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# **European Investment Bank: a force of Pan-European integration: the case of South-Eastern Europe**

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## **South-Eastern Europe-a review of the current economic situation**

South-Eastern Europe has experienced falling or stagnant economic activity in the past decade. War and civil unrest, and the geographic characteristics of the region have been clearly one of the main reasons. A further key element of the economic stagnation, however, is the low level of saving and investment in the region. These are respectively only one-half and two-thirds of the figure seen in the more successful transition economies in Central Europe. Without hinting that the low level of savings and investment is necessarily the determining factor behind the poor economic performance in the region, being a financing institution, the EIB will concentrate on the latter.

Following a sharp initial decline in output at the outset of this decade, many countries in South-Eastern Europe have failed to show the kind of rebound observed in the more successful transition economies. GDP in Poland -- the most successful of the transition economies, was 20% larger in 1998 than at its previous late-1980s peak. FR Yugoslavia's economy -- at the other end of the spectrum -- stood at less than half its peak one decade ago<sup>1</sup>. A string of post-disintegration wars in the former Yugoslav republics account for some of the economic stagnation in the region, but failure to transform domestic economies and institutions are at least of equal importance.

The experience of high-growth in CEECs and other emerging market economies does strongly suggest that higher saving and investment ratios are key to successful economic development in South-Eastern Europe. However, not all components of saving can be expected to rise markedly from current levels. At around 7% of GDP, foreign saving is stretched to the limit and higher FDI inflows are required only to change the composition of capital inflows rather than to increase them. Raising domestic saving is also associated with limitations. Weak government finances and the need to reduce tax rates further means that the scope for much higher government saving is limited. At the same time, high unemployment rates and low income levels limit the scope for increased household savings, at least in the short term. Macroeconomic uncertainty and the absence of functioning financial intermediation also limits the scope for channelling household saving to corporate investment. Weak property rights and weak accounting standards make it nearly impossible to assess credit risk, which is a key factor behind the region-wide lack of effective financial intermediation.

The best means of raising private saving and investment levels in this environment is to raise corporate profitability. Corporate saving -- the internal financing of corporate investment from retained earnings -- overcomes the problem of low household saving rates, dysfunctional financial intermediation and lack of credit risk information. In the highly diverse “region” of South-Eastern Europe, post-war reconstruction programs similar to that in Bosnia and Herzegovina are likely to be the exception rather than the rule. Aid-financed reconstruction of housing and infrastructure

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<sup>1</sup> For a discussion on the economic impact on FR Yugoslavia from the Kosovo conflict, see for instance Dinkic, ed. (1999).

reconstruction may be a necessary requirement for restoring some sense of economic normality in war-torn Kosovo. The rest of the region, however, needs to make progress on structural reforms rather than aid inspired public spending programmes.

## **EIB's role and strategy in the Balkans**

Being the financing arm of the European Union, for supporting the Union's political objectives, and with a view to underscoring its commitment to post-war reconstruction in the Balkan area, the EIB participated in establishment of the Stability Pact for South-Eastern Europe at the Ministerial Meeting in Cologne in June 1999.

As an immediate response to the leading role given to the Bank by the High Level Steering Group and the Stability Pact in drawing up and coordinating basic infrastructure investment programmes in the region, the EIB set up a Balkans Task Force to evaluate investment needs and identify priority projects in post-war South-Eastern Europe. The region includes Albania, Bosnia-Herzegovina, Croatia, the Federal Republic of Yugoslavia (consisting of Serbia and Montenegro), the Former Yugoslav Republic of Macedonia (FYROM), as well as Bulgaria and Romania.

In September 1999, the EIB put forward a first report on reconstruction needs in cooperation with the European Commission and the other multilateral financing institutions.

Projects have been grouped into a Quick-Start Package of capital investment, with implementation scheduled to commence, or tenders to be awarded, up to March 2001, and a Near-Term Package of investment which appears *prima facie* economically justified and does not raise major sectoral or project issues.

The list comprises a total of 85 projects involving some EUR 4 billion. Of these, 35 are Quick-Start projects worth EUR 1.1 billion. The EIB has a lead role in 14 of them, costed at around EUR 800 million, i.e. 72% of the total. The other 50 Near-Term projects total some EUR 3 billion. The EIB is likely to be involved in 18 of them, running to some EUR 1 billion, i.e. 33% of the overall amount.

The 14 Quick-Start projects for which the EIB is the "Lead Agency" have advanced considerably: EIB loans totalling EUR 711 million (i.e. almost the entire EIB-led Quick-Start projects) have been signed for 9 transport projects:

- two in Albania (roads/Corridor VIII for EUR 34 million)
- two in Bosnia-Herzegovina (roads/Corridor V for EUR 57 million and electricity transmission for EUR 60 million),
- two in the Former Yugoslav Republic of Macedonia (Skopje bypass and border crossing to Greece via Gevgelija: EUR 70 million),
- two in Bulgaria (Sofia airport development: EUR 150 million and the bridge Vidin (Bulgaria) and Calafat (Romania) for EUR 70 million)
- one in Romania (road section Bucharest-Cernavoda: EUR 270 million).

Having already a reconstruction programme well under way, the EIB extended its lending efforts in the region in sound capital investment projects laying emphasis on regional infrastructure, modernising the local financial sector and building up private enterprise as part of economic liberalisation, a prerequisite for closer integration between the region, the greater Central and Eastern European area, and the European Union.

The EIB has been active in South-Eastern Europe since the mid-1970s. In addition to the reconstruction programme, the EIB is financing projects in the Balkans under its normal lending activity in the region.

In Albania, Bosnia-Herzegovina, Croatia and the FYROM, the Bank is operating under the current mandate for Central and Eastern Europe handed down by the Council of Ministers for 2000 to 2007,

which provides for EIB lending of up to EUR 8.7 billion in the ten Accession Countries and in four Balkan states, which do not yet have candidate status: Albania, Bosnia-Herzegovina, Croatia and the FYROM. The existing mandate will soon be extended to the Federal Republic of Yugoslavia (including Serbia and Montenegro). In Bulgaria and Romania, in addition to lending activity under mandate, loans are also made available under the second Pre-Accession Facility authorised by the EIB's Governors, providing for EIB lending of up to EUR 8.5 billion in the Central and Eastern European Accession Countries as well as in Cyprus and Malta between 2000 and 2003.

EIB lending in the Western Balkans totals EUR 352 million: Albania has attracted EUR 102 million for transport, energy and SMEs since 1995, Bosnia-Herzegovina, EUR 125 million for transport and energy since 1999 and the FYROM, EUR 130 million for transport since 1998.

EIB operations in the Western Balkans will increase substantially in the near future when progress on project preparation gains added momentum thanks to the streamlining of legal, administrative and technical procedures. Again, EIB lending will be carried out in close cooperation with the European Commission and the other multilateral institutions, and will focus specifically on transport and energy.

EIB financing under this Mandate aims at promoting long-term growth and stability in the countries concerned. It does so in practical terms by fostering investment in infrastructure, private sector and the development of the local banking systems:

#### *BUILDING THE PHYSICAL LINKS: EIB A MAJOR LENDER FOR INFRASTRUCTURE*

Economic development of the area will depend to a significant extent on expanding and strengthening links among the South-Eastern European countries themselves, as well as their collective and individual links with the neighbouring Central and eastern European countries, as well as the European internal market of some 300 million consumers.

The EIB has been financing the creation of the necessary physical links, that is national and regional infrastructures facilitating trade, personal exchanges, and the use and distribution of common resources. It has also been working actively on extending the intra-EU Trans-European networks (TENs) for transport, telecommunications and energy to Pan-European networks in Central and Eastern Europe.

Traditionally, infrastructure has been planned, built and financed by the public sector. In recent years, however, the private sector has been playing an increasingly important role in the financing, but also in the planning and management of a number of infrastructure projects which generate revenues to cover their operating and partly their capital cost.

EIB's long experience in Public/Private Sector Partnerships (PPPs) for infrastructure finance within the Union, is being transferred to countries outside the Union, where there is a growing demand for investment finance for joint ventures and 'Buy-Operate-Own'/'Buy-Operate-Transfer' (BOO/BOT)-type arrangements with European companies in all the main economic infrastructure sectors. In such cases, the Bank does not only complement local and other international sources of finance, but acts as a catalyst, helping "things to happen". The market generally interprets the Bank's agreement to fund a project as a result of sound appraisal and financial prudence.

#### *PURSuing THE VISION OF SUSTAINABLE DEVELOPMENT: ACTIONS IN FAVOUR OF THE ENVIRONMENT*

Given the environmental degradation in the region, protection and rehabilitation of the environment represent a priority objective for the EIB.

#### *STIMULATING INITIATIVE: FINANCING THE PRIVATE SECTOR*

The EIB has been giving particular emphasis to strengthening the private industrial and financial sector throughout the region. Lending concentrated on private sector development, of large-scale industrial investments, as well as small and medium sized enterprises (SMEs). Support to SMEs has been channelled through loans to the local banking sector.

### **(DO NOT) MESS UP THE CIRCLES - (MH MOY) TOYΣ KYKΛΟΥΣ TAPATTE: A PRACTICAL WAY TO INTEGRATION**

One of the reasons for the delayed “economic transition” of South-Eastern Europe are the specific geographic characteristics of the area (Petraikos), namely the peripheral location to the European Union and the Central and Eastern European countries, the mountainous character which has been hindering communications for ages helping in part to bring about or accentuate cultural differences which overtime have brought about numerous confrontations and unrests, resulting in a very low economic and trade communication among the neighbouring South-European countries themselves.

Economic development in the European Union, as well as in the Central and Eastern European area, seems to follow two co centric circles: an inner circle where the core of economic activity has developed in the “resources-oriented” economic development model prevailing in the last centuries as a result of a concentration of population, natural resources and as a consequence capital, and an outer circle of countries struggling to overcome their periphery disadvantages in order to achieve the same economies of scale for their products. With the “information-oriented” New Economy model emerging currently, whereby “news are more valuable than gold” (Kavvadia), the significance of being “in” or “out” drawing the term from the social context, or in other words the established co centric economic development “borders” is fading gradually away.

From the very outset, one of the primary objectives of the Treaties establishing the European Community has been to build a united and interdependent Europe in which regional disparities would be reduced. It is therefore not surprising that the European Investment Bank, as the Union's financing institution, devotes for over 40 years of existence, the largest proportion of its lending to correcting regional imbalances, by “messaging up the circles”: regional development financing, TENs infrastructure for physically interconnecting regions, and recently, in order to assist the New Economy in Europe, the Innovation 2000 Initiative, the priority of the Lisbon European Council (March 2000), for SMEs and entrepreneurship, diffusion of innovation, research and development, information and communications technology networks, and human capital formation. i2i also embraces investment in European audiovisual projects in order to strengthen the financial base of Europe's audiovisual and film industry and its capacity to adapt to the challenges of digital technology.

Since May 2000, total EIB loans worth more than EUR 1.6 billion in communications networks (EUR 965 million) and education (450 million), and venture capital operations of more than EUR 215 million in favour of innovative SMEs have been concluded.

### **The EIB: a force for European integration-its “toolbox”**

First of all, what is the European Investment Bank? Set up under the Treaty of Rome in 1958, with headquarters in Luxembourg, the EIB has spent the last 40 years working hard at bringing about greater integration in the European Union's Member States through long-term lending to capital investment projects.

While our "raison d'être" is to finance largely the physical integration of the European Union, as a self-financing institution, we have to have recourse to the capital markets to finance our activities. So much so, that today we are one of the largest international capital market AAA operators - certainly by far the largest of the multilateral financing institutions. Our extensive presence on these markets

has enable us to play a crucial role in the 1980s in development of the Euro's older sister - the ECU, and pioneering the way to the Euro with an intensive pro-active euro-strategy on the capital markets.

Just for the record, the EIB is a “non-profit” institution, owned by the fifteen European Union Member States, who provide us with subscribed, guaranteed capital, which is EUR 100 billion as of 1<sup>st</sup> January 1999. They have only ever paid in a minimum amount. Our outstanding loans are more than EUR 155 billion. According to the requirements of the statutory ceiling for our lending activities, as a gearing of the Banks capital, EIB’s lending volume can reach up to EUR 250 billion. Therefore a new capital increase is already in preparation for 2003.

The EIB is now one of the largest multilateral, long-term financing institutions in the World. In 2000 total lending amounted to some EUR 36 billion, of which some EUR 30.6 billion went for investment within the European Union.

This concentration on investment to stimulate sustainable growth and employment within the Union is not at the expense of our lending outside the Union. Indeed, our lending in some 120 non-Member countries in support of EU external cooperation and development policies, has over the years constantly increased, reaching a total of nearly EUR 5.4 billion in 2000. We are in this way active in Africa, the Caribbean and the Pacific (under the Lomé Convention), in Asia and Latin America, in Central and Eastern Europe, the Mediterranean and the South-Eastern European area.

EIB operations outside the Union are pursued in parallel with the general political agreements concluded between the Union and countries or groups of countries. These agreements are wide-ranging in scope, covering trade, social affairs and general policy issues. They also contain financial clauses which are the concrete reflection of Community development aid and cooperation policies, implemented in conjunction with the Bank and on the basis of mandates which it accepts at the request of the European Council or – in the case of operations in partner countries in Africa, the Caribbean and the Pacific – at the collective request of the Member States of the Union. These lending mandates are designed to support the Union's policies in relation to partner countries, while the task of identifying and appraising projects to be financed is entrusted to the Bank. The political risks of such operations under mandate are supported by a system of blanket guarantees intended to cover the risks attached to operations in these countries.

EIB’s “toolbox” successfully tested over 40 years in context of European integration, is extended now outside the Union for the economic integration of regions and their integration with the Union. The aspects relevant to the economic development of South-Eastern Europe comprise:

- Long-term partner: understands the challenges of investment in the region, having been involved for some 35 years in financing projects in South-Eastern Europe;
- Extensive knowledge base: operates both in industrialised countries (the EU) and more than 120 countries around the World under co-operation/development policy agreements with EU;
- Regional projects: as International Financial Institution of the EU –the world’s biggest exercise in economic partnership – the EIB has extensive experience in cross-national and regional investments;
- Catalytic role: Europe’s largest industrial and banking concerns, many with existing or potential interests in the South-Eastern European region, are EIB clients;
- “Added value “through independent project appraisal (technical, economic, financial, environmental);
- Diversified loan portfolio: Wide spectrum of sectors covered, types of borrowers, sizes of investment;
- Up-to-date banking practice

•Efficient operations: Banking, business-driven culture; easily accessible through EIB staff with country-specific responsibilities.

## **A tangible contribution to Pan-European integration**

The EU is now preparing for the most difficult and complex enlargement. It faces the adhesion of over 80 million people with a current per capita GDP only a third of the EU average, and with huge deficiencies in physical and institutional infrastructure and environmental standards in some of the candidate countries. In the Accession countries, the bulk of EIB's financing went to support the upgrading of key communications and energy infrastructure. The investment financed focused on economic integration, both with the Union and within the region, and on support for the adoption of the EU's rules, regulations and standards (*acquis communautaire*), with particular emphasis on environmental protection.

In order to ensure optimum use of banking and budgetary resources, the EIB works in cooperation and synergy with the PHARE Programme and other Union Assistance Programmes and financing facilities. It also cooperates closely with other multilateral financing institutions in the region, in particular the European Bank for Reconstruction and Development and the World Bank.

Being established already as the largest international lender both in the European Union, as well as the candidate countries and South-Eastern Europe, EIB's role in furthering development is crucial. The level of its financing will continue to grow in the run-up to accession. Priority will be given to modernising infrastructure, such as transport, telecommunications and energy, environmental protection investment, and productive industry, in particular SMEs.

In this setting, the South-Eastern European area faces an opportunity and challenge at the same time. The European integration "puzzle" will not be completed without the development and prosperity of this area. Economic and social order would suffer. Being well aware of the difficulties as well as the prospects and necessities of the region, the EIB will be pleased to assist.

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