sharing finance, risk capital and funding for technical assistance).

In the EU's ACP (African, Caribbean and Pacific) partner countries covered by the Cotonou Agreement, the EIB is mandated, for the period 2003-2007, to provide loans from its own funds of up to EUR 1.7bn and manage an Investment Facility of EUR 2bn. The latter is designed as a revolving fund, with the repayments being invested in new projects. In 2005, political problems or difficult economic situations in some countries, and the resulting sluggish foreign direct investment, hampered the EIB's activity. Loans granted from EIB resources and the Investment Facility totalled EUR 540 million, with the focus on infrastructure projects and support for SMEs via local banks.

Borrowing activities in 2005

Under the 2005 funding programme, the Bank raised EUR 49.8bn through 330 transactions across 15 currencies. While overall volume was almost identical to 2004, the composition of funding shifted significantly in response to changing market conditions. Noteworthy growth areas included long-dated issuance (maturities of 10 years or above), notably in EUR benchmarks, and also structured issuance in EUR. Long-dated issuance raised over EUR 23bn equivalent, double last year's issuance in this maturity spectrum. Overall, issuance in EUR (39% of the total) accounted for the largest share of funding, followed by USD (29%) and GBP (20%). Currency diversification continued, with issuance in 12 additional currencies (12%). This reflects the Bank's ongoing contribution to the development of capital markets in currencies of the new Member States and Acceding/Accession Countries, where issuance in local currency also supports the development of the EIB's lending activities. ◻

EIB President Philippe Maystadt stays on

Mr Philippe Maystadt was reappointed President of the EIB by the Bank's Board of Governors, the EU Finance Ministers, at the end of 2005. Belgian by birth, European by vocation, Mr Maystadt has been at the helm of the EIB since January 2000 and his first term expired on 31 December 2005. His new mandate allows him, together with his colleagues on the Management Committee, to ensure that the EIB helps to implement priority EU policy objectives on a day-to-day basis.

EIB adapts its European lending operations structure to meet the challenges of its new strategy

The strategic orientations approved by the EIB's Board of Governors in 2005 for financing investments in Europe focus on innovation and quality as well as reinforcement of the value added of EIB operations and a controlled increase in the Bank's risk-taking. These strategic objectives also provide for the development of new financial instruments (including with the European Commission), notably to support the Lisbon Agenda/ i2i and the Trans-European Networks (TENs), as well as enhanced ways of cooperating with the banking sector to strengthen support for SMEs.

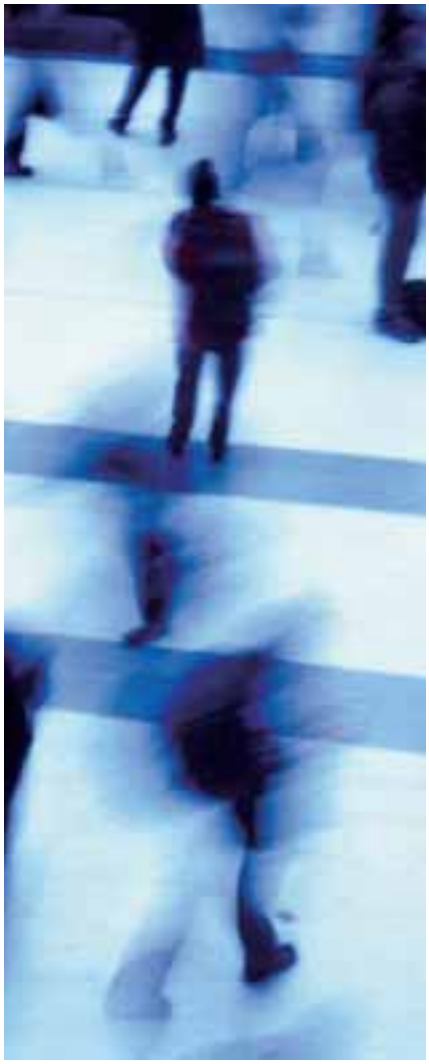
by Daniela Sacchi-Cremmer
Communication and Information Department

In order to implement this new strategy, the EIB's Management Committee decided to strengthen the set-up of the Bank's main lending directorate covering operations in Europe. The new structure became effective as of 1 January 2006.

The revised organisation consists of six (previously eight) geographic lending departments and, for the first time at the EIB, a new product-based department (AGI/Action for Growth Instruments) responsible for structured finance and advisory activities, especially in support of i2i and TENs. Most of the geographic departments comprise a mix of old and new Member States, thus continuing the cross-fertilisation and integration already developed under the previous structure established in time for the 2004 EU enlargement.

The AGI Department, headed by Thomas Barrett, will in particular be responsible for higher risk-taking through the use of the Bank's Structured Finance Facility (SFF). AGI will have overall responsibility for all SFF activity relating to transport and energy projects along the Trans-European Networks (TENs), as well as for financing in support of research, development and innovation under the Bank's i2i initiative and environmental projects. The AGI Department will also be responsible for the development of the EIB's Centres of Expertise in these sectors. It will coordinate the lending Directorate's advisory activities and lead operational work with the European Commission in the development of joint financial instruments.

These adaptations build on the success of the Lending Directorate's existing organisational model and respond appropriately to the increasingly challenging and complex operating environment with a view to providing additional value added in the Bank's operations.



Directorate for Lending Operations in Europe

Thomas HACKETT,
Director General

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  Thomas BARRETT,
  Director
- Western Europe,
  Laurent de MAUTORT,
  Director
- Spain and Portugal,
  Carlos GUILLE,
  Director
- Central Europe,
  Joachim LINK,
  Director
- Adriatic Sea,
  Antonio PUGLIESE,
  Director
- South-East Europe,
  Grammatiki TSINGOU-PAPADOPETROU,
  Director
- Baltic Sea,
  Andreas VERYKIOS,
  Deputy Director General

More information on the Organisation Chart on www.eib.org.

Enhanced role of the Structured Finance Facility/SFF

The Structured Finance Facility (SFF) was established in 2001 to enable the EIB to provide additional support to priority projects through the assumption of risks that it was previously unable to take. It has been designed as a specific financial instrument for the Bank to finance the low end of the investment grade spectrum and non-investment grade investments where appropriate. Under the SFF, the Bank can provide financial products such as senior loans, mezzanine and subordinated debt, as well as financing investment funds with equity-type instruments. The SFF is designed to have a high added value, being generally used in limited amounts and with a high leverage factor.

In line with the Bank's strategic orientations, there has recently been a heightened focus on financing projects under the SFF, resulting in accelerating growth in SFF commitments and the generation of an extensive pipeline of projects both in Europe and the Mediterranean area. Consequently, to ensure sufficient resources, the Bank is now examining the possibility of increasing the capital allocated to SFF activity - a proposal which may be considered by the Bank's Governors in the course of 2006 - in order to support the development of a significant and sustainable SFF programme. ◻

EIB Group and Commission provide more support to SMEs in new Member States

The EIB Group and the European Commission are joining forces to assist credit institutions in the new Member States in developing their lending operations in support of small and medium-sized enterprises (SMEs).

The EUR 2 million facility, called "Preparatory Action", financed by the European Commission and managed by the EIF on behalf of the EIB Group, complements the existing SME Finance Facility (SME FF) and is aimed at fostering the micro-lending skills of credit institutions not participating in the SME FF, in particular those operating regionally. Grants will finance Technical Assistance (TA) to credit institutions developing micro-lending to small and medium-sized enterprises. This must be coupled with an EIF guarantee or an EIB global loan.

The EIF will take the overall responsibility for arranging the Technical Assistance to credit institutions and for reporting to the Commission, while the EIB will be able to propose credit institutions to be targeted by the facility.

Eligible credit institutions include commercial banks and credit cooperatives, locally registered, licensed or incorporated entities and also subsidiaries or branches of EU banks. Although credit institutions from all Member States are eligible under this facility, priority is given to those registered in the new Member States.

The sub-loans/leases provided by the participating credit institutions and benefiting from the EIB global loan or EIF guarantee are required to support SMEs, with preference given to small and micro enterprises. Participating credit institutions will have to achieve a certain level of lending to eligible SMEs in order to be able to utilise the grant. Although the SMEs will not receive the grant themselves, they are expected to benefit from the larger number of credit institutions offering lending to SMEs and from the better lending conditions resulting from the participation of the EIB Group.

The facility's objectives include:

- that staff of the participating credit institutions (PCIs) should become familiar with the concept of lending to SMEs and its implications for their business;
- that the volume of PCI loans extended to SMEs should be larger than at present;
- that the loans extended to SMEs should have longer maturities than at present;
- that the number of SME clients of PCIs should be larger than at present.

Applications

In order for potential projects to be assessed, the credit institution should contact the EIB or EIF (see contacts below), respectively, for global loan or guarantee applications, and should be ready, upon request, to provide a description of the project requiring technical assistance, its objectives and its justification.

Use of funding

Funding resulting from the EIB global loan or the EIF guarantee must be used to provide loans to SMEs making investments in fixed assets and long-term working capital. This may involve new projects or the modernisation or expansion of existing businesses within sectors such as manufacturing, agribusiness, hotel, tourism, energy saving and the environment, construction, trade and services. The average size of investments financed under the Preparatory Action may not exceed EUR 25 000.

Eligible SMEs

SMEs eligible to benefit from PCI financing under the Preparatory Action are enterprises with a maximum of 249 employees, a maximum annual turnover of EUR 50 million and/or a maximum annual balance sheet of EUR 43 million.

Preference should be given to small (< 50 persons; balance sheet/annual turnover < EUR 10 million) and micro enterprises (< 10 persons; balance sheet/annual turnover < EUR 2 million).

Eligible SMEs must have majority private ownership and control, or be in the final stage of the process of privatisation. They must not conduct business in the following activities: gambling, real estate, banking, insurance or financial intermediation, the manufacture, supply or trading of arms, or other activities on the EIF's or EIB's exclusion lists.

Technical assistance

Technical assistance (TA) will only be financed in conjunction with the EIF guarantee (with a maturity of a minimum of 18 months) or the EIB global loan. It will be provided by external consultants to PCIs and/or leasing subsidiaries controlled by PCIs to strengthen administrative, credit and management capabilities for loans (in particular micro-loans) or financial leases made available to SMEs.

Activities eligible for TA include (but are not limited to):

- installation of management information systems specifically geared to SME portfolios;
- training of PCI staff in supporting SMEs and in the appraisal, supervision and administration of loans extended to SMEs;
- introduction and implementation of the related organisational and managerial procedures and practices involved; or
- circulation of information to SMEs regarding the facility and, in particular, microlending. ◻

The SME Finance Facility

The SME Finance Facility is a programme jointly developed by the Commission, the European Bank for Reconstruction and Development (EBRD), the EIB and the Council of Europe Development Bank (CEB) in association with Kreditanstalt für Wiederaufbau (KfW). The objective of the SME Finance Facility is to induce financial intermediaries (banks and leasing companies) to expand and to maintain in the long term their financing of SME operations in eight Member States that joined the EU in May 2004 (Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia, Slovenia) and in Bulgaria and Romania. Croatia, Turkey and some other countries may eventually also become eligible.

Contacts

To submit a request for an EIB global loan to be linked with technical assistance, please contact the loan officer responsible for relations with your credit institution, or:

Māris Briedis
Lending Operations,
European Investment Bank
100 boulevard Konrad Adenauer,
L-2950 Luxembourg
(+352) 4379 7450
(+352) 4379 7498
m.briedis@eib.org

To submit a request for an EIF guarantee to be linked with technical assistance, please contact:

Guarantees Division,
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43 avenue J.F. Kennedy,
L-2968 Luxembourg
(+352) 42 66 88 300
(+352) 42 66 88 312
PrepAction@eif.org

Project monitoring enhanced at the EIB

The physical monitoring of projects is a crucial element of the EIB's strategy, which focuses on value added and transparency.

In particular, physical monitoring includes follow-up and support activities related to the technical, economic and environmental aspects of projects. These take place between the signature of a loan contract and the end of the first year of a project's operation. A series of actions approved by the Management Committee at the end of 2004 is currently being implemented by the Projects Directorate to improve the project monitoring process, as part of a broader effort by the EIB to enhance overall monitoring activities.

Project monitoring checks that funds are used in line with the corresponding objectives. It tracks the project quality and soundness and keeps abreast of developments concerning the project. Finally, the Bank verifies that the project is implemented in

accordance with the contract and evaluates its implementation and initial operation results.

The Projects Directorate traditionally plays a central role in project monitoring, in co-operation with the Lending Directorates and the Risk Management Directorate for operations involving credit risk. Monitored projects include investment loans, both single project and multi-scheme operations, as well as framework loans.

The Bank's approach relies on the reporting required from the promoters and can involve on-site assignments. The monitoring procedures can be adapted to the complexities and difficulties involved. The results of recent years consistently show that the Bank rates more than 85% of projects good or satisfactory at completion stage. However, significant follow-up efforts by the Bank are necessary to obtain timely and relevant information during a project's progress and at completion.

Following an in-depth analysis also based on ex post evaluation results, the Management Committee approved a series of structural improvements.

Enhanced visibility of monitoring: assessment of promoters' monitoring track record at appraisal, if applicable; introduction of watch lists for projects presenting particular risks and tracking of promoters that have not complied with contractual requirements as regards monitoring.

Clarity and consistency in modulation choices with regard to monitoring procedures: a clear focus on projects requiring active follow-up during implementation, with particular emphasis on procurement and environmental requirements.

Enforcement of promoters' contractual obligations: rigorous use of finance contracts to detail monitoring requirements; use of early reminder letters to promoters ahead of reporting deadlines; in cases of non-compliance, implementation of actions including site visits and notification of the Management Committee

Consistency and quality: systematic use of site visits for a substantial sample of projects, thereby requiring additional resources; definition of clear procedures for the management of framework loans; internal feedback seminars on monitoring.

The Bank's Corporate Operational Plan 2006-2008 includes specific criteria and targets for inclusion in Physical Monitoring and Project Completion Reports (to keep the Board informed on the results and progress).

by Daniela Sacchi-Cremmer
Communication and Information Department

Outlook

The strengthening of the physical monitoring process is well under way, and will require a continued management effort and the reinforcement of resources in order to be fully effective and sustained over the next years.

The recently approved measures are in the course of implementation and their positive impact will develop over time. Since physical monitoring is receiving increased attention within the Bank, progress can be noted in terms of information flow and quality. ◻

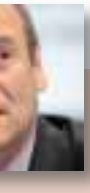



An industrial policy for Europe?

The 2006 EIB Conference on Economics and Finance, held on January 19, brought together researchers and practitioners from numerous countries and institutions to shed light on a topic - industrial policy - that touches upon many facets of the EIB's lending operations. In the EU context, industrial policy broadly refers to deliberately using public policies, frameworks and institutions to promote the competitiveness and growth of European industry. The orientation, effectiveness and even definition of industrial policy, however, continue to be subject to considerable controversy.

The conference was opened by **Philippe Maystadt**, President of the EIB. He observed that industrial policy has a tendency to resurface from time to time as a fashionable topic. Even though industrial policy has a long track record of implementation, its economic underpinnings and consequences remain relatively poorly understood. This was the issue that the conference aimed to address.

James Foreman-Peck of Cardiff University started the conference with an overview of the history of industrial policy in Europe. He identified several distinct phases in industrial policy over the past century: 1) relatively liberal industrial policies in the early years of the last century; 2) a prolonged era of nationalism, state interventionism and an eroded faith in free market economics after World War I; 3) an economic boom following WWII, characterised by a combination of high economic growth, expanding world





by Kristian Uppenberg
Economic and Financial Studies

trade in manufacturing goods, improving public finances and steadfast belief in the constructive role of the state in promoting industry; 4) the decline of traditional industries in the 1970s; 5) a period of privatisation and substantially reduced state intervention in the 1980s.

Olivier Debande of the EIB's Projects Directorate focused on industrial policy since the 1970s. This was a period of "deindustrialisation", involving a declining share of manufacturing in total output and employment in many industrialised countries, despite continuing high output growth in real terms. There were several drivers of this process: internal drivers (higher productivity growth in manufacturing relative to services and a shift in consumption towards services as a result of higher incomes and population ageing); and external factors (continuing trade liberalisation, which has shifted the comparative advantage of the richest countries towards more human capital-intensive activities). Since these drivers are all part of a normal and indeed growth-enhancing process of structural change, the case for using industrial policy to "lean against the wind" is not very strong on efficiency grounds.

The second session of the conference concentrated on the question of when industrial policy is justified from an economic perspective. **Elie Cohen** of Sciences Po in Paris presented the key arguments for and against industrial policy. The key difference between the public and private sectors is the latter's superior ability to terminate bad projects. In contrast, neither sector has an obvious advantage in "picking winners", which means that the government and the private sector should work together to determine in which area countries should specialise. The role of industrial policy is thus to facilitate technological breakthroughs and the creation of national comparative advantages. According to Cohen, this is especially important in knowledge-based economies. However, the success or failure of industrial policy is ultimately dependent on the quality of the public sector and its institutions, and the design of an adequate incentive structure for all the economic agents.

Considering industrial policy from the perspective of other economic policies, **Timo Välilä** of the Economic and Financial Studies Division of the EIB asked how the interaction between different policy areas affects the scope for economically sensible industrial policy. He assessed the goals of different industrial policies - such as innovation support, horizontal mergers, strategic trade policy and structural adjustment policies - from the perspective of competition and trade policies, concluding that there is clear scope for conflict between, on the one hand, the goals of industrial policy and, on the other, free domestic competition and free international trade. Another potential source of conflict between industrial and other policies is the fact that industrial policy does not possess a set of independent policy instruments but has to "borrow" instruments from fiscal, trade or competition policies. Using tariffs, for instance, to achieve industrial policy goals will also compromise free trade. The policymaker will thus have to consider first whether the goals of industrial policy are so valuable as to justify compromising other policy goals. Such trade-offs make industrial policy a particularly fine balancing act.

Andreas Strohm of the European Commission's Competition DG focused on the role of competition policy as an important complement to industrial policy. History has shown that an internally competitive market helps companies, and the economy as a whole, to become more competitive internationally. The need to prevent excessive market power in the home market through the control of mergers and acquisitions must be balanced against the need to exploit economies of scale in a globalised economy. As a principle, the Commission prohibits direct state aid to firms, since this distorts competition and the "survival of the fittest". Instead, it pushes for reforms that make state aid less distortive and better targeted, primarily in order to stimulate innovation.

Charles Edquist of Lund University looked at industrial policy from the perspective of systems of innovation. Edquist stressed that because systems of innovation are evolutionary, an optimal or ideal system of innovation cannot be specified ex ante. Industrial policy should only focus on promoting new activities, serving as a "midwife" for new innovative activities. Markets and firms perform least efficiently with regard to new activities, where uncertainty and risks are large. Historically, large-scale and radical technological shifts have rarely taken place without public intervention. Government support can take many forms, including financing, research facilities, a supportive regulatory environment and higher education. However, selecting the right set of industrial policy tools remains a challenge for governments since their relative importance and effectiveness have never been properly determined.

The third session looked at the application of industrial policy in practice. **Otto Toivanen** from the University of Helsinki examined European industrial policy experiences from a traditional neo-classical perspective: an observed market failure is needed to justify public intervention. He drew on two case studies that may shed some light on the effectiveness of industrial policy. Both Finland and Norway have devoted substantial public resources to national R&D spending, but the success rate of these two efforts has been very different, with Finland achieving notably higher R&D spending as a share of GDP in the 1990s, while Norway did not. Different approaches to supporting R&D may account for some of this divergence. Finland's innovation system has been based on unsolicited applications and a review process that aims at achieving commercial applications of publicly supported R&D efforts, essentially adopting a horizontal approach to industrial policy. In Norway, by contrast, public support for innovation has been heavily concentrated on promoting production and applications of IT, mostly in large firms. A large portion of these efforts - mostly in the form of vertical industrial policy - eventually proved fruitless, as many supported firms went out of business in the early 1990s, having focused on non-viable technologies. This suggests that governments may have difficulty "betting on the right horse" when concentrating resources on a few uncertain technologies.

Jordi Gual of IESE Business School presented the results of an empirical investigation into the effectiveness of state aid in the EU. The study focuses on vertical aid, i.e. aid that targets some industries or firms at the expense of others. While the underlying idea behind such targeted aid is to "pick winners", Gual pointed to empirical evidence suggesting that governments in reality often support losers and that on average state aid is not found to boost multifactor productivity growth in the supported sectors. At the same time, Gual recognised that it cannot be determined with certainty whether this means that state aid is ineffective, or whether state aid is driven more by equity considerations than economic efficiency arguments.

East Asia has a long history of active industrial policy, some of which brings useful lessons for Europe. **Ha-Joon Chang** of

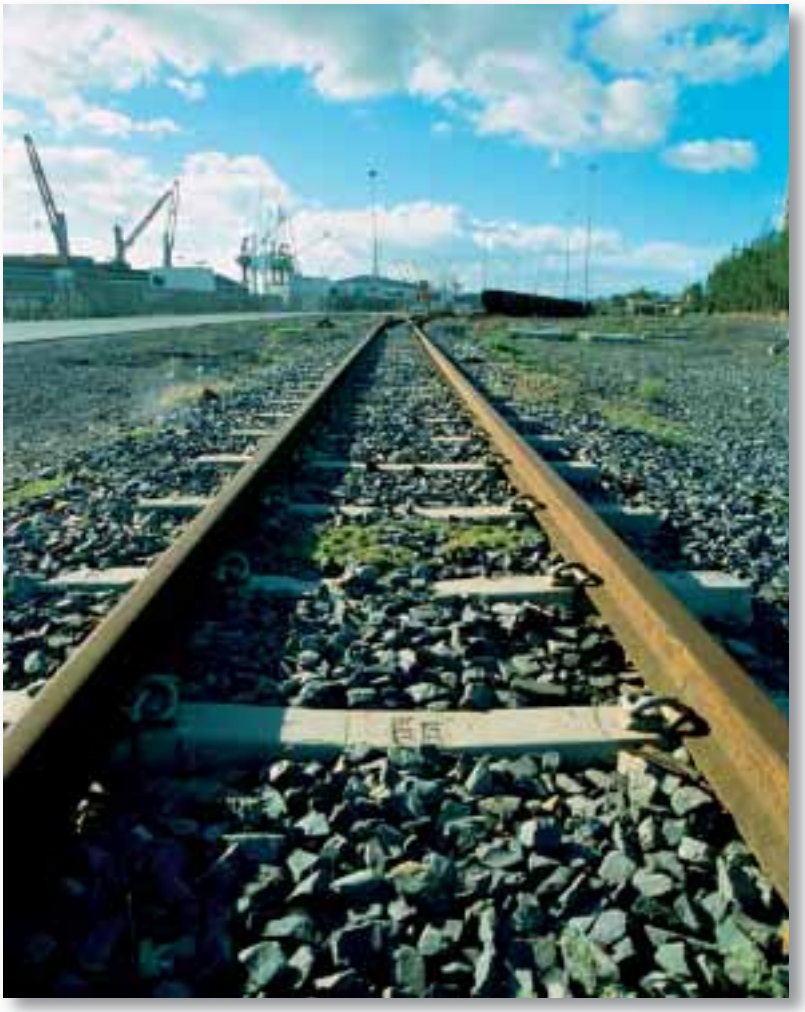
the University of Cambridge discussed the experiences of Japan, South Korea, Taiwan and Singapore. While all these economies have had active industrial policies, the characteristics of these policies have not been identical. This makes it more difficult to draw general conclusions from these experiences, or to speak of a distinct "Asian model" for industrial policy. Still, there are a few general lessons to be learned. First, state-supported industries have often become successful only after a very long time of questionable performance. Hence, one must be careful making judgements about the effectiveness of industrial policy too quickly. Second, while governments do make mistakes in conducting industrial policy, it is still noteworthy that all the Asian economies with such policies have at the end of the day demonstrated impressive growth performances. Third, successful industrial policy has typically been part of an export-oriented strategy rather than one focusing on import substitution.

Philippe Martin addressed the question of whether there is a need to cordinate national industrial policies in order to take into account spillover effects. In many cases, the economic justification for coordination is sound. For instance, when there are potentially large spillovers from R&D and innovation, individual countries might be tempted to free-ride, thus leading to an under-provision of R&D relative to the social optimum. The need for coordination is also linked to competition policy and state aid in the case of individual countries pursuing policies for national gain at the expense of EU-wide welfare. In general, however, the case for coordination is weaker than one might have expected. The reason is that good industrial policies rely on local information. Coordination at - or even delegation to - EU level should therefore only take place when there is a very strong case for it on the basis of spillover effects. Martin also pointed to some circumstances when coordination can lead to an excessive amount of industrial policies. On balance, the case for EU coordination of industrial policy is thus weaker than for monetary and fiscal policies.

Gert Jan Koopman from the European Commission's Enterprise and Industry DG stressed that industrial policy touches upon many policy areas and is thus not really a field in itself. One common denominator may be that industrial policy is essentially concerned with the competitiveness of industrial sectors, which can be increased through innovation policies, the regulatory framework, international trade policy and the facilitation of structural change. The fact that many of these areas are associated with substantial cross-border spillover effects generates coordination problems, which is why several have been delegated to the European level. There is a broad shared framework in Europe on what industrial policy can and should do. While the role of the European Commission is certainly not to pick winners, it does have an important coordinating role in working with sectors to build a pan-European consensus of what direction industries want to go in, and supporting this through a combination of vertical and horizontal action. ◻

The 2006 EIB Conference on Economics and Finance was a special occasion because it brought together various strands of a policy area that are rarely discussed in a single framework. Volume 11 of the EIB Papers, scheduled for publication in the summer of 2006, will present the contributions of the conference speakers.

The appraisal of rail projects

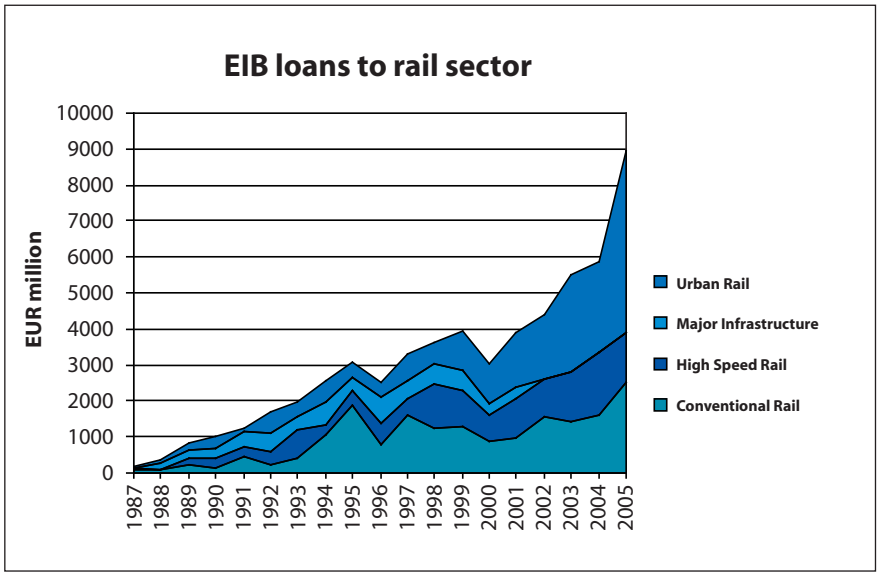


by Mateu Turró
Projects Directorate
and Patrizia Fagiani

The EU transport system should eventually become an integrated, multimodal, efficient, competitive and sustainable system. EU policy documents and legislative interventions of the last two decades have aimed at this, whilst trying to accommodate both the needs of users and the specificities of Member States. A main objective of the Common Transport Policy is to achieve a substantial rebalancing between modes of transport. For this, railways and waterborne modes have to become more competitive and ensure effective intermodality ("linking up the modes") with dominant road transport. Given the observed trend of market share loss of railways, it is not surprising that a key focus of EU action in the sector is the revitalisation of railways to enhance their competitiveness. Through three legislative "rail packages" the EU has been introducing measures to clarify accounting, liberalise the provision of services and create a Europe-wide market through interoperability (to standardise infrastructure, energy supply, signalling and rolling stock) and the elimination of administrative barriers to competition.

Integration and multimodality of the transport system to support growth and cohesion are also the key concepts underlying the trans-European transport networks (TEN-T) strategy, first formulated in the Maastricht Treaty and now a pillar of the European Action for Growth approved by the European Council in 2003. Railways play a key role in the TEN-T strategy: the trans-European rail network should include by 2020 about 94 000 km of railways, including some 20 000 km of high-speed rail lines suitable for speeds of at least 200 km/h. The EU budget, through the Structural Funds and the TENs budget line, has provided grants to many rail projects and is expected to maintain strong support for the upgrading and development of rail infrastructure, notably in the new Member States. The EIB, on the other hand, is also clearly committed to the sector, which has consistently benefited from its long-term loans (see graph).

Rail project financing is still reliant on important support from the public sector in most EU countries. However, the involvement of private capital in the sector is seen as an essential component of its desired modernisation and its pursuit of competitiveness. The new rules requiring the separation of the accounts of infrastructure managers and service operators and more sophisticated procurement schemes, including public-private partnerships (PPPs), which have introduced new approaches to risk-sharing principles in the sector, require adapted indicators for decision-making.

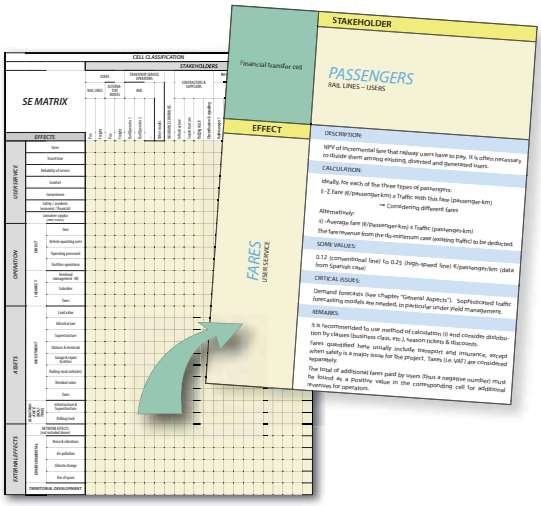


In this context, it appears critical to ensure that projects funded by EU institutions are not only consistent with EU priority objectives, but also of high overall quality and soundness. The project's technical definition, the description of implementation and operation phases, procurement schemes, investment and operation costs, economic and financial profitability, environmental and social impacts, are all aspects which have to be accurately and appropriately taken into account.

Project appraisal is a standard practice in EU countries to justify public funding of infrastructure projects. However, a wide variety of approaches can be observed. National methodological frameworks are often the result of particular theoretical developments and are applied in different regulatory contexts. The comparison of proposals coming from different countries becomes extremely difficult and this has deep implications, especially when it involves trans-national (and cross-border) projects. These considerations are particularly relevant to the rail sector, where national practices seem to diverge even more than in other sectors[1]. In addition, traditional evaluation tools are unable to appropriately reflect the implications of projects for a market that is rapidly changing under the impulse of the EU reform packages.

The Rail Project Appraisal Guidelines, **RAILPAG**, have been produced to respond to the need for harmonised procedures for rail project appraisal. RAILPAG is an initiative of the EIB, carried out with the support of DG TREN and the participation of international rail associations (CER, EIM, UIC, UNIFE) and other IFIs (World Bank, EBRD), which are involved in the project through the RAILPAG Steering Committee. RAILPAG falls within the remit of the Memorandum of Understanding signed between the Bank and DG TREN and is the first example of a joint Commission-EIB effort to provide sector guidance for project quality.

The RAILPAG Guidelines are simple indications of best practice that should be adapted to the particular requirements of the project (size, complexity, stakeholders, etc.). The ultimate responsibility for the appraisal methodologies remains with the Member State; the Guidelines are therefore not thought of as a compulsory requirement for obtaining EU and EIB financing. It is obvious, though, that they can help to improve the quality of rail project appraisals while at the same time fostering harmonisation throughout the EU.[1]



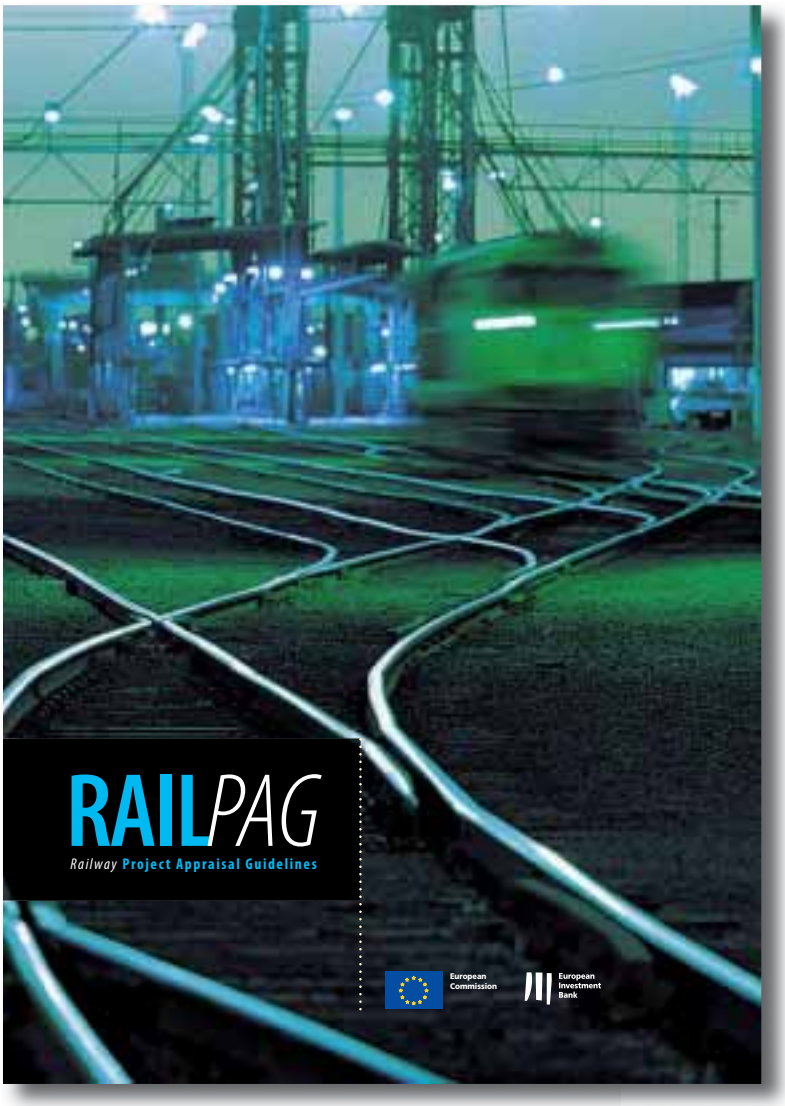
RAILPAG contains general recommendations on how to carry out cost-benefit and financial analyses for rail projects, fiches on specific topics with the indication of appropriate methods and parameters to be used, and case studies. RAILPAG also includes a particularly relevant innovative tool which allows assessment of the distribution of costs and benefits across the stakeholders concerned by the project: the Stakeholder-Effects Matrix will prove to be an effective appraisal instrument especially in large and/or complex projects, where the synthetic results of the profitability analysis would hide the geography of winners and losers.

RAILPAG requires continuity and continuous upgrading. The project has been launched through the publication of the printed Guidelines in English and French, but the

[1] The evaluation of road projects, for instance, has well-established methods for calculating capacities, average speeds, etc. that are not available across rail networks.

RAILPAG project will be kept alive through its website *(www.railpag.com)*, where the Guidelines can be downloaded in both English and French[2] along with case studies and the latest version of the fiches. The website is conceived as a working area, where specialists from rail companies, transport administrations, academics, consultants and researchers will be able to easily access updated versions of the Guidelines and information on related news and events, and also contribute to extending and improving the current set of case studies.

The RAILPAG project will also be pursued through specific workshops and presentations to interested professionals in various member countries. ◻



[2] Paper versions can be requested through the infodesk@railpag.com.

RAILPAG Guidelines Contents

- Rail projects: appraisal and decision-making
- Planning context
- Traffic forecasting
- Definition of alternatives
- Environmental, social and cohesion aspects
- Cost-benefit analysis
- Distributional aspects

Handbook

on "Sovereign Debt Markets in the EU Mediterranean Partner Countries"

by Richard Teichmeister
Finance Directorate

Following the success of the Debt Market Handbooks on the Accession Countries and new Member States, the EIB has produced a new publication in the series examining the sovereign debt markets in the European Union's Mediterranean partner countries. The aim of this handbook, which is available in English and French, is to increase awareness and stimulate the further development of the government debt markets of the countries in which FEMIP operates. The countries covered are Algeria, Egypt, Israel, Jordan, Lebanon, Morocco, Palestine, Syria, Tunisia and Turkey.

Based on responses from debt management and other official bodies in the Mediterranean partner countries, the handbook provides detailed information on the management of debt, both short and long-dated, in these countries and at the European Investment Bank. Information is provided on domestic currency and foreign debt as well as on secondary market arrangements. Chapters on the currency regime, market regulations and regulatory bodies as well as on proposed reforms of the markets and trading/settlement conventions are included in the entries for each country. A summary of replies to the questionnaires is provided at the end of the handbook, along with a list of important contacts in each market. ◻

info

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Please consult the Bank's website for any change in the list of existing offices and for details on offices which may have been opened following publication of this brochure.

New EIB publications

November 2005

- Innovation 2010 Initiative
- Sustainable Urban Renewal
- FEMIP and the Mediterranean partner countries
- Environment and sustainable development in the Mediterranean partner countries
- Energy in the Mediterranean partner countries
- Transport in the Mediterranean partner countries
- Private sector in the Mediterranean partner countries
- Investment capital in the Mediterranean partner countries
- Technical assistance in the Mediterranean partner countries

December 2005

- Sovereign Debt Markets in the EU Mediterranean Partner Countries - 2005
- Social and Economic Cohesion
- Guide for procurement of services, supplies and works by the EIB for its own account

January 2006

- COPEC'S 2004 Annual Report
- Corporate Operational Plan 2006-2008

February 2006

- The European Investment Bank in Brazil

Coming soon

- The EIB in the Baltic States
- Small and medium-sized enterprises (SMEs)
- Annual Report 2005

All brochures can be downloaded at www.eib.org/publications.