The Growth Initiative:
Further report to ECOFIN prepared by the EIB

1. Based on the European Council of Thessaloniki conclusions, the EIB prepared a Memorandum dated 11 July in view of the ECOFIN meeting of 15 July on "The EIB's role in promoting long-term growth through investment in TENs and major R&D projects" (cf. Doc. ECOFIN 210, Nr. 11399/03). ECOFIN mandated the Economic and Financial Committee to prepare an assessment of the overall situation and requested further reports from the Commission and the EIB which should be ready in time to allow the EFC to assess these reports and to prepare further ECOFIN discussions at its meeting of 7 October, so as to report to the October European Council meeting. A final report should then be prepared in view of the ECOFIN Council of 25 November and the European Council of 12-13 December.

2. This second report provides such additional information from the EIB. It has been prepared in consultation with the responsible services within the Commission and it should be read as a complement to the Memorandum produced on 11 July. It provides an interim assessment of the situation and may be further substantiated over the next couple of months.

In sum, the report confirms the availability and readiness of EIB to support the financing of projects in the TENs and Research, Development and Innovation (RDI) areas relevant for the growth potential of the EU. It is important to stress, however, that, beyond this support, implementing such perspectives requires a full mobilisation of all relevant participants, whether public or private. In particular the role and responsibility of governments remain crucial in this respect.

3. The report to ECOFIN consists of three components:

- A cover note summarising the main findings and developing some horizontal considerations
- An attachment on the EIB's potential for reinforcing support to TENs
- An attachment on the EIB Group's support to RDI

4. The **main points on TENs** are as follows:

- The EIB has been a major source of finance for TENs. It is involved with 12 of the 14 Essen priority projects as well as most other large transport projects contributing to the implementation of the TransEuropean Transport Network. Over the last decade some 50 billion euros of loans have been approved for TEN transport projects inside the Union; a further 10 billion euros of loans have been approved for projects in the Acceding Countries. The EIB has also contributed substantially to the financing of private sector participation in infrastructure both through its financing for PPP Infrastructure projects (over 10 billion EUR in recent years) as well as through its development of guarantee mechanisms and its Structured Finance Facility (SFF) for Infrastructure.

- The TIF (TENs Investment Facility) part of the Memorandum already outlined to ECOFIN builds on the extensive expertise established by EIB in the infrastructure sector and proposes material enhancement for EIB support for the financing of TENs, in collaboration with the Commission, Member State public authorities and the private sector developers and financiers, through a commitment of an up to EUR 50bn financing facility for TENs for the period up to 2010. A key objective of the TIF is that it seeks to create increased leverage for EIB financing through more carefully targeted

prioritisation of TENs projects as well as a more targeted development and application of financial instruments. The TIF proposals also take full account from the lessons learnt from the past, notably the current unsatisfactory state of development of the Essen priority list projects and the characteristics of congestion and inadequate facilities that currently mark the TENs more generally. Financing issues can only explain part of the existing backlog of investment in TENs, in particular for the 14 Essen priority projects; delays have been more often caused by a lack of consistency in the definition of projects as well as administrative and institutional barriers.

- The future TENs strategy must ensure that projects are technically sound, and economically and financially viable. Projects need to be supported by real and binding commitments of national authorities to solve associated problems of a legal, administrative and technical nature, in particular for cross-border projects. The European dimension must be reinforced. A more precise identification of costs and benefits at a broader level may help to identify new ways of finding the right financing scheme for a particular project.

- It should also be emphasised that a sound TENs strategy should go beyond projects on the Essen list to include support for investments across the broader TENs network. Though often smaller in scale, such investments may have equally strong European interest as some of the very large "missing link" projects. It may also be possible to accelerate some of these smaller investments more rapidly than very complex large projects due to the institutional issues mentioned before.

- Private sector participation and financing in TENs projects can be increased and every effort, as outlined in the TIF Facility, should be made to do so through the appropriate application of PPPs and other instruments where this is necessary to ensure the development of the TENs network. However, it should be recognised that the bulk of finance, notably for major cross-border projects, will have to come from public sources (whether via grants or guarantees). For its part, the EIB stands ready to provide its full support to the development of TENs. Within the context of its current TIF plans, EIB envisages lending up to 50 billion EUR for these projects by 2010. Apart from providing appropriate financial support, the EIB is also able to contribute to the speeding up of TENs projects by sharing its expertise with public bodies during the planning and preparation phase of projects.

- Any European Action for Infrastructure should be seen within a **pan-European context** and encompass the new EU-25 and the remaining Accession Countries, the Western Balkans and the New Neighbours (incl. Russia). Along the lines of the present EU policy, a differentiated but still fully integrated and coherent approach is required.

5. The **main points on RDI** are as follows:

- The EIB Group has a solid track record in financing RDI and a strategic base for pursuing it with its Innovation 2010 Initiative (i2i), itself based on the Lisbon process as well as the Barcelona objective to reinforce R&D and innovation. In total, EIB intends to mobilise lending of up to 50 billion EUR for i2i over the decade, of which some 40 bn over the period 2003 - 2010.

- EIB lending supports RDI in the private and public sector, related to infrastructure or to research activity (intangibles), both of small and of large/corporate entities. EIB cooperates with other entities, notably the Commission, and it actively promotes new partnerships as well as the development of its lending instruments.

- Particular attention is given to the private sector (itself called upon to double its RDI investment over the decade) and also to identify RDI operations in the EU's less developed regions as well as in the new Member States.

- The EIF stands ready, within a difficult market context, to reinforce its support to SMEs, notably as a fund-of-funds in the venture capital field, as well as through guarantees to cover SME loan portfolios of banks.

6. The EIB's support both to TENs and to RDI has to be integrated into its **overall lending priorities and resources**, and it obviously has to be conforming to sound banking rules as well as to its vocation as a policy driven public bank. The following considerations should in particular be mentioned:

- The question has been raised if the EIB's contribution to the Growth Initiative would impact on the EIB's capital and reserve requirements, i.e. whether the envisaged lending volumes from 2003 onwards (50 billion for TENs as well as a further 40 billion for i2i, until the end of the decade) could imply the need for an acceleration of the next capital increase planned for the EIB; it is recalled that the latest increase came into effect on 1 January, 2003 and that it should last for at least 5 years, as decided by the EIB Board of Governors. This imperative is reflected in the Bank's 3-year rolling planning process, the Corporate Operational Plan (COP), which limits lending within the EU-15 to a nominal increase of 5% per annum. However, it should be stressed that the envisaged contributions within the Growth initiative are compatible with the current COP as well as the present capital increase scenario. Should, however, the Member States require the Bank more strongly than currently envisaged under the Growth Initiative to increase its commitments in either of these areas, then an acceleration of the next capital increase or a more substantial re-prioritisation of lending by the Bank would need to be considered.

- The issue of prioritisation between lending objectives derives from the already mentioned ceiling for lending operations within the EU. Accordingly it becomes increasingly delicate to balance alternative lending priorities, notably if they tend to exclude each other. The issue is presented in the RDI paper for the case of regional versus innovation lending, and for the latter in relation to keeping corporate lending within tight limits; the case of TENs, though probably less conflictive, may raise similar trade-offs, notably in relation to regional lending.

- Another prioritisation issue relates to the use of annual surpluses, either for general reserves (which can then permit over time a self-sustaining process of capital increases through transformation of reserves into capital), or for dedicated reserves, e.g. for reinforcing the capacity to undertake more higher risk operations within the Structured Finance Facility (SFF), or for reinforcing mandates given to the EIF. The alternative nature of the different uses of the annual surpluses needs to be kept in mind; however, the practical importance of any trade-offs depends on the actual figures in play that in any case must be approved by the Bank's Governors.

- An additional question raised by ECOFIN in July related to the likely impact of the Growth Initiative on the EIB's credit rating. EIB strategy in general is designed to maintain EIB's position as a leading AAA-rated non-sovereign benchmark borrower, and its sound reputation in financial markets. This is reflected in its credit policy guidelines. The Bank has autonomy over its decision-making processes, and supports only investment projects that its appraisal shows to be technically sound, and economically viable. It is thus to be expected that whatever efforts the Bank undertakes in promoting long-term growth through investment in TENs and RDI projects, will be implemented in

such a way as to have a benign impact on the EIB's existing AAA credit rating. The additional proposal in the Bank's Memorandum to consider strengthening the Structured Finance Facility does not change this assessment. In line with normal banking/ credit worthiness principles, operations under SFF are linked to the constitution of dedicated reserves through annual allocations of the Bank's surplus, and for a given reserve, the volume of possible operations depends on the risk profile of the products. The increased risk entailed by SFF is thus contained through a dedicated use of part of the surplus and hence does not endanger the EIB's credit rating.

7. The EIB Group stands ready to play a substantial and positive part in the Growth Initiative. But its resources and capacity focus primarily on financing issues. In a number of cases, though, the prime bottleneck is not the lack of (loan) finance; it rather relates to the overall **legal, administrative or technical framework**, or to a lack of **grant financing** to bridge the gaps between economic and financial returns of projects. This is notably highlighted in the attached paper on TENs, but similar arguments could be presented for RDI activities (as indeed set out in the Action Plan to reach the Barcelona objective). Therefore, the Bank's action can only be fully effective if it is complemented by improvements in the framework conditions, which are beyond its own control. Some of these issues must be tackled at an EU level, but often the role of the Member State is even more decisive.

8. Co-financing between the EIB and other sources of finance is the normal pattern for most EIB loans, whereby EIB acts in partnership with others borrowers, within syndicates or through intermediaries. An additional dimension relates to **co-financing between EIB loans and EU grants**. Again such co-financing occurs regularly, within mandates for EIB lending outside of the EU but equally within the Union, notably with the EU Structural Funds (specific Cooperation Agreements exist with ERDF, Cohesion Fund and ISPA), and also with other sources, like the TENs budget line. Efforts are ongoing to further develop co-financing with Structural Funds, notably in the new Member States, and to extend such schemes also to other EU budget sources, like the FP6 resources for R&D.

In practice, co-financing with the Commission can be complex as both institutions apply different criteria and procedures (part of which reflect the inherent difference between grants and loans), or because the grant applicant/borrower contacts the various funding sources at different stages of the investment cycle. Also, procedures for applying for grants can vary, depending upon the programme in question and its underlying objectives. Coordination and, where possible, harmonisation of procedures can help to some extent; moreover, **complementary financing**, whereby for instance grants support an earlier phase in an investment process, and EIB loans a subsequent, later stage, may often be a perfectly viable alternative. In all cases it is important that in particular grant finance, as the comparatively scarcer source of funding, be used only to the extent that it can be justified on the base of the project's specific cost and revenue characteristics. This allows loans (from EIB or another source) to be deployed in a way to maximise the leverage effect of the existing grants. In some cases, available grant support may exceed the desirable level, in others, the contrary rather seems to be the case. As stressed in particular in the annexed TENs paper, certain types of investment can only be developed on the base of significant grant support (whether from EU or national sources), as it is unlikely otherwise that private capital will take a firm commitment to invest in them. Further progress should be achieved in co-financing (and in complementary financing), in order to generate a maximum impact on the ground.

Attachments: 2

Attachment 1

TIF – TENs Investment Facility

1. Introduction:

1.1 This note has been prepared as a complement to the EIB Memorandum to ECOFIN of 11th July in order to respond to various issues raised by the ECOFIN Council on the TENs Investment Facility (TIF). It is also to be read as a complement to the proposals being developed by the Commission which address other strategic aspects of the development of TENS, including the work currently envisaged by DG TREN on the prioritisation of the TENs investments outlined in the recent Van Miert Report.

The EIB Memorandum on TIF submitted to ECOFIN in July presented the five main "Building Blocks" that could be undertaken by the EIB in support of the TENs growth initiative; this initiative is based on enhanced co-operation being developed with the Commission and the Member States as well as the Private Sector promoters and financiers.

The purpose of the TIF initiative is threefold:

1) To foster the investment in the implementation and operation of TENs in a more co-ordinated manner with the Commission and Member States by the development of an integrated series of measures which would aim at resolving the fundamental issues that have adversely affected the development of the TENs Network, notably in the EU as well as in Accession and neighbouring countries over recent years.

2) To increase the EIB resources available for the development of TENs transport for a sustained period up to 2010.

3) To improve the range of financial instruments available from the Bank, in collaboration with the Commission, Member State authorities and private sector in the most cost-efficient manner for the public and private sector partners.

2. Main Challenges to the Achievement of the TENS Transport Network

2.1 The ECOFIN Council requested an analysis of the obstacles to the development of the TENs Transport network which is characterised by a worrying increase in congestion due to the persistence of bottlenecks and of missing links and a lack of interoperability. These characteristics are well known and have been described in a comprehensive manner in the Van Miert and other major reports. The prospect of enlargement accentuates the need for a more substantial approach to preserve the competitiveness of the European economy and to guarantee a balanced and sustainable development of transport. A new impetus is therefore required to create a more effective trans-European network.

2.2 The past decade saw not only a worrying increase in traffic congestion in urban areas, but also a new phenomenon of congestion on the major arteries of the trans-European network, increasing the number of bottlenecks. Missing links in the infrastructure, and a lack of interoperability within specific transport modes and for intermodal transport systems, are all reasons aggravating this congestion of the network. In addition, the peripheral regions still suffer from isolation due to a lack of connections with the centre of the continent, and also congestion on the central parts of the network. The peripheral countries of the European Union are thus directly affected by the deterioration of traffic conditions in transit countries.

2.3 Background to the Development of TENs

The idea of Trans-European Networks (TENs) emerged within the EU by 1990 in conjunction with the proposed Single Market, characterised by freedom of movements for persons, goods and services. Linking various regional and national energy, telecommunications and transport networks by modern and efficient infrastructure was seen as one of the key conditions for achieving the Single Market and improving competitiveness. The TENs policy aims to coordinate the planning of international infrastructure networks across the EU without, however, defining technical standards. The decision to launch the TENs was taken in the context of the Delors White Book on Growth, Competitiveness and Employment (1992), with a mix of short-term and long-term motives. As regards transport, a list of 14 priority projects were adopted by the European Council in 1994 in Essen and two years later, in 1996, the European Parliament and the Council adopted Guidelines for the development of Transport European Transport Networks - TEN-T - (road, rail, inland waterways, seaports, airports and combined transport). These Guidelines are basically a declaration of intent by the Union for the development of an integrated, multi-modal transport network to meet the needs of the transport sector by the year 2010.

Development plans for the Eastern part of Europe started with the first Pan-European Transport Conference in 1991 in Prague with the objective of identifying Pan-European Corridors and concentrating efforts on these corridors. The Prague conference was followed by two further Pan-European Transport Conferences (Crete in 1994 and Helsinki in 1997). Ten long-distance transport corridors were defined. In 1996, in addition to the promotion of the Pan-European Corridors, the Commission also set up a process to assess the long term needs for transport infrastructure in 11 applicant countries[1] (the "Transport Infrastructure Needs Assessment" or TINA). The idea was to co-ordinate infrastructure development projects in these countries with those implemented/planned in the EU, with a view to implement a coherent Trans-European Transport Network in the future enlarged EU. The so-called TINA network is composed of a backbone network, which is identical with the ten above-mentioned Pan-European Transport Corridors on the territory of the TINA countries, and additional network components linking up to the main corridors as proposed by TINA working groups. The TINA network comprises 18 000 kilometres of roads, 20 000 kilometres of railways, 38 airports, 13 seaports, and 49 river ports for a total investment of about 100 billion euros.

2.4 Obstacles to the Development of the Essen / TENs Network

10 of the 14 Essen Priority projects are expected, on current timetables, to be completed and in operation by 2010. To date, only 3 of the 14 Essen priority projects are fully operational and about one third of total investments necessary to complete the Trans-European Transport Network have been realised (see attached table). This means a significant delay compared to the agreed timetable.

Looking more carefully at the implementation speed of projects, it appears that national governments favoured the development of projects of an immediate national interest rather than projects with a wider European interest, which may be far more profitable if a broader point of view were adopted. This tendency was often reinforced by the mismatch between costs and benefits, as the true beneficiaries are not the same actors as those who have to pay for the investment.

[1] Bulgaria, Poland, the Czech Republic, Hungary, Slovenia, Estonia, Cyprus, Latvia, Lithuania, Romania and Slovakia

The limited size of EU budgetary resources specifically allocated to TEN projects[2], together with an inability to mobilise enough public money at the national level has often been a major blocking factor particularly as major transport infrastructure projects require in most cases a significant level of subsidisation. By their very nature indeed, these projects yield a much higher economic than financial return. This implies that, unless projects are delayed or significantly scaled down, the direct contribution from users in most cases can only cover a portion of initial investments though certain projects could make a more material contribution to their cost if the public authorities were prepared to seek an increased direct payment by users. This financial gap can reach significant levels (up to 80%), in particular for projects yielding large external benefits.

However, financing issues can only explain part of this existing backlog of investment in TENs, in particular for the 14 Essen priority projects; delays were often caused by a lack of common priorities and timetables as well as technical and administrative complexities, the roots of which are to be found in failing co-operation between national public authorities and inconsistencies in the identification of priorities at European level.

As regards the Essen projects, the experience so far has shown that they did not share any common concept. Rather than a calibrated set of major projects glued together by a common logic, it was a collection of current national priorities. Besides, the projects were entirely different in terms of dimension, degree of definition and preparation, size and scope. The result of that lack of internal logic and coherent approach was uncertainty and unpredictability. The uncertainty about the technical description, the costs and benefits of the projects (in particular their European interest), the real deadlines for their implementation and their financial framework brought about unpredictability of the overall outcome of the strategy, as has been amply demonstrated by the experience until today.

The TEN-T guidelines, set up in 1996, were elaborated within a more consistent framework but they were still driven by national interest and did not really prioritise projects according to the degree of their European interest. The whole process came out with a very extensive set of selection criteria, which lead to a wide range of eligible projects and reduced the leverage effect of Community action, in particular on financial issues.

2.5 **Need for a new ambitious but more focused TEN strategy**

The on-going review of the TENs strategy, of which the Van Miert Report is but the first element, aims to deal with past difficulties by inserting a more consistent set of selection and evaluation criteria of projects, by setting out more appropriate financing mechanisms and by creating adequate frameworks for cooperation on cross-border projects.

The future strategy must ensure that selected projects are economically viable on the basis of analysis of the socio-economic costs and benefits. Projects need to be supported by binding commitments of national authorities to solve flanking problems of legal, administrative and technical nature, in particular for cross-border projects without which the economic profitability of the projects diminishes or vanishes completely. Projects need to be technically sound and may need to be phased in their dimensioning if this is necessary to improve economic viability. In addition, in view of the limited availability of public resources at national and Community level, investments will have to be strongly prioritised so that those that contribute most to the TENs policy objectives are favoured.

[2] About 600 millions euros per year from the TEN budget line - maximum 10% of total project costs, but on average much less - plus 50% of Cohesion Fund resources, which involve a higher amount - up to 1.5 bn euros par year - but are more restricted geographically. ERDF resources for TENs are quite modest.

The strategy also needs to reinforce its European dimension by focusing support on projects of clear European interest. A more precise identification of costs and benefits at a broader level may help to identify new ways of finding the right financing scheme for a particular project. It should also be considered whether there is a need and scope for strengthening the capacity for public financing at the European level, even in the face of the current budgetary constraints, in order to have access to more catalytic power for true European projects.

Various solutions have been proposed on this issue such as a European fuel tax or, in sensitive areas, cross financing schemes from road to rail similar to the Swiss mechanism. Private sector participation can also, to a certain extent, reduce the need for subsidies by enhancing users' contribution through commercially oriented management and by optimising financing structures, but it cannot change the fundamentals of projects[3].

A particular effort will have to be devoted to the development of TEN-T in future Member States. The Accession negotiations confirmed the importance of needs regarding transport in the acceding countries. The effects of enlargement on the trans-European transport network are not limited to those parts of it located in the future Member States. The integration of markets will be accelerated by enlargement and this will lead to the generation of new traffic flows on the network of the current Member States. Some of the existing peripheral Member States will benefit from new intra-EU connections with central areas, for instance through the Baltic states or the Eastern Balkans.

In the context of an enlarged Union, it is even more essential that the future TEN strategy, which will replace the Pan-European corridors and TINA network in the new Member States, be based on well-defined projects of true European interest selected in accordance with sound economic selection criteria.

3. Next Steps – Development of an Enhanced TENs Network

3.1 The Van Miert Proposals

The European Commission established in late 2001 a High level Group of representatives of the Member States chaired by Karel Van Miert to examine and recommend to it a strategy for the development of the priority projects for TENs up to 2020 which would be based on proposals from the Member States and Accession Countries.

The conclusions of this Report, submitted to the Commission in June 2003, endorsed an ambitious development programme for TENs over the long term to 2020/2030 and beyond, the estimated total cost of which is EUR 600 billion.

A summary of the key elements of the TENs Investment Programme as well as the changes and reforms, particularly to the financial and legislative framework, as proposed by the Van Miert Group are summarised in Appendix 2.

The Community framework to address these issues in support of the national and various sectoral frameworks already exists and has been used. The Treaty of Maastricht gave the European Community "competence" on the Trans-European networks and instruments for

[3] The main reason for private sector participation into the development of public infrastructure is to provide improved value for money. Accounting aspects (classification of assets off or on general government balance sheet) can also become important in case of tight budgetary constraints, but are not considered the appropriate driver for PPP policy (60% of UK PFI projects are still on the general government balance sheet).

their development. In accordance with Article 154 of the Treaty establishing the European Community, the Community contributes to the establishment and development of trans-European networks in the sectors of transport, telecommunications and energy infrastructures. The role of EIB within this framework is clearly established as one of the substantial sources of finance for both the public and the private sector

The Van Miert Group stressed the crucial role of the EIB through its lending policies. It suggests developing the financing capacity of the Bank through various financial engineering techniques in particular for cross-border projects. Moreover, it suggests that the EIB strengthen its links with the European Commission.

Without neglecting the funding of other projects of common interest in the transport field, the Group also recommends that the Commission and the European Investment Bank concentrate their financial efforts as far as possible on the priority projects.

The Van Miert Group also called for initiatives to promote the further development of public-private partnerships; an appropriate legal framework, particularly as regards concession rights and charging for infrastructure use, should be introduced throughout the Community. It also called for new guarantee mechanisms to be set up.

The Commission will now conduct a detailed assessment of the Van Miert proposals and propose a revision of the decision on the guidelines for the development of the Trans-European transport network in the autumn.

3.2 TIF: Financial Resources and Instruments

The EIB envisages enhancing its support for the development of the TENs under TIF through its development of five main “Building Blocks”:

3.2.1 Long-term loans, for which a realistic objective of EIB loans up to EUR 50 billion by 2010 for investment-grade projects under the TENs Investment Facility (TIF) has been indicated. EIB has made a strong recommendation that projects should be prioritised by Member States authorities and the Commission according to their overall economic viability. EIB had also stressed, given the limited public sector financial support currently available for TENs investment, that particular priority should also be given to the development of economically viable projects which are of Investment Grade and which could potentially increase the availability of financial resources (whether debt or equity) from the Euro and other markets. This could also, in general, increase the opportunities for private sector participation both in the development and/or operation of the projects themselves as well as in their financing without or with a reduced need for public sector underpinning.

EIB lending for infrastructure is done through extensive collaboration and co-financing with other public and/or private sector sources, paying due account to the principles of complementarity and subsidiarity. EIB can play a Value Added role in the overall structuring and financing of TENs, notably for the public sector but also the private, through its extensive due diligence and through the catalytic effect it has on the financing and support of such projects by third parties.

EIB also considers that the Member States and the Commission should seek to create the conditions under which transport entities can make substantially greater use of the Euro banking, capital and insurance markets for financing TENs so as to increase the non-public sector resources available for investment in infrastructure. EIB is seeking to do what it can to facilitate this development through co-financing arrangements as well as product innovation in the banking and capital markets. One key criterion, in the majority of cases, to facilitate greater EURO market institutional participation is that the project financing

instruments should be acceptable in the financial markets, which in the case of Senior Debt means that it should be capable of becoming Investment Grade Debt in its own right or otherwise benefit from third party or public sector support that would give it such status.

The importance therefore of prioritising economically viable projects of Investment Grade status is justified by not only the benefits that arise from such investments in their own right but also the benefit they create through reducing or spreading over time the need for comprehensive public sector support.

EIB shares the broad endorsement given by the Van Miert Group Report to the further development of PPPs throughout the EU and Accession countries as an additional instrument for improving/increasing private sector participation in the development of TENs in appropriate circumstances.

EIB, which has approved loans of over EUR 10 billion to PPP Infrastructure Projects in recent years, would also underline the importance of using PPPs only in circumstances when they are well suited; PPPs are not a panacea that can be used in all situations. As this is not the appropriate place for an extensive review of the merits or otherwise of PPPs, it suffices to say that the choice of procurement method (whether the traditional approach or PPPs/BOT, etc.) should be decided by key public procurement criteria such as Value for Money; Affordability; and Feasibility as well as the more standard issues of Public Accountability and Public Policy objectives.

Although the use of PPPs for infrastructure procurement is yet at an early phase in many countries, experience to date in those countries that have utilised them extensively gives grounds for belief that, with appropriate management and regulation by the public and private sectors, they can make a material impact on the accelerated provision and quality of infrastructure and services. EIB is prepared, in association with the national authorities, to share its experience and expertise in the development of PPPs both at policy and at project level where appropriate.

3.2.2 Establishment of a guarantee system for TENs.

The EIB Group already has an established track record in providing and monitoring guarantees for TENs projects. EIB is authorised under its Statutes to issue guarantees as well as loans. Examples of such guarantees include transport, communication and energy TENs projects. Such guarantees have to be backed by the same security as EIB loans (third party guarantee, reliance on promoter balance-sheet or project assets and revenues) and are subject to the same gearing ratio as loans (1:2,5). EIB may also issue guarantees under its SFF Facility. The EIB has also taken over and manages the outstanding TENs guarantee liabilities of the EIF.

The availability of an EIB guarantee for investment grade projects should enable EIB to maintain its existing risk profile while transferring the funding role to third parties while nevertheless giving a clear signal of continuing EIB support for TENs.

The accelerated implementation of the BIS decision (already proposed) to reduce the risk weighting attached to the EIB (and other IFIs) guarantees to 0% merits attention and priority as it would also reduce costs of financing, and facilitate the development of guarantees in the capital and banking markets; this would give an additional impetus to the development of the guarantee market as it would increase the synergy and cost competitiveness of EIB guarantees compared to the recent past as well as provide much needed additional capacity to enable EIB to co-guarantee financings with other guarantors or financiers (see Monolines below).

The use of capital and banking markets for TENs financing will be facilitated once guarantee instruments are more widely available as they will reduce the cost of finance and/or increase the coverage of risks.

The availability of guarantees from EIB and commercial market sources will in large measure be influenced by the quality of the underlying credit (whether Investment Grade or not) and, in the absence of such rating, by the availability of public sector underpinning.

There has been a pronounced development in the provision of guarantee facilities for infrastructure by commercial institutions in recent years, notably by the monoline insurance companies. There would seem to be further scope for the development of this market, notably for investments that are or are capable of becoming Investment Grade credits over time.

The public authorities could facilitate the development of this market by various mechanisms which widen the range of options for the public sector to provide necessary support, but which do not constitute comprehensive financial guarantees. Examples are:

- Capacity payment mechanisms where payment is based on the availability for use and performance of the infrastructure or service required. Examples in the rail sector are the High Speed Train (HST) in the Netherlands. Examples following similar lines in the road sector are the SCUT Shadow Toll Road project in Portugal or the DBFO Capacity Payment Road projects in the UK.
- Minimum traffic/revenue guarantees where Member States/Public authorities underwrite the minimum volume of traffic/revenues that will be paid for by the public authorities: examples include the Rail Minimum Usage contract by SNCF/NTR for Eurotunnel and the minimum passenger usage by the UK authorities for CTRL.

EIB considers that the current proposal from the Commission (which is being communicated directly by the Commission to the EFC) to establish a new financial instrument to provide partial guarantees on a matched basis with the Members States in respect of Capacity Payment Mechanisms or Traffic/Revenue guarantees as outlined above, is interesting and merits further consideration.

The impact of such guarantee mechanisms on the Public Sector Deficit is controlled by Eurostat in accordance with the rules of ESA 95. The stabilisation and clarification of these rules through Eurostat is a further area of potential importance and merits additional attention in view of its potential impact on the infrastructure sector as well as financial market and public sector financing generally.

3.2.3 Development of a Structured Finance Facility - SFF

The EIB Governors authorised in 2001 the main elements of the necessary framework for EIB to implement the Structured Finance Facility. Under this Facility the Bank has been authorised to provide different financial products (senior debt, subordinated debt, mezzanine and quasi equity) the credit profile of which is lower than the standard senior debt normally provided by EIB. It was foreseen that SFF products could be applied both to i2i and TENs operations.

Sufficient market experience has been gained to satisfy the Bank that, in the context of TENs, the demand for SFF is potentially significant in private sector/PPP financings. From a policy point of view, SFF is particularly valuable as it has a high value added, is generally used in limited amounts and therefore has a high leverage factor.

It is also clear from the initial operations completed to date, though limited in number and amount, that the SFF can be an appropriate instrument for infrastructure development in collaboration with other market and financial intermediaries, particularly in the context of PPPs.

EIB has now in place the core methodology and risk management framework it requires for the further development of SFF operations and expects to be able to make full use of the reserves already committed to SFF as well as the quasi-equity facility of up to EUR 90m available to EIB under the TENs Budget.

As far as potential future volumes under SFF are concerned, they are limited through the constitution of a dedicated reserve by annual allocations from the Bank's surplus (to be decided by its Board of Governors) and, for a given reserve, depend on the risk profile of the products. Under present rules and within existing decisions, the available global financing capacity under SFF could be up to 2.3 billion. Further increases would necessitate lessening of capital allocation requirements and/or additional annual allocations from the Bank's surplus. An allocation to the SFF reserve in the order of 200 millions allows for up to EUR 1.3 billion in new SFF operations under the present capital allocation requirements.

The EIB Board will in due course consider, for submission to the Board of Governors what level of reserves should be committed to SFF as part of the overall TIF and Growth Initiatives.

It should also be noted that SFF is potentially valuable as a financing instrument for smaller infrastructure projects as well as for large ones. There is already evidence of potential demand from financial intermediaries which are prepared to establish quasi-equity funds for smaller infrastructure projects on a co-financing basis with EIB. Such investments may have equally strong European interest. Moreover, it may be possible to accelerate some of these smaller investments more rapidly than very complex large projects due to the institutional issues mentioned above.

3.2.4 Securitisation in the field of infrastructure.

Securitisation is becoming an important tool for financing infrastructure at all levels, both for the public as well as private sectors. Securitisation of infrastructure is a rather technical domain and is based primarily on cash flow from projects (with or without guarantee support from third parties/public sector). It quite different from securitisation of consumer receivables, SMEs, etc, each of which have been developed using their own specific techniques and risk assessment/management systems.

EIB already has experience in securitisation in the infrastructure sector where PPPs have in many cases been structured as a form of project securitisation. **Moreover, the Bank has already financed a series of corporate securitisations** in which EIB has participated both as senior and mezzanine financier.

Though securitisation is a valuable tool in appropriate circumstances to 1) reduce / manage credit risk; 2) access large capital markets; 3) improve regulatory capital relief for intermediary institutions, it is nevertheless still a highly specialized instrument, the institutional and market conditions for the wider utilisation of which are only being gradually achieved (as yet somewhat unevenly by country) even within the Euro market.

As securitisations will in most cases involve a "true sale" of government assets, the wide application of this technique in Member States may raise questions about the availability and acceptability of privatising assets in this way. Such securitisations will also require increased "political commitment" to a level which has yet to be seen in practice for the proceeds of such securitisations to be dedicated entirely to new infrastructure investments, as discussed under the Italian Presidency proposals.

Current expectations are that the utilization of Securitisation will develop more slowly than its potential would suggest until such time as there is a deep market of Investment Grade projects capable of being securitised, Investment Grade criterion being a key to market access. PPP infrastructure securitisations are therefore likely to be the main elements of these programmes for the time being until the broader policy and political issues on wider securitisation are resolved. EIB intends to continue its development of Infrastructure Securitisation subject to meeting its standard credit policy and other criteria.

3.2.5 EIB Institutional Role and Collaboration with Public Authorities and Financial Institutions.

The Bank has over time expanded the role it is prepared to play with the Commission and Member States authorities in sharing its expertise and providing technical and financial support upstream in the appraisal and selection process for ERDF, Cohesion Fund, ISPA, etc.

EIB is considering further developments in this area, particularly for strategic advice in respect of financing, including financial structuring, PPPs, securitisations, etc, preferably on a case-by-case basis for priority TENs projects when requested by the relevant Member States or the Commission.

The development of a more coordinated use of EIB and EU budgetary resources, particularly in ACC countries, is highly desirable and needs to be pursued in the context of the ongoing preparation for the Community Support Frameworks for the 2004-2006 period. Means to achieve this co-ordination are under discussion with the Commission.

Close collaboration by EIB with specialised bodies at national level such as the various national PPP Task Forces or entities such as PUK (UK); Kennecentrum (NL); PPP Competence Centre (D), Infrastructure Spa (I), GIF (Spain), NDFA (Ireland) as well as long term credit institutions such as KFW (D), CDC (F), ICO (Spain), SPIMI (I) will also be of potential importance in increasing the leverage of EIB resources committed to TENs.

3.3 EIB Credit Policies and Financial Resources

EIB's strategy is designed to maintain EIB's position as a leading AAA-rated non-sovereign benchmark borrower. The AAA rating is fundamental to EIB value-added activity, and is an essential prerequisite for making loans on the best possible terms and for serving EU policies effectively. In conclusion, whatever is proposed in terms of EIB's role in promoting long-term growth through investment in TENs (and R&D) projects, will be implemented in such a way as not to have a deleterious impact on the EIB's existing credit rating.

Appendix 1

Essen/Dublin Project Priority (figures in m€)	Investment until 2002 (EU Com figure)	Investment necessary in total (EU Com estimate)	EIB approvals (investment costs)	EIB approvals (loans)
1. High- speed train/ combined transport north–south (Berlin -Erfurt-Halle/Leipzig- Nuremberg & Brenner axis Munich-Verona)	4596	17762	848	384
2. High- speed train PBKAL (Paris– Brussels– Cologne–Amsterdam– London)	11115	23306	23908	4993
3. High- speed train south (Madrid-Barcelona-Perpignan-Montpellier & Madrid-Vitoria-Dax)	1615	15359	8649	2500
4. High- speed train east (Paris-eastern France-southern Germany including Metz- Luxembourg branch)	264	5713	3995	830
5. Conventional rail/ combined transport: Betuwe line (Rotterdam - NL/D border - Rhine/Ruhr)	2219	4546	0	0
6. High- speed train/ combined transport, France– Italy (Lyons-Turin & Turin-Milan-Venice-Trieste)	281	26590	0	0
7. Greek motorways (Pathe: Rio Antirio, Patras-Athens-Thessaloniki-Promahon (Greek/Bulgarian border) & Via Egnatia: Igoumenitsa - Thessaloniki - Alexandroupolis - Ormenio (Greek/Bulgarian border) - Kipi (Greek/Turkish border))	6931	12604	9737	4098
8. Portugal/Spain multimodal link with the rest of Europe through developing rail, road, sea and air connections in the following three Iberian corridors: Galicia (La Coruña) / Portugal (Lisbon); Irún/Portugal (Valladolid-Lisbon); Southwest corridor (Lisbon-Seville).	0	6212	6700	2804
9. Conventional rail link Cork– Dublin– Belfast– Larne–Stranraer (NB: completed)	357	357	103	44
10. Malpensa airport, Milan (NB: completed)	945	945	1741	399
11. Øresund fixed rail/ road link between Denmark and Sweden (NB: completed)	4158	4158	5891	1996
12. Nordic triangle rail/ road	2223	6966	3676	1818
13. Ireland/ United Kingdom/ Benelux road link	634	3665	1115	451
14. West coast main line (rail)	2154	7700	2888	618
All Essen/Dublin Priority Projects	**37492**	**135883**	**69251**	**20935**
For comparison:				
Other TEN-T Projects	141157	299674	107027	32984
Acceding and Accession Countries (10+2)	7839	90000	21844	9801

Remarks: The information on investments until 2002 and overall investment needs (colums 2 and 3) conccerning the Essen Priority Projects is taken form the document "TEN-T projects", published by the EU Commission in September 2002. The information in column 2 and 3 concerning "other TEN-T projects" and column 2 for acceeding and accessi from the "TEN-Invest" report by consultants Planco et.al., published in September 2003 on the EU Commission webpage and relates to the investment reported including 2001. investment needs (column 3) of acceeding and accession countries stems from the TINA report, published October 1999. Columns 4-6 are derived from EIBs own statistics.

Appendix 2

Van Miert Group Main Recommendations

1 Carry out priority projects for the enlarged EU

 Complete, before, 2010 five of the Essen projects still to be completed (List 0).

 Start work, before 2010, on 18 new priority projects, including Galileo, the upgrading of the Danube, "motorways of the sea", the interoperability of the Iberian network, the Paris-Budapest railway line and the Gdansk-Vienna motorway (List 1).

 Continue studies with a view to four new priority projects for the longer term, including the high-capacity Pyrenees railway crossing and the Seine-Scheldt canal (List 2).

 Take into account other important projects for territorial cohesion when making use of structural financial instruments (List 3).

 Establish rail, air and maritime traffic management systems and a freight-dedicated rail network.

 Take into account certain links with third countries when making use of the structural financial instruments and in the association agreements between the Community and the third countries concerned.

2 Put in place an appropriate financial and legislative framework

 In the next financial perspective, give the Community appropriate budgetary resources providing an incentive, and focus them on the priority projects.

 As proposed by the Commission, increase the rate of Community financial aid for cross-border projects (from 10 to at least 20% of the project cost), develop new lending facilities and enhance the role of the EIB.

 Promote public/private partnerships through an appropriate regulatory framework with regard to concession rights and infrastructure charging and new loan guarantee mechanisms.

 Establish a series of major axes in order to organise cooperation, focus Community aid and rank priorities on the occasion of future revisions.

 Enhance and institutionalise coordination between States along these axes, on a financial and operational level, by designating for each of them an entity to promote cooperation.

 Establish common assessment methods and examine the possibility of joint transnational investigation procedures in the case of cross-border projects.

 Provide for a new High-level Group around 2010, making sure that, in advance, detailed independent studies (e.g. by the EIB) on the projects submitted to it for examination are available.

Attachment 2

The EIB Group's support to Research, Development and Innovation (RDI) under the Growth Initiative

1. Background and Conclusion

The development of Research, Development and Innovation (RDI), together with the Trans European Networks (TENs), is one of the major objectives of the EU in its renewed efforts to relaunch economic growth and integration. This has been highlighted in the Thessaloniki European Summit conclusions (June 2003) as well as at the first Ecofin meeting (July 2003) under the Italian Presidency of the EU. The EIB Group's support to RDI is in line with the objective to facilitate the emergence of the European knowledge-based economy and society; it is based on a sound track record and developed in the context of the new Innovation 2010 Initiative (i2i), approved by the Bank's Board of Governors in June 2003. It enshrines the objective defined in Barcelona in March 2002, inter alia, to contribute to double private research in the EU by 2010, and it intends to mobilise EIB lending of up to 50 bn EUR for Research, Development and Innovation over the decade. Finally it supports the implementation of the actions defined in the recent Commission Communication "Investing in Research: An Action Plan for Europe" (COM(2003) 226 final).

With the Innovation 2010 Initiative, the EIB Group proposes a wide range of funding instruments to co-finance the various types of research and innovation projects in Europe. Its **lending instruments** can support investment in all main areas of RDI, be they in the **private or public sector**, related to infrastructure or to research activity (intangibles), of smaller or larger/corporate entities. Basically only direct military research is per se excluded from EIB finance. **EIF financial products** cater to the specific needs of SMEs, covering the crucial areas of **venture capital** as well as of **loan guarantees.** These instruments are deployed such as to maximise synergy of action within the overall EIB Group.

The EIB Group furthermore undertakes to make actors in the RDI field and financial intermediaries better aware of its wide spectrum of existing and forthcoming funding instruments under i2i, be it from the Bank or the EIF It makes its potential known through its websites, through the publication of a forthcoming specific brochure aimed in particular at the research community and by specific promotion organized jointly with the Commission.

However, the full benefits of this set of instruments will only accrue if a number of internal and external constraints can be loosened and if the funding by the EIB Group can act in complementarity with parallel efforts improving the overall framework conditions for RDI.

2. EIB support to RDI

2.1. Existing EIB intervention areas

The EIB has a track record of RDI financing of some 20 bn (approvals); most of it has accrued since 2000, within the first phase of i2i (15.8 bn), now to be extended and reinforced. Many of the investments are directly in the R&D sector (mainly by private borrowers), whereas others relate to higher education, ICT and audiovisual/media projects with a substantial, even if sometimes indirect, RDI component. EIB operations typically concentrate on the following areas:

- **Large Research Infrastructures** with a long time horizon benefit from (direct) EIB loans. The financing of the Large Hadron Collider of CERN is a prototype for further operations with Research Organisations. The Bank's value added also derives from the good timing of disbursement of funds, in line with the needs of the investment project, and reducing dependency of the promoter on budget allocations or high cost bridging loans. Another project of this kind recently approved by the Bank is the 300mm semiconductor wafer plant of IMEC, a non-profit organisation founded by the University of Leuven, to perform contract research in advanced semiconductor technologies, and other operations are being identified.

- RDI Infrastructures comprise **science parks and incubators** that provide state-of-the-art facilities for start-ups or young enterprises. Significant recent EIB loan operations in this area comprise the Heidelberg Bioscience Infrastructure, the Turku Centre for Biotechnology, or the Finnish Science Parks.

- **Innovation by SMEs** is financed through the EIB's well-established system of global loans (GLs). Where possible, innovation-dedicated global loans are set up with specialised intermediary financial institutions. Though limited at present, the importance of dedicated global loans is expected to increase. A good example is the ICO GL for Innovation in Spain. This also requires contacting suitable intermediaries and agreeing with them on flexible and comprehensive concepts of relevant project/investment cost (including intangibles).

- **Industrial RDI** represents an important part. It comprises investment in enterprise research facilities, as well as in research activities. Funds are also provided during the earlier stages of research or innovation, when commercial outcome is more uncertain. In order to diversify the risk, EIB operations often consist of several research lines (within one company) aiming at different commercial applications. They are generally financed either directly, or indirectly through an intermediary bank with which the Bank has a working relationship. Recent operations are e.g. Boehringer Ingelheim, EADS R&D, Philips Semiconductors R&D, Ericsson R&D Network Facility, and Schering Berlin Pharma R&D.

- **Prototypes, pilot plants and first commercial production units** are another common feature of the Bank's RDI funding. An example is the Primorec iron and steel making waste reprocessing unit, for the production of pig iron from a wide variety of steel wastes, with recovery of all by-products. Another example is the project Carl Zeiss Semiconductor Lithography, which involves the development of a new generation of optical systems for nano-metre lithography.

- **Information and Communication Technologies (ICT)** are both a source of innovation as well as a means of diffusing innovations. The relentless pace of innovation in semiconductor technology and other ICT hardware requires a significant and steady funding of R&D. The Bank has been continuously active in this field providing loans for EUR 1.5bn over the last three years for projects in ICT. Examples are (in addition to the abovementioned operations) Infineon Technologies Dresden, Alcatel R&D and Telecom Italia R&D and Services. Broadband telecommunication networks are of prime importance in diffusing innovation, and the Bank has provided a total of EUR 2.9 bn to a variety of broadband telecommunications platforms in the field of fixed (ADSL, cable TV) and mobile telecommunications (UMTS pilot projects).

- Universities and technical colleges play an important role in research ; more generally the **education** sector (incl. **training** activities) is crucial for enabling the labour force to apply and develop innovation and new technologies. EIB has provided significant lending (1-1.5 bn p.a.) over the last few years to education projects, covering a number of countries and types of projects, and i2i continues funding of education/training activities as an integral part, with a special emphasis on operations directly contributing to RDI.

2.2. New developments

New partnerships: EIB will further develop its funding activities in the above sectors of activity. Synergies with other organisations will be used to the extent possible to reach greater efficiency and to pave the way for supporting new and often transnational and collaborative RDI activities, such as:

- Contributing to Research Programmes supported by the Commission under the Sixth Framework Programme for Research and Technological Development (**FP6)**. Depending upon the composition and declared interest of the participating entities, EIB can co-finance a multipartner research programme, or the part of the research undertaken by one participating research entity. It can also participate in the financing of downstream development and investment activities that result from the original research. Projects and borrowers are expected to satisfy usual bank criteria. Basic requirements are the existence of a legal structure that is allowed to borrow, has a capable management structure and the financial solidity to service debt. The loans can be provided directly, or through a specialized funding agency.

- Loan financing of research projects that are considered worthy by the Commission, but are not retained under FP6 because of limited budgetary funds and related prioritisation needs. The same conditions as above apply.

- **Eureka**-approved projects, which may often be close to commercial applications, can be supported via loans covering the research or innovation, or the post-Eureka market introduction phases.

- Support to activities by consortia or individual firms that emerge in the context of strategic RDI plans developed under the "**European technology platforms**" presently being set up by the Commission in established sectors (e.g. aeronautics and space, rail, steel) or in new ones (e.g. hydrogen, photovoltaics, nanotechnology, etc).

- In order to facilitate the effective implementation of the diversified instruments and related tasks, outside support will at times be mobilized. Assistance in promoter and project identification, and in locating specific expertise needed in some appraisal cases, might be provided by the Commission (DG RTD, DG ENTR, DG INFSO and from JRC/IPTS) as well as by other organisations such as the European Science Foundation (ESF).

New instruments: EIB moreover adapts and further develops its lending instruments in a pragmatic way and always subject to respecting sound banking practice and procedures, in order to better respond to borrower needs as well as its lending objectives. Amongst the currently earmarked adaptations for RDI-related operations that will be further defined in the light of the operations brought to the attention of the Bank, the following deserve particular attention:

- **Grouped loans**, whereby an intermediary institution or firm regroups several activities from different promoters or subsidiaries under one umbrella operation. This simplifies lending procedures and permits to better draw on local intermediation expertise, even if individual operations have to be appraised. It is applicable notably when individual project size is larger than the limit for global loan allocations (i.e. 25 million EUR).

- A similar approach can in particular be used to reach **midsize firms** ("midcaps"). They can be very active in RDI activities, but so far they have been less well covered by EIB loans, as the typical size of their investment often exceeds global loan limits, while not yet easily qualifying for direct loans. EIB, in cooperation with the Commission, is defining a specific instrument to meet the needs of midsize companies.

- **Framework loans**, for supporting programmes of small to medium sized projects of one firm in various locations. While the firm undergoes a normal appraisal of its situation and internal investment approval procedures, a simplified appraisal of the individual projects is made.

- **Extension of tenors and grace periods** to accommodate for the generally longer time span necessary to reach the market launch and pay back stages of research-based projects. For example, it can take 10-15 years from idea to market launch in the pharmaceutical industry.

- **Increase of the maximum EIB loan amount.** In order to underline the priority character of RDI operations, and in line with what was already announced for TENs, selected key projects in the i2i area should continue to be financed up to an exceptional limit of 75 % of investment cost. It is recalled that the normal EIB ceiling is 50% of investment cost, and in practice often less than that (cf. also 2.3.); currently there are temporary exceptions to that within the Accelerated Finance Initiative launched at the invitation of the Ghent European Council (October 2001) and which runs out in early 2004.

- In the wake of increased securitisation of lending risks (such as Asset Backed Securities transactions), **risk sharing** has become a priority for commercial banks. The Bank has limited, but so far not fully exploited possibilities to enter into operations with higher-than-normal risk under its **Structured Finance Facility** (SFF), available in particular for selected projects in the TENs and i2i areas. The fuller deployment of products under SFF needs to be actively considered and suitable operations, for which the risk can be reasonably quantified, to be identified. Moreover, and beyond the possibilities offered under the EIB's SFF, an additional risk sharing with third parties, e.g. the EU Commission, might be helpful in reducing commercial bank exposure to risky RDI projects. This could increase the intermediaries' willingness to lend to these projects. These issues need to be studied in more detail, but could potentially open new promising options.

2.3. Specific needs and constraints

In the pursuit of the above objectives, however, several constraints may limit the funding of RDI funding operations.

- First, the volume of lending by EIB, as a policy-driven public bank, is contained within a pluri-annual growth scenario set by its capital requirements. In practice,

therefore, lending within the EU/15 (i.e. some 85% of total lending) is limited to on average 5% nominal increase per annum to match a programmed and basically self-financed process of periodical capital increases (through transforming accumulated free reserves into paid-in capital). Within the overall ceiling different lending priorities compete. In particular, the Bank pursues to channel 70% of overall EU lending to projects contributing to economic and social cohesion, i.e. mainly to projects benefiting to assisted areas. This limits space for projects contributing to other objectives (e.g. i2i), unless their main thrust falls within assisted areas; such is, however, not the case for most research activities in Europe. The Bank consequently undertakes particular efforts to identify innovation projects that simultaneously contribute to regional development.

- Second, and partly for the same reasons, EIB has self-limited its lending to "large corporates with an easy access to capital markets", when they invest outside of assisted areas, to not more than 30% of their external funding requirements (as compared to up to 50% of investment cost for projects in Objective 1 areas). This can, however, compromise EIB support for large corporates in their role as prime movers of R&D in Europe (available data show that the top 150 European companies alone account for up to 85% of business R&D spending). Moreover, the important role of SMEs and midsize companies in the overall innovation process is often related to activities by larger corporates, through out-sourcing, sub-contracting or other forms of partnership. Europe cannot reach its declared objective (Barcelona, March 2002) to double the private sector's share in research and innovation to 2% of GDP (within the overall DRI objective of 3%) without also boosting corporate R&D. Therefore, a more differentiated application of the existing EIB lending ceiling should be considered when it comes to financing "leading-edge" research and innovation projects, even if they are promoted by corporates.

- Third, and more generally, the objective to raise R&D to 3% of GDP will only be reached if the framework conditions for investments in RDI are improved, like the regulation on intellectual property, standardisation, competition and State Aid rules, the design of financial and fiscal instruments that encourage RDI, activation of industry-university links, and a greater awareness of the academia and private companies towards the value creating potential of efficient RDI-management. Evidently, these measures fall outside the scope of the EIB.

3. EIF support to RDI

3.1. Existing instruments and resources

It is recalled that, according to its statutes, the EIF is required to support the objectives of the European Union and, at the same time, generate an appropriate return on its resources. This last point is especially relevant for the banks and financial institutions that make up 9% of EIF's shareholding. The EIF operates always through financial intermediaries.

The EIF manages two types of financial instruments:

- **venture capital**, acting as a fund-of-funds and
- **guarantees** to cover the SME loan portfolios of banks

Both instruments are complementary to the global loan activity of the EIB. In the area of **venture capital**, the EIF's portfolio currently exceeds EUR 2.5 billion, invested in more than 185 funds across the EU and the Acceding/Accession countries. The EIF focuses its

investments on high-tech funds specialised in early-stage capital. The EIF uses mainly (85%) EIB resources, which have been made available within the framework of mandates entrusted to it in paricular after the 2000 reform of the EIF (in parallel with the launching of i2i), in which EIB became EIF's majority shareholder, acquiring 61% of its share capital. At that time, management of the EIB Group's venture capital activities was delegated to the EIF. It should be noted that EIF also operates the "ETF Start-up Facility" using European Community budgetary resources under the Multiannual Programme for SMEs 2001-2005 (MAP). ETF Start-up investments represent 5% of EIF's total venture capital portfolio, and are focused on seed capital, which is complementary to EIF's activity carried out using EIB resources (early-stage capital).

Currently, EIF venture capital investments support more than 1500 high-tech enterprises in Europe, active in key sectors such as biotechnology, nanotechnology, and new materials. EIF investments represent approximately 15% of the early-stage market in Europe and the impact of these investments is substantial: the EUR 2.5 bn committed by the EIF have effectively contributed to mobilising more than EUR 10 bn in co-investments for the benefit of young and high-tech enterprises (not yet in their commercialisation stages) that require substantial finance to develop patents and new products.

Synergies with European Union R&D initiatives exist. For instance, numerous investments have been made in funds that are linked to research centres and universities. Thus, EIF's investment activity contributes to the commercialisation of research and is hereby fully in line with the 3% objective. This objective also places responsibility on the EIF to play a "catalytic" role alongside private investors, a role that is particularly important in the context of the current venture capital market (in 2002, technology investments have decreased by two thirds in comparison to 2001). Using public resources, the EIF operates commercially in the private market, where the criterion of the independent management of funds is strictly upheld. For this reason, the cases where co-financing of technological enterprises by FP5/FP6 coincide with the EIF's indirect support through venture capital are purely by chance.

With regard to **guarantees**, the EIF also intervenes indirectly, using budgetary resources to provide counter- and co-guarantees under EU mandates, or using its own resources for the securitisation of SME loan portfolios (credit enhancement). The purpose of EIF guarantees is to provide effective support for SMEs through the **leverage effect** of the products on the volume of loans which banks can make available. In addition, EIF guarantees are particularly attractive for financial institutions, which are able to benefit from the provision of regulatory and economic capital relief and high credit standing and can thus support more SME lending. For example, EIF's status as a AAA-rated Multilateral Development Bank under the European Union's solvency ratio directive and its financial standing allows for reduced regulatory capital allocation on assets guaranteed by the EIF thanks to the 20% risk weighting (instead of 100%).

Furthermore, EIF contributes to the diffusion of best market practice and product innovation (e.g. by contributing to the development of the **securitisation** markets of SME credit risk) throughout Europe. EIF sees its main role in securitisation transactions in supporting enhanced access to debt finance by SMEs, by facilitating the SME credit risk transfer from the originating banks to the capital markets.

Currently, the EIF guarantees portfolio totals EUR 5bn and consists of 128 different operations.

The guarantees instruments implemented in the framework of the MAP may already cover investments made by SMEs in R&D. In light of the Lisbon strategy and in the framework of the 3% objective, this possibility could be further enhanced in the MAP successor scheme,

after 2005. It is however not suggested to establish a dedicated "RDI window" within the MAP guarantee instruments: in this case, the high risk profile of loans for research would lead to the consumption of significant amounts of budget resources. The **dilution** of the high "research risk" in more generalist SME portfolios of banks seems therefore preferable.

3.2. Development of new EIF financial means and instruments

For venture capital, the EIF can count on the continued, and in some cases enhanced, support of its main shareholders. For its part, the EIB has already begun the process of freeing EUR 500m in additional resources for the EIF to continue to pursue and further develop its activities, notably under the "Risk Capital Action" mandate, begun in 2000 in the context of i2i. These extra means, which will be drawn from the EIB's reserves, will have a gearing of 200%, hereby ensuring that EIF's investment potential increases by EUR 1bn. It is hoped that this significant commitment by the EIB will be accompanied by a further increase in budgetary resources of the Multiannual Programme for enterprise and entrepreneurship, when the budget is reviewed in 2004.

In deploying the resources it manages for the EIB (Risk Capital Mandate), the EIF will extend its investment focus to cover not only the seed and start-up phases of an enterprise as is currently the case, but also the subsequent development stages. Considering the lack of exit opportunities in the current market context, this extension of stage focus is considered essential. The EIF equally reinforces synergies with national operators (notably public) pursuing similar objectives, to respond to market needs in a flexible and common manner.

At the end of 2002, the EIF also decided to launch a new "advisory" activity to aid in the structuring of guarantee and venture capital schemes. Carried out independently from EIF's guarantee and investment activity, the advisory services will contribute to the spreading of the Fund's expertise and "best practice". Initiated in collaboration with DG REGIO, this specialised activity may potentially benefit, among other organisations, to seed capital funds linked to research centres and universities.

3.3. Specific needs and constraints

However, it is to be noted that the current resources available for the EIF to deploy in the area of venture capital are not necessarily best structured to tackle the very specific needs of Research and Development.

Therefore, beyond the actions mentioned above which will enable the Fund to pursue the 3% objective, EIF, in liaison with the Commission's DG Research, has also explored other ways to reinforce synergies in relation to R&D and to responding to market needs. Both private and public actors in the sector have been involved in this process through working groups.

First and foremost lies the need to structure pan-European seed capital funds linking together the best European research centres i.e. the idea of the "PASTEUR" fund ("Projet d'Appui à la Science et Technologie Européenne issue des Universités et de la Recherche" or support project for European science and technology stemming from universities and research). This type of financial structure, encompassing technology transfer and venture capital aspects, can be eligible according to the criteria of private sector management; however, it does not correspond to the parameters of any of the existing mandates under which the EIF operates. Indeed, for reasons relating to risk profile, size, duration of investment, and the maximum percentage of public funding allowed, neither EIB nor

Commission nor EIF own resources can currently be mobilised in favour of such structures. Moreover, since there has been a considerable depression in the market for early-stage finance, and since the participation of private investors in such a situation is limited (particularly for long-term projects), financing for such a project would most likely not be eligible for the 6th Framework Programme. Extensive discussions have already been conducted towards setting up an EU-funded mandate to be managed by the EIF.

Specifically for the above-mentioned pan-European seed capital funds linking together the best research centres, the EIF could also, through its (fee-generating) Advisory Services Unit, undertake a wide-ranging feasibility study (of structure, objective, governance, etc.) and subsequently lead the implementation to be carried out in partnership with national co-investors, including capitalisation terms, which thereafter could be launched as a pilot project with Community budget support (or possibly as a specific action of the 6th FP). This study could also be conducted in cooperation with EIB. This might be a pragmatic way to kick-start the process, as it is estimated the EIF costs related to such a study would not exceed EUR 750 000.

Lastly, from the EIF's point of view the strategic importance and innovative character of a pan-European pre-seed/seed capital fund, representing a federation of input and energy from the best research centres in Europe to support the realisation of the fruits of research, fully justifies a Community intervention. Such a fund would also contribute to the 3% of GDP research objective, and would fit within the context of a European strategy to compete with the best of American research. By demonstrating how such a scheme can be implemented, EIF and DG Research hope that in a subsequent phase private investors can be attracted to participate in similar funds.

4. Networking and building bridges between the research and financial communities

EIB's and EIF's contribution is not "only" limited to providing funding. Both also contribute to building bridges between the research and financial communities, which all too often develop their efforts in isolation, notably in the field of public research. Established contacts with financial intermediaries as well as cooperation with the Commission and other institutions active in promoting RDI activities help in overcoming the gaps between both communities, signalling to financial intermediaries the strategic importance of RDI finance and raising awareness among the research community of loan or equity finance as additional funding resources.

Moreover, the EIB Group actively promotes its existing and new instruments. Sensitisation actions primarily comprise a more explicit and more complete chapter on RDI on the EIB and EIF websites, the publication of a specific brochure that will be widely distributed to professional bodies, research organizations and national/regional authorities. When appropriate, specific communications will be delivered to specialized audiences in conferences, seminars and dedicated workshops.

A special effort will be undertaken towards the New Member Countries and the Candidate Countries.