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Speech at the SUERF conference:

“Next steps toward an innovative Europe”

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Good afternoon, ladies and gentlemen.

I am proud that the European Investment Bank has participated in the organisation of this conference alongside our partners at SUERF, the European Money and Finance Forum, as well as Société Générale and Columbia University. It is my belief that the EIB must constantly cooperate with academia, with think tanks, with investors and bankers. In doing so, we share the knowledge, the expertise and experience that are such vital currencies in today’s fast-changing economy.

The aim of this cooperation today is to facilitate understanding of European issues in the United States. We have brought key Europeans – policy makers, academics, and finance professionals – to the US, because we believe that the economy of the future is one that is shared by all of us, globally. We must all *think* together, so that we can all *prosper* together.

The title of my address is: ‘Next steps *toward* an innovative Europe.’ Perhaps this is too modest. Europe is already a great place for innovation; at the forefront in many areas.

It is also true that this is a moment in which we are facing some dramatic challenges. Indeed, the President of the European Commission Jean-Claude Juncker last month called it an “existential crisis.” One of the biggest economies in Europe has voted to

leave the EU. Politicians all over the continent find themselves pressured by local resentments that are at odds with EU policy on issues of migration and the economy. Societies are under stress, and it seems the EU Member States are pulling in many different directions.

But you need to understand that it is challenges like this that make us stronger and that move the European project forward. When you think about it, the process of political and economic transformation in Europe has proceeded at a tremendous pace in recent years, first the integration of the Eastern Bloc countries, then the introduction of the euro, and then the rapid building up of new measures such as the Banking Union to deepen and strengthen the complete the euro area in the face of an unprecedented global economic crisis. They say “necessity is the mother of invention”, and Europe has been nothing if not innovative in taking challenges as opportunities to build a closer and more effective Union. I have no doubt that this process will continue.

Ultimately, I do believe the current situation is an opportunity for all of us who are committed to the European project. It is a moment to clarify what is most important about the EU. We have many strengths. On issues like social inclusion, economic inequality and the creation of a cohesive society, I think we actually fare very well in international comparison, notwithstanding the real problem of high unemployment and the tensions that exist. We just want to do even better.

But one area where we do lag behind is in competitiveness and productivity growth. We estimate our potential growth rate to be about half of yours here in the United States, and low productivity growth accounts for a major part of that.

Europe does need to get better at innovation. This is particularly the case in strategic areas such as digitalisation where the United States is currently really in the lead.

Innovation is not what it used to be. It is no longer just a matter of coming up with a new product. It is also about how you manufacture it. It is about developing cloud-based control systems to run factories around the world in which the product is made, harvesting economies of scale. Or it is about creating digitalized supply and delivery chains that operate automatically around the clock.

The transformation of manufacturing into a digitalized process is at the forefront of today's remaking of the business world. US firms have a big advantage in the service sector because of their digital advances over the last two decades. Europe arguably still holds a slight lead in manufacturing expertise. Within a few years, however, manufacturing will be fully digitalized too. If we don't innovate our manufacturing quickly with massive investment and a greater appetite for new approaches that carry a high risk—and high potential return.

Let me give you an example. This year we have just funded a German company called Heidelberger Druckmaschinen. It is a world leader in traditional offset printing, but that market is in decline. That's why it's re-focusing on digital printing technologies and digital automation in the printing industry, aiming to become part of the Fourth Industrial Revolution . It's why we are funding R&D by the company to the tune of 100 million euros through the European Fund for Strategic Development – the so called “EFSI”.

US innovation pushed ahead of Europe in the 1990s, with the result that all the companies dominating digital services are American—Google, Amazon, Facebook, Apple. In fact, Europe performs worse than the US across a range of innovation dimensions. The largest gaps with the US are in company spending on R&D and collaborations between universities and industry.

Achieving the EU's objective of 3% GDP expenditure on R&D will require an additional 130 billion euros of annual R&D spending above current levels. Of this total,

approximately 70 billion euros is accounted for by a gap in private sector R&D spending.

We have to get better at linking up universities and business, turning research findings into commercial applications. U.S. universities have long “spun out” their research into separate companies, but in Europe, this is little known outside the United Kingdom. That’s is why I am proud of another venture we have funded through EFSI: Quadrivium 1 is the first French investment fund to provide seed funding for life sciences and digital technology projects that start out at the best French universities. Here we are explicitly learning from what has worked here in the United States.

If we are to build this dynamic, innovative economy, we also need to create a culture in which firms constantly reinvent themselves or replace each other. New firms bring new ideas, products, services and processes into the economy. Old inefficient firms need to make way for younger, more innovative ones. This frees valuable labour and capital resources.

The EU has a larger proportion of stable firms (meaning firms that either *grow* or *shrink* less than 5% a year in terms of employment) and a lower share of fast-growing firms, compared to the US. Allow me to quote a great North American, albeit a Canadian, who said of his success on the hockey rink, “You miss one hundred percent of the shots you *don’t* take.”

If Wayne Gretzky had been an economist, rather than a hockey player, he would have said that the root difference is a less experimental environment in the EU and a slower pace of resource reallocation—both of which are fundamental drivers of productivity growth.

So what do we Europeans need, in order to create an enabling environment for innovation? We must focus on:

- our markets for goods and services;
- our labour markets and the availability of human capital;
- and the ability of productive and innovative firms to finance themselves.

In each of these areas, there is a clear policy dimension, in the form of public investment in infrastructure, growth-friendly regulation of product, labour and financial markets, and the opening up of markets to free and fair competition—both within the EU and with the rest of the world.

The public policy role underpinning innovation growth can be seen in areas of investment that are not often associated with innovation. Transport and storage services account for about 10 to 15% of the cost of finished products in the EU, while traffic congestion costs the EU about 1% of GDP every year. Transport and energy networks represent essential complements for other productive inputs, such as capital and labour.

Yet transport infrastructure in Europe is increasingly strained, because of years of underinvestment. In 2008, annual investment in transport infrastructure was broadly consistent with historical levels of about 1% of GDP. However, investment fell during the crisis, creating a backlog. It is now estimated that investment needs to double to 160 billion euros a year until 2020 at minimum, if we are to address the backlog and regain historic investment levels.

Infrastructure is also the key to competitive energy access, alongside the shift to a low-carbon economy. The secure supply of energy at reasonable prices to industry and households is crucial to Europe's competitiveness. Sustained and well-targeted investment is required to achieve sustainability and security and yet put downward pressure on prices.

We do need to reduce market fragmentation, which in turn leads to inefficient allocation of productive resources. This hinders innovative start-ups when they try to become bigger. European businesses have difficulties in scaling up.

Market fragmentation hampers fixed investment through two channels. The first channel is by reducing the size of the potential accessible market for any one investor. This is particularly acute in the case of the riskier investments that characterise innovative start-up companies and investments in new technologies. Without a big end-market to exploit, it is harder to recuperate large and risky up-front investments in new production capacity and R&D. Perhaps it is even so hard that those investments may never be made in the first place. Even though the total European market is substantial, in many industries it is served by a larger number of firms with regional or national focus than would be the case with a truly unified European market.

The second channel through which market fragmentation may impede investment is by hampering cross-border competition, creating markets where local players enjoy a more protected position. Evidence of market fragmentation in the EU can be illustrated by a comparison with intra-US trade. Trade in manufactured goods *between* EU countries stands at just over 20% of GDP. Compare that to 35% between the states in the United States. Similarly, consumer prices differ around three times as much across EU countries as they do across US states.

Moving beyond national boundaries is vital in digital markets. The digital economy contributed \$2.3 trillion to the G20's GDP in 2010. By the end of this year, estimates show that figure at \$4 trillion. By 2020 it is expected to have reached \$6.6 trillion, or 7% of GDP. The digital economy has become a global engine for growth with tremendous potential.

Transition to a truly digital economy implies a shift away from the local or even national provision of goods and services. Instead, it means pan-European or global coverage, not only for manufacturing firms, but increasingly also in services.

The extent of this challenge is considerable and the details involved are profound. The so-called Digital Work Package of the current Slovak Presidency of the EU includes no fewer than 15 objectives, ranging from the modernisation of the value-added tax system to account for the digital economy, to harmonising market regulation for 5G telecoms, and on to stronger privacy protections. These are not all headline-grabbing issues, perhaps, but they are vital to Europe's economic future.

Realising the single market in goods and services goes hand in hand with realising the digital economy. The digital market remains fragmented, too, however. This undermines investment in new ventures that would become profitable only if they reach a market of sufficient size. To rectify this, more effective data-protection security measures are needed on a pan-European level, with a regulatory framework for the digital economy that establishes technical and legal security and privacy standards.

Market structure and financing are important to innovation. But ideas are most important of all. In this, too, Europe has lagged behind the US.

The demand for young people with excellent post-secondary training and a skill-set that fits the needs of future jobs will increase. Skills in high demand will be in areas that support the application of new technologies such as IT, robotics, or medical technology.

Yet the EU spends significantly less on education than the US. Expenditure per pupil in the US is 40% higher for schools and double for tertiary education. Even by conservative estimates, closing the gap with US funding levels would require an additional 100 billion euros per year. Most of that would be for university education.

So, you see, it is possible to define some clear steps that need to be taken to great a more innovative European economy. It is even possible to put a price tag on some of these steps, in terms of the huge volumes of investment that will ultimately be needed.

Perhaps the numbers involved seem daunting. But the good news is that European countries are working together to take bold action.. I am proud to say that the European Investment Bank, is really at the heart of these efforts. We are uniquely positioned to collaborate with Member States and other EU institutions to build the innovative future we all want.

The EIB is the EU Bank. We are owned by all 28 Member States, financing and supporting priorities set by the EU.

We are the largest multilateral lender and borrower in the world. We have a balance sheet of around 570 billion euros, lending 78 billion euros last year. This lending will support an even greater investment in the real economy—around 230 billion euros.

Though we are accustomed to dealing with tremendous sums, we have recently drawn even greater confidence from our ability to respond to a massive challenge presented to us by the policymakers and Member States. Let me tell you that story.

In late 2012, our shareholders voted for a 10 billion euros capital increase. They asked us to play a stronger role supporting investment in Europe. Those 10 billion euros allowed us to lend an extra 60 billion euros by April last year, enabling an estimated extra 190 billion euros of investment projects to take place.

We delivered the investment that was asked of us, and we believe the impact has been profound. Our total lending supported 372 billion euros of investment between 2013

and 2015. Our preliminary estimates suggest that this may increase the EU's GDP by around 1.1% by 2030, adding about 1.4 million jobs.

This long-term effect chiefly results from the productivity-enhancing effects of investments in areas like transport networks and R&D.

We are currently working to replicate and, indeed, surpass the success of this capital increase with EFSI – the European Fund for Strategic Investments – which is a pillar of the EU's Investment Plan for Europe. With the backing of an EU budget guarantee and our own resources, we are aiming for a similar multiplier to the one at work in the capital increase. The target is EUR 315 billion of investment enabled over three years. This will complement standard EIB lending of around EUR 150 billion, enabling a further EUR 450 billion of investment to go ahead.

This initiative is highly significant because it specifically and precisely targets investments with a high socio-economic return in sectors that are crucial for EU competitiveness—small and medium-sized enterprises, innovation and critical infrastructure linkages. One EFSI project that is close to my heart is Énergies POSIT'IF, a public-private company that aims to renovate thousands of condominium buildings in the Île-de-France region to make them more energy efficient. Think about it: this cost-cutting investment is not only good for the climate but good for competitiveness. EFSI funding is enabling Énergies POSIT'IF to make loans directly to the owners of each apartment, making the company a one-stop shop for renovation. This is relieving a market failure because previously, matching individual apartment owners with banks for loans for small renovation loans was just too costly.

EFSI is a way of using EU funds better. Instead of giving out grants and subsidies, it provides guarantees and loans, leveraging private investment and multiplying the impact that can be achieved with scarce public resources.

The EFSI guarantee allows us take on more risk to crowd-in private investors and mobilise additional capital while providing a stamp of quality on long-term strategic projects.

This summer, after its first year of operations, EFSI had already sparked investment with the potential to trigger the first 115 billion euros of its target. It is a major achievement for the EIB Group that in that period we put together 289 approved transactions in 26 EU countries, potentially sparking 37% of the full 315 billion euros envisaged. So far these transactions have hit every one of the target sectors—with investment mobilised in the energy sector, RDI, and digital. Smaller businesses account for 25% of the total additional investment expected. We are confident we can continue to build its impact.

I am happy to say that policymakers share our view on the critical importance of investment and the centrality of the EIB to Europe's response. In his State of the European Union speech last month, President Juncker proposed to extend EFSI to at least 2020, taking the target for investment mobilised to half a billion euros, with a proportional increase in resources made available to the EIB and encouragement for Member States to contribute further financial resources to the plan. Indeed, Juncker even proposed that EFSI eventually be doubled – to 630 billion euros of investment by 2022.

European economies need certainty about policy. So I am glad that things are moving forward fast. Following the independent evaluation of the first period of EFSI that is taking place, we will hopefully have a final decision on the extension of EFSI in December.

Having started my talk by saying that its title was 'Next *steps* toward an innovative Europe,' I would suggest that perhaps I was too conservative. I dare say that a projected investment of well over a half-trillion euros should not be called a step. It is, in fact, a

great leap. By the time that leap is completed, Europe's economy will look very different to the way it does today. I am confident that we shall have a good landing.

Thank you very much.