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HOW TO UNLOCK THE EUROPEAN INVESTMENT BANK'S POTENTIAL: FOUR REFORMS

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ABSTRACT

The European Investment Bank (EIB) is the EU's multilateral development bank. In this policy paper, we suggest four reforms that would help progressive policymakers to utilize unlock the EIB's potential to play a greater role in the EU economy and its transition to a more resilient, climate-neutral, and progressive economy. First, we suggest the EIB adopts more comprehensive lending targets based on social and environmental criteria. Second, we highlight the need for a stronger focus on equity-like instruments rather than debt instruments, especially in the ongoing response to the Covid-19 crisis. Third, we propose to strengthen the EIB's accountability towards the European Parliament to ensure a legitimate political direction and democratic control of its activities. Fourth, we propose to convert the EIB's retained profits into paid-in capital, unlocking up to €110 billion of additional lending capacity. To simultaneously accomplish increased democratic accountability, we suggest converting the EIB's retained profits into EU capital and thus making the EU an EIB shareholder.

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INTRODUCTION

1. INTRODUCTION

The European Investment Bank (EIB) has been described as the European Union's 'hidden giant' (Financial Times 2019). It is the EU's multilateral development bank, mandated to support European integration and the common market by means of infrastructure financing and support for entrepreneurship in all EU member states. The EIB acts as a long-term lender that corrects for market failures, funds socially valuable investments, and supports structural convergence among member states. In this policy paper, we suggest four reforms that would help progressive policymakers to unlock the EIB's potential to play a greater role in the EU economy and its transition to a more resilient, climate-neutral, and progressive economy.

Our argument is structured as follows. First, we describe the background in which the EIB has been operating, namely an incomplete monetary union with competences unevenly distributed between the European and national level. We next analyse how the EIB has acted under these circumstances, considering especially the years after the financial crisis in which there was a drop in public investment and a need for counter-cyclical lending. Here, we also consider how special-purpose vehicles, such as the so-called Juncker Plan, facilitated the required expansion of the EIB's activities, off the EIB's balance sheet. We look at the scale and focus of EIB lending since the 1980s, identifying the influence of the prevailing political goals, and its long-standing shortcomings as well as recent improvements.

We continue to outline a vision of an EIB that -compared to today- is more aligned with progressive political goals, acting as a more important driver of structural economic, climate, and social transformation by way of a larger loan capacity and a lending policy that finances more socially or economically desirable projects, subject to more democratic accountability. To accomplish this, we identify four reforms.

First, we suggest that the EIB adopts more comprehensive lending targets based on social and environmental criteria. Second, we highlight the need for a stronger focus on equity-like instruments rather than debt instruments, especially in the ongoing response to the Covid-19 crisis. Third, we argue that stronger accountability mechanisms, especially in terms of democratic accountability towards the European Parliament, are required to ensure a legitimate political direction and democratic control of the (expanded) EIB's activities. Our suggestion is to mirror the institutional design of the special-purpose vehicles that constitute the EIB lending policy outside its core business, which already favours a more impactful allocation of funding by way of political control. To accomplish increased democratic accountability, we suggest converting the EIB's retained profits into EU capital and thus making the EU an EIB shareholder. Fourth, to increase the EIB's lending capacity we propose to convert its retained profits into paid-in capital, unlocking up to €110 billion of additional lending capacity, approximately 20 percent of its outstanding loans.

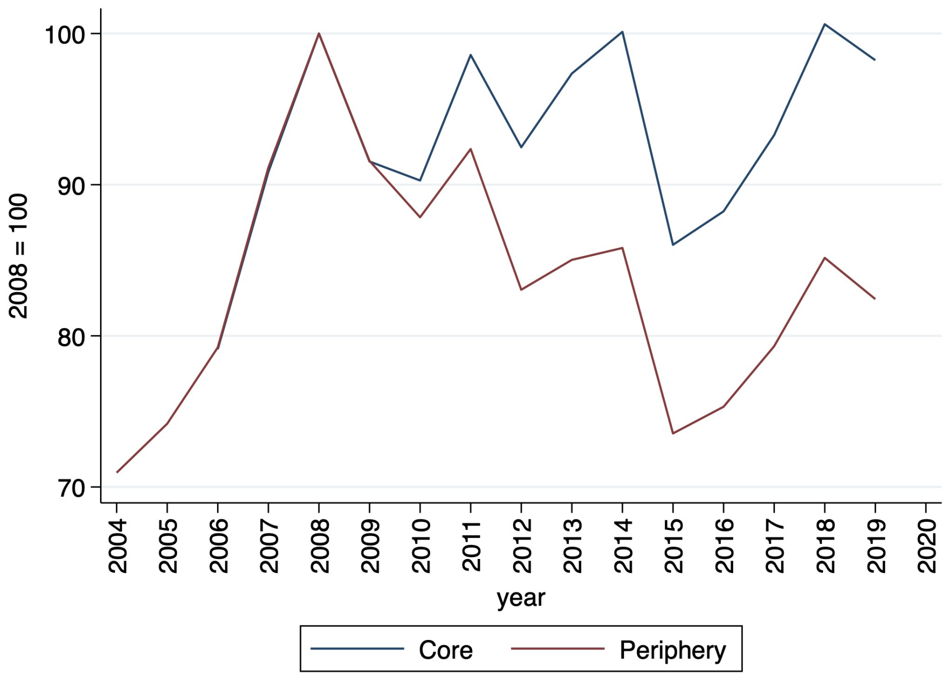
THE EMU'S EXPERIENCE

2. THE EMU'S EXPERIENCE

During the EMU's first decade, apparent stability concealed increasing economic divergence between a more export-led 'core' in Northern and Western Europe and a more demand- and debt-led 'periphery' in Southern Europe (Iversen and Soskice 2013; Stockhammer 2015). A revalued common exchange rate compared to national exchange rates prior to the euro introduction led to differences in EMU countries' relative unit labour costs, contributing to divergence in competitiveness and persistent trade deficits (Johnston et al 2014; Perotti and Soons 2020). Euro member states could no longer use their monetary or exchange rate policy in support of their domestic economies.

The collapse of Lehman Brothers in 2008 paved the way for the EMU's sovereign debt crisis in 2010. The ECB's early decision to act as a lender of last resort for private banks but not for governments pushed countries already in trouble into a bad equilibrium of rising borrowing costs and 'panic driven' austerity (De Grauwe 2013). This resulted in a stark divergence in economic growth, as shown in Figure 1.

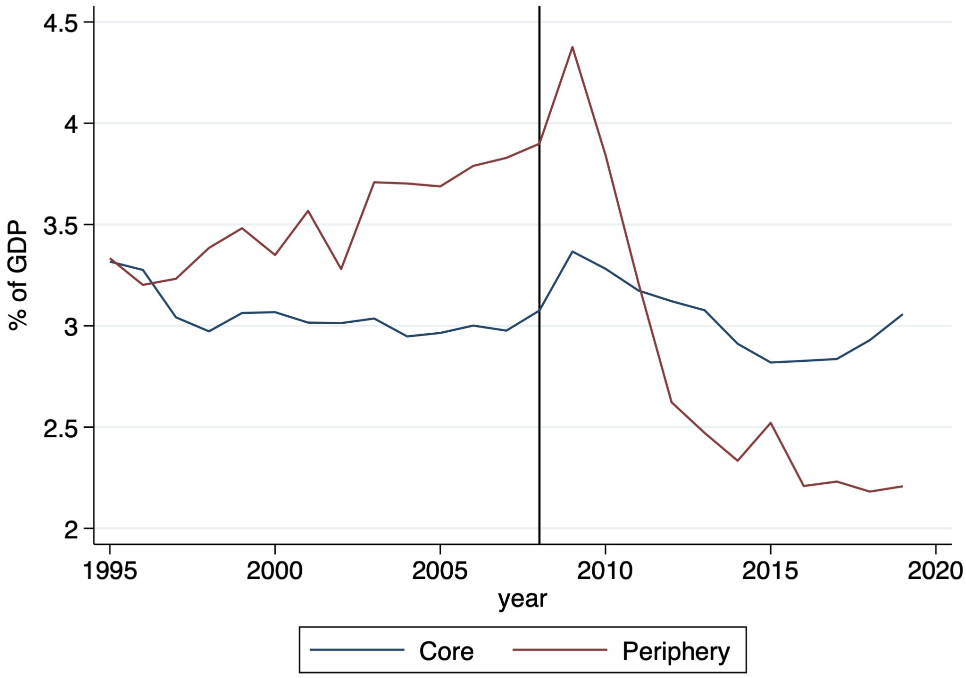
Fig. 1: Total GDP in core and periphery economies, 2008 = 100



Note: data obtained from the OECD. Core is the average of NLD, GER, FRA, AUS, and FIN, periphery is the average of ITA, GRC, POR, and ESP.

The economies of the EMU's periphery were forced into a process of export-led adjustment via internal fiscal and wage devaluations and market-oriented structural reforms (Scharpf 2016). Austerity imposed through formal and informal means of conditionality by the ECB, ESM and the other members of the Troika led to severe cuts in Southern Europe's welfare states (Perez 2019; Sacchi 2015) and governments in Europe's periphery substantially cut public investment spending. The yearly gross investment by periphery governments collapsed from about 4 percent of GDP in 2008 to 2 percent a decade later (see Figure 2).

Fig. 2: Government gross capital formation in core and periphery economies, in % of GDP



Note: data obtained from the OECD. Core is the average of NLD, GER, FRA, AUS, and FIN, periphery is the average of ITA, GRC, POR, and ESP.

Today, the EMU remains an incomplete monetary union in which national governments have lost control over key policy instruments while similar capacities (for example, a supranational fiscal and/or wage policy) have not been recreated at the supranational level. This disconnect has led to suboptimal public responses to recent crises, including a sharp drop in public investment in Europe's periphery.

It is in this context that the EIB can be used as a second-best policy instrument to smooth the credit cycle, compensate for credit rationing, counterbalance the consequences of an incomplete union, and support in particular Europe's periphery economies in their transition. We argue that if the political will is there, the EIB can do much more than it currently does to achieve these goals.

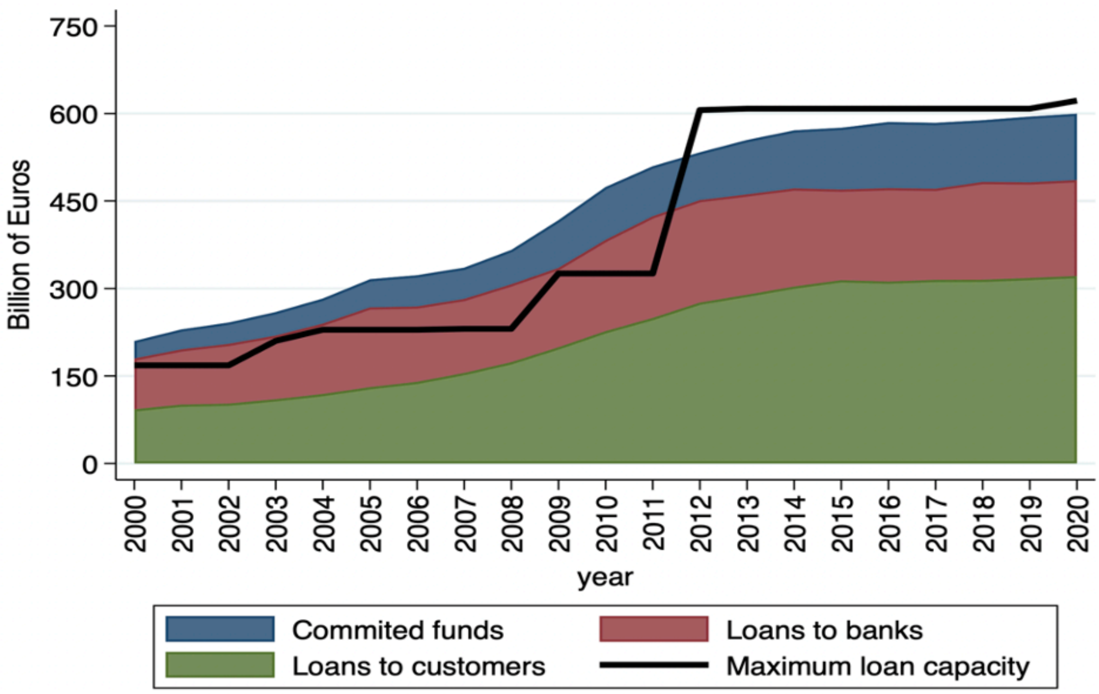
THE EIB'S OPERATIONS WITHIN THE EMU: A DESCRIPTION

3. THE EIB'S OPERATIONS WITHIN THE EMU: A DESCRIPTION

Over the past decade, there has been a notable expansion of development banking in the EU (Mertens et al 2021). The EIB has been part of this expansion, with its total outstanding loans expanding from €366 billion in 2008 to €600 billion in 2020 (Figure 3). The EIB balance sheet notably expanded between 2008 and 2015, almost doubling in just seven years.

Not only did the EIB (and national development banks) compensate for the drop in public investment after the crisis and the failure of the financial sector to provide long-term funding for projects of political interest across the EU, but they also provided states with a way to circumvent the fiscal straitjacket imposed by the EU economic governance regime (Mertens and Thiemann 2019).

Fig. 3: Total outstanding loans and funds of the European Investment Bank, in billion euros



Note: data obtained from Bankfocus, supplemented by data from the EIB annual reports.

In line with its mandate, the data in Table 1 shows that in the face of a pan-European credit crunch (Wehinger 2014), in the last decade a large share of the EIB loans was targeted at providing credit lines to non-financial corporations. By doubling its liquidity provisions to the business sector between 2009 and 2020 compared to the period 1999 to 2009, the EIB has substantially supported businesses that were expected to be profitable but were unable to receive credit from troubled banks. In line with its mandate to finance infrastructure, a significant share of EIB lending has covered loans to fund investment projects in the transport, energy, industry, water, and sewage sectors and urban development.

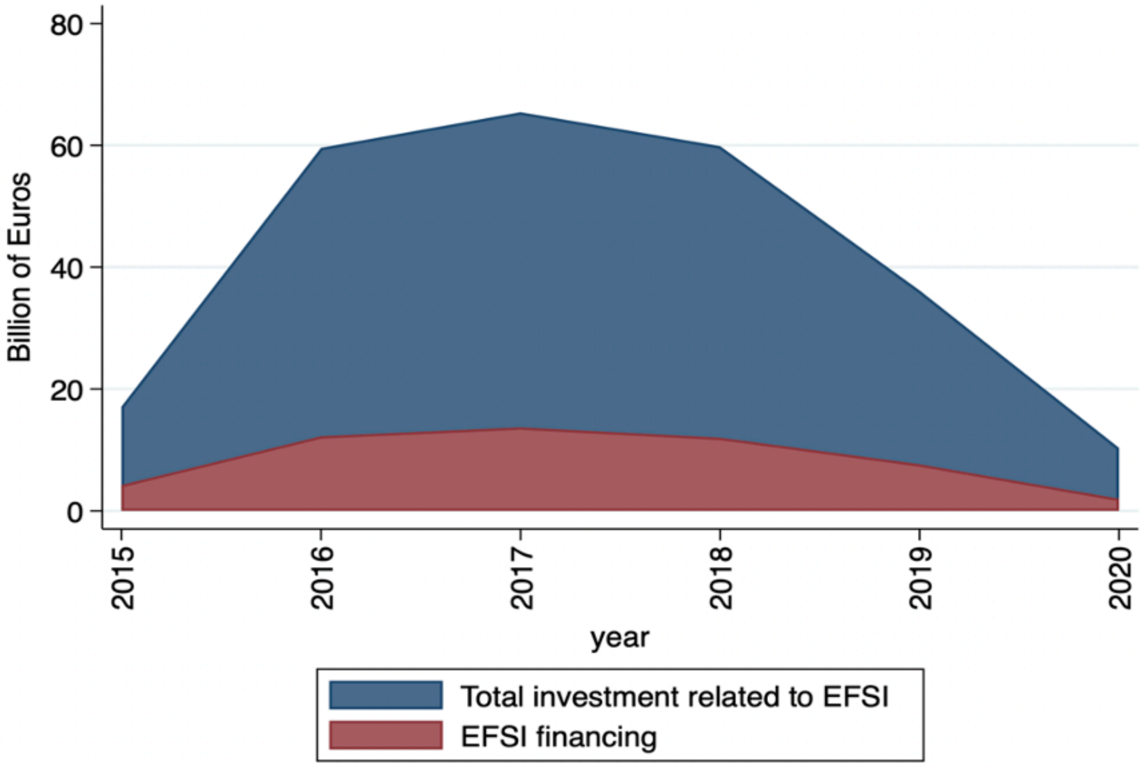
Table 1: EIB's loans breakdown by sector before and after the financial crisis, in billion euros

Sector	1999/2009	2009/2020
Credit lines	134.8	254.7
Transport	135.4	153.4
Energy	55.5	116.3
Industry	49.4	82.5
Water, sewerage	23.9	39.6
Services	18.9	36.9
Urban development	20.3	34.8
Education	16.3	33.2
Telecom	22.3	26.8
Health	13.9	20.3
Composite infrastructure	11.9	7.7
Agriculture, fisheries, forestry	0.6	6.8
Solid waste	3.1	3.9
Total	506.3	817.1

However, since 2015 the expansion of the EIB's core lending activity has slowed down. Instead, due to political initiatives, special-purpose vehicles such as the European Fund for Strategic Investments (EFSI), part of the so-called Juncker Plan, continued to provide financing to the European economy.

Via the EFSI, the EIB in partnership with the European Commission supported up to €60 billion a year in extra lending activities across Europe for a total of €248 billion in loans between 2015 and 2020 (Figure 4).

Fig. 4: Total investment supported by Juncker Plan (EFSI), in million euros



Note: data obtained from the EIB website.

THE EIB'S OPERATIONS WITHIN THE EMU: SOME SHORTCOMINGS

4. THE EIB'S OPERATIONS WITHIN THE EMU: SOME SHORTCOMINGS

4.1 Statutory limitations on lending

Despite its steady expansion in the aftermath of the sovereign debt crisis, the EIB's core lending expansion has stalled since the launch of the EFSI. This was not because of a lack of investment opportunities that, for instance, support the climate transition or economic convergence, as evidenced by the fact that the funds offered by the Juncker Plan had no trouble finding borrowers. Rather, it results from its institutional set-up, as total subscribed capital puts a direct limit on the size of the EIB balance sheet: under its Statute, the Bank is authorised to have maximum loans outstanding equivalent to two and a half times its subscribed capital (Art. 16 [5], EIB Statute). By our calculations, the EIB is operating close to this statutory limit on the maximum loans it can support (Figure 3).

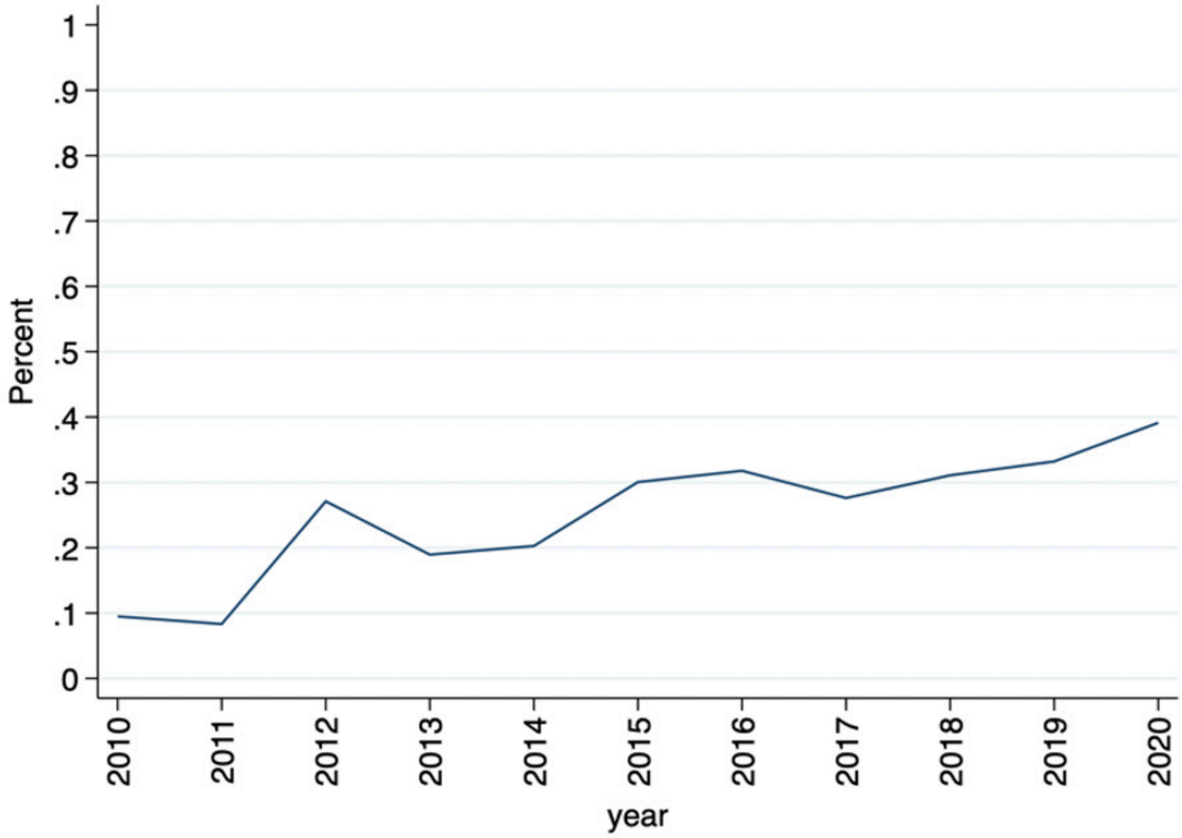
4.2 Conservative lending

Critics consider the EIB to be an 'ultra-conservative lender', which means that, despite its mandate of development banking, the EIB 'too often falls for easy-to-fund, no-risk projects that flatter its balance sheet without substantial added public value' (Financial Times 2019). Although these accusations are difficult to support empirically, the EIB's conservatism and extreme aversion to loss-making is perhaps best captured by its low loss rate of its lending and its high equity ratio. One measure that captures the low loss rate of the EIB's lending is its impaired loan ratio, calculated as

$$\frac{\textit{impaired loans (in euros)}}{\textit{outstanding loans (in euros)}} \textit{ x 100}$$

where impaired loans are those loans of which it is determined that it is likely that the EIB will not be able to collect on the originally contracted amounts. We calculate the EIB's non-performing loans ratio between 2010 and 2020 using the balance sheet data reported in the EIB's annual report. This is displayed in Figure 5. The average impaired loan ratio of the EIB between 2010 and 2020 was 0.25 percent, meaning that for every €1,000 of outstanding loans, only 2.5 euros was considered impaired. In comparison, the same calculations for the 20 largest banks in the EU during these years gives an average impaired loan ratio of 6.4 percent, which is 25 times higher than for the EIB.

Fig. 5: EIB non-performing loans ratio



Note: data obtained from Bankfocus, supplemented by data from the EIB annual reports.

A second measure that captures the EIB's conservatism is its equity ratio, that is, how much equity it has on its balance sheet compared to its assets. We calculate the equity ratio of the EIB and large commercial banks as

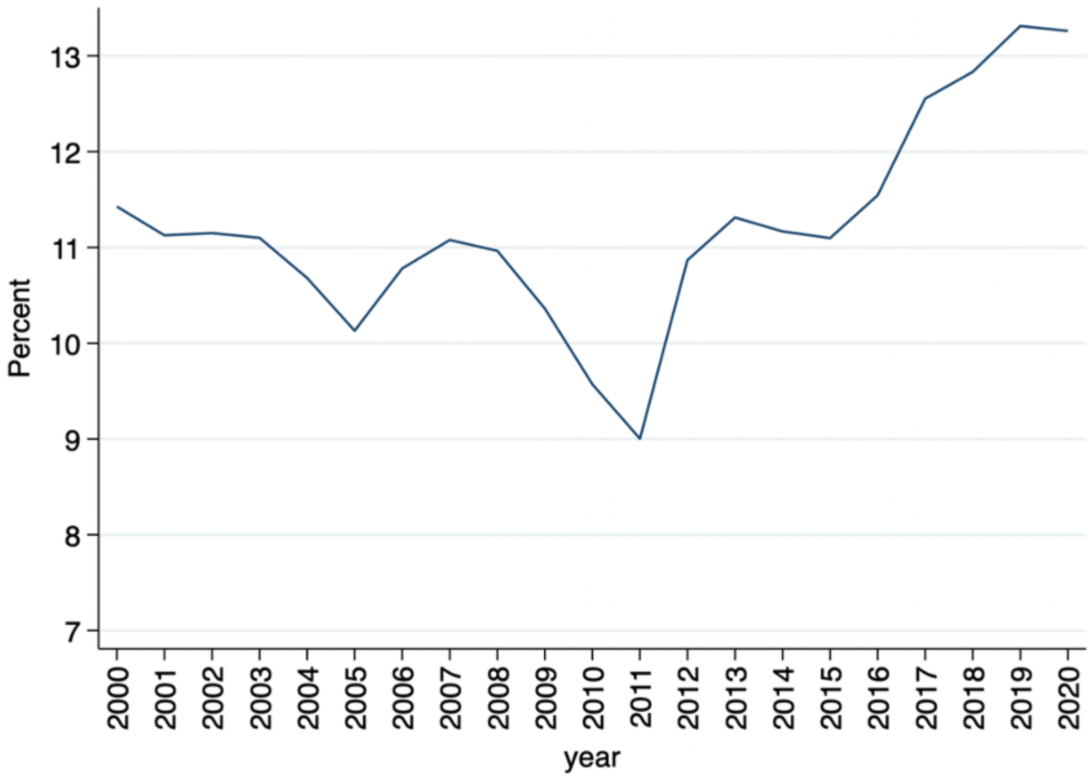
$$\frac{\textit{equity (in euros)}}{\textit{total assets (in euros)}} \; \textit{x 100}$$

We find that the average equity ratio of the EIB between 2010 and 2020 equals 11.5 percent, while the average equity ratio of the 20 largest commercial banks in the EU during these years was 5.5 percent.[1] Thus, the EIB operates with much lower leverage than commercial banks. Over time, the EIB's equity ratio has increased from 9.6 percent in 2010 to 13.3 percent in 2020 as the EIB accumulated profits while not increasing its lending (Figure 6).

1 The average equity ratio of the 20 largest commercial banks in the EU between 2011 and 2020 is calculated as the equally weighted average equity ratio of the 20 banks with the highest average total assets. The data is obtained from Bankfocus.

Its high equity ratio and low loan losses help to ensure that the EIB maintains the highest possible credit rating (triple-A status) which in turn ensures a low cost of funding. This enables the EIB to offer loans at low interest rates while remaining profitable. However, there is no obvious reason why ensuring a low cost of funding requires such a high equity ratio and low loss rates, especially if one considers the EIB's implicit political guarantee. Rather, these indicators point to a missed opportunity by the bank of the European Union to use its existing resources to finance more projects with larger potential impact (and risk) on European economies and societies.

Fig. 6: EIB equity ratio



Note: data obtained from Bankfocus, supplemented by data from the EIB annual reports.

4.2.1 The historical development of the EIB's conservatism

The fact that the Financial Times considers the EIB a 'conservative lender' may be traced back to the bank's original mandate and function as a political institution in the form of a development bank rather than a credit institution that works similar to private banks. Whether the EIB's conservatism can be empirically substantiated is one question; whether the shape and form of the EIB can be changed is another. To investigate the latter question, we look at the history of the EIB to understand how the EIB became the institution it is today.

The original objectives outlined in 1958 fit into three categories: development; integration; and financial mediation. At that time, there was no EU, only European Communities, financial markets were heavily regulated, and the state was considered a vital player in economic management. Against this background the EIB was established as a conservative lending institution, funding state and municipality projects for development and integration, and thereby acting as a traditional bank rather than a passive financial market mediator.

The EIB in its early days was primarily used to support underdeveloped regions in the union's periphery. As a response to the oil crises in the 1970s, the EIB's function developed an emphasis on financing energy projects. The EU realised that being overly dependent on oil imports from foreign countries for energy is a suboptimal political situation and thus started to establish its own energy paradigm. As a result, between 1973 and 1982 the EIB tripled its lending to support energy projects (Bussière 2008). Clearly, the EIB was used as a vehicle to support a political vision (Clifton et al 2014). At the same time the World Bank shifted its orientation away from development towards structural adjustment programmes, which created additional pressure for the EU to re-evaluate the role of its own bank.

Following the rise of neo-liberalism in the 1980s, the EIB's function also changed. The neo-liberal ideology meant that the state should not substitute private capital, rather only guarantee its smooth functioning. Corresponding to the new political climate, the EIB became a 'market maker' institution, which meant that it had to consider potential 'crowding out' of private investment in its lending decisions. The EIB changed its focus towards supporting the private economy and the profit-making ability of private firms, rather than complementing or substituting private capital. The dogma was that private capital would seek innovative investment opportunities, and the EIB should support that. The EIB's functioning has effectively remained this way ever since, as highlighted by its ongoing need to show that there is a market failure before it can provide financing as specified in its Additionality and Impact Measurement framework.

Importantly, similar to the shift towards independent energy production in the 1970s, the EIB's shift towards promoting and supporting private capital in the 1980s was a conscious choice influenced by contemporary political visions. To conclude, a lesson from the history of the EIB's conservatism is that it is a political choice grounded in its historical context. However, this also implies that it can be changed if there is the political will to do so.

4.3 Low environmental and social impact of lending

As we have outlined above, the EIB's lending largely follows a logic of addressing market failures rather than providing an alternative to market conditions. Since the 1980s, most EIB lending has been governed by an essentially market-based set of criteria (Clifton et al 2014), where a distinction is made between 'financial appraisal' and 'economic appraisal'. Financial appraisal assesses the financial sustainability and rate of return of projects, much as a private-owned bank would. It is in economic appraisal that the EIB is meant to evaluate projects based on broader criteria that would not be applied by private actors. As explained in the EIB's most recently published guide to economic appraisal, it is intended to correct for the inadequacy of financial appraisal in providing an 'estimate of the value of the project from a 'social' or 'European' point of view (EIB 2020, 16).

However, the social elements of the measure for economic appraisal are limited, as acknowledged by the EIB in its own account of its economic appraisal: 'economic appraisal tends, in practice, to focus on economic efficiency, implicitly valuing a euro of additional income equally across different income and social classes. Explicit welfare weights can be introduced in theory but have proven difficult to apply in practice' (ibid). The potential of the EIB's economic appraisal is moreover restricted by the fact that it is developed in a manner which is only able to assess risks and benefits by consciously seeking to correct market imperfections, using cost-benefit analysis to attach a price to these risks and benefits (ibid). The market logic of the EIB's economic appraisal is perhaps best illustrated by the fact that it must show that its involvement produces a financial advantage to the borrower. Acknowledging some of these shortcomings, the EIB adds that 'for this reason, the Bank requires that – outside of any cost-benefit calculation – the Bank's social guidelines are observed as a precondition for financing a project' (ibid, 27).

In contrast to its social lending impact, the last few years have seen important modifications to its project evaluation logic to support the focus on sustainable finance. An 'Environmental Policy Statement' and 'Environmental Guidelines' were developed by the EIB for the first time in 1996 and 1997 (EIB 1997). In 2009, these two initiatives were combined into the 'Environmental and Social Policy Statement' (EIB 2009), which is being updated in 2021 (EIB Group 2021). In 2009, the EIB also established a 25 percent target for climate-related financing. It exceeded this to reach 43 percent in 2019 and will aim for a target of over 50 percent by 2025. It actively voices its desire to turn into a 'climate bank', launching its Climate Bank Roadmap in 2019 (EIB Group 2020). Today, the EIB completes a climate risk assessment for each potential investment project. This assessment includes a shadow cost of carbon in the economic appraisal of projects (EIB 2019). As outlined recently by Carreras and Griffith-Jones (2021), these changes have amounted to a substantial improvement in green financing through the EIB.

Furthermore, an increasingly important exception to the conventional criteria for normal EIB funding comes from the funds associated with 'Special Activities', such as the EFSI and InvestEU programmes. A central stated aim of both the EFSI and InvestEU has been to provide 'additionality', seeking to providing funding to 'address market failures or sub-optimal investment situations' that 'could not have been carried out in the period during which the EU guarantee can be used, or not to the same extent, by the EIB, the EIF or under existing Union financial instruments without EFSI support' (European Commission 2021). Although assessment of how these criteria operate in practice is hindered by a lack of transparency (Rinaldi and Ferrer 2017), it nonetheless seems to have provided and mobilised new levels of investment for targeted areas such as digital and energy projects, especially in Western Europe (ibid). By 2018, Special Activities constituted 30 percent of the total signature volume, in contrast to 9 percent in 2015, where the vast majority was in the form of EFSI funding. This trend is expected to continue when InvestEU replaces EFSI in 2021.

We can see that the EIB's scope and functioning has again changed alongside contemporary political ideology. It is notable, however, that this recent shift towards environmental concerns has not been complemented by a comparable concern for a just transition, or for social or economic goals more generally. In many respects, its social and economic considerations remain limited, especially when it comes to labour standards. For instance, as outlined in the EIB's operational translation of the 2009 Environmental and Social Policy Statement, recipients are required only to abide by ILO Core Labour Standards and national law (EIB 2018). The ILO Core Labour Standards represent a bare minimum, with requirements for freedom of association, freedom from forced labour, freedom from child labour, and non-discrimination in employment.

An exception to this has been developed through the EU Programme for Employment and Social Innovation (EaSI), which in 2019 launched a funded instrument for social enterprises, managed by the EIF [2] with contributions from the EIB and EU Commission. However, the EaSI-funded instrument also shows the limits in this area of EIF or EIB financing in several respects. First, it is a by-product of a particular EU Commission programme and has no equivalent in either core EIB financing or in the EFSI or InvestEU. While the EFSI and InvestEU have emphasised many priority areas for investment, social enterprises, or enterprises with higher social or labour standards, are not among them. Second, the amount of financing involved in the EaSI-funded instrument is very small in the context of overall EIB Group financing, with a fund of only €200 million. Third, the range of targeted enterprises covered under EaSI conditions remains quite broad. As well as encompassing all enterprises that can claim to fit under the broad rubric of a 'social enterprise', it is also meant to support microfinance projects.

2 The EIF is a public-private partnership made up of the EIB, the European Commission and a plethora of financial institutions from the EU member states, the UK and Turkey and part of the EIB Group.

4.4 A lack of political accountability

Accountability can be described as an obligation by an institution 'to explain and justify their actions or decisions against a set of criteria' to another institution thereby assuming responsibility for shortcomings therein (Howarth and Spendzharova 2019, 897; with reference to Lastra and Shams 2001). Accountability is associated with higher output legitimacy (Benedetto 2020, 229; Stephenson 2017, 1146) and has been referred to as 'a cornerstone of legitimacy in representative democracy' (Howarth and Spendzharova 2019, 897), serving as a safeguard against abuse of power (Przeworski et al 1999; Schedler 1999).

A measure of accountability can be seen in the ways individuals can seek redress if their interests are affected by EIB decisions (vertical accountability; Howarth and Spendzharova 2019, 897). The EIB's vertical accountability [3] is regarded as relatively advanced (Lloyd et al 2008; Nanwani 2014). More importantly for our purposes, there is also the EIB's accountability to other national and supranational bodies, especially the democratic accountability to the European Parliament (EP) (horizontal accountability; Howarth and Spendzharova, 2019: 897). The EIB's horizontal accountability is first and foremost to its shareholders, that is, the EU member states. Their finance ministers form the EIB's Board of Governors, responsible for the most fundamental governance decisions. Furthermore, high-level officials from national finance ministries, complemented by one Commission official, make up its Board of Directors, which formally takes the majority of important operational decisions (Art. 7 and 9 EIB Statute).

Regarding the EU level, the EIB is accountable mostly to the Commission, one of the members of the Board of Directors being nominated by the Commission (Art. 2.2 [2] EIB Statute). Moreover, the Commission must deliver an opinion on each investment project before approval. A negative opinion can only be overwritten by a unanimous vote (Art. 19.2 [2] and 19.6 EIB Statute).

In addition, the EIB also has a relation of accountability with the Council; this is firstly because the ministers making up the Board of Governors are also council members (usually the ECOFIN [Economic and Financial Affairs] Council). The Council can also request the EIB to take initiatives (see for example Art. 126.11 TFEU), the president of the EIB is invited to attend ECOFIN meetings, and EIB representatives are present in meetings of Council preparatory bodies (Ban and Seabrooke 2016, 38).

The European Parliament, the institution that could provide the most robust direct democratic accountability, is the institution that has the least close accountability relationship with the EIB. Formally, the EIB is not required to appear before the EP or answer to it. The EP does not have any reporting obligations on the EIB's activities (Kramer 2015, 198 ff, 205 f). If a case moves from the internal EIB Complaint Mechanism to the European Ombudsman, this latter body reports to the EP (Article 228.2 [2, 3] TFEU). This adds a certain layer of formalised democratic accountability (Pistoia 2014, 343), but this democratic oversight is extremely indirect, only works ex post, and regards only individual issues of stakeholders.

In practice, the EIB's intergovernmental accountability logic leaves only limited accountability toward the EP. This is somewhat mitigated by the own-initiative interest that the EP is showing and co-operative behaviour of EIB officials. The EP issues an own-initiative report on the activities of the EIB on a yearly basis (see for example, European Parliament 2021). The EIB president appears once a year before the EP and questions are generally answered (Kramer 2015, 200 f, 205 f). However, due to the voluntary nature of the report, the EP does not have full access to EIB material but can only draw on public documentation. Finally, and maybe most importantly, although the yearly EP reports are of course forwarded among others to the EIB, the latter has no obligation to justify itself, react to the report's findings, name improvements made, or give reasons why the report's proposals have not been followed.

3 The EIB has an internal complaints mechanism that individuals can turn to. If the matter is not resolved by this mechanism, the individuals can turn to the European Ombudsman as an actor independent from the EIB.

The lack of horizontal EIB accountability to the EP is in stark opposition to the situation that could be found in the EIB-related EFSI when it was operational (2015-20). Given the fact that it administered EU money (EU budget guarantees), the EP had large-scale controlling rights (Benedetto 2020). The same can be said about InvestEU, although it does not totally follow the example of the EFSI and thus does not fully reach the level of accountability of the EFSI. In any case, the EIB is significantly more accountable towards the EP in its off-balance-sheet activities than in its core lending business.

OUR PROPOSALS TO UNLOCK THE EIB'S FULL POTENTIAL

5. OUR PROPOSALS TO UNLOCK THE EIB'S FULL POTENTIAL

For the EIB to become more important in supporting the progressive policy goals to foster development and innovation across the European Union, it must become a more explicit fully fledged political instrument with greater loan capacity and accountability vis-à-vis EU political institutions. To achieve this end, we propose four sets of reforms on three dimensions of the EIB's nature: (6.1) the EIB's lending activities; (6.2) the EIB's democratic accountability; (6.3) the EIB's funding capacity.

5.1 The EIB's lending activities

5.1.1 Lending targeted to social and environmental criteria

The evolution of the EIB's climate-related financing can serve as a model for developing the social element in EIB funding. Just as the EIB's environmental criteria have evolved from relatively weak negative guidelines to positive targets for climate-related lending, the relatively limited negative baseline of social guidelines contained in the Environmental and Social Policy Statement should be complemented by positive targets for a substantial percentage of EIB financing to be allocated to projects and enterprises that follow exemplary social standards. Three separate targets could be developed:

First, a target could be set for financing to be allocated to bodies with a democratic ownership structure such as co-operatives.

Second, a further target could be set for funding the broader category of 'social enterprises', following the European Commission's definition of social enterprise as 'an operator in the social economy whose main objective is to have a social impact rather than make a profit for their owners or shareholders', including:

- those for whom the social or societal objective of the common good is the reason for the commercial activity, often in the form of a high level of social innovation;
- those whose profits are mainly reinvested to achieve this social objective;
- those in which the method of organisation or the ownership system reflects the enterprise's mission, using democratic or participatory principles or focusing on social justice.

Third, a broader target should be set for financing companies who follow exemplary standards in their internal management and engagement with communities, including gender equality, application of standard employment contracts to all workers, union recognition and wage-setting through collective bargaining, with such criteria to be applied to all enterprises regardless of size.

5.1.2 Provide more patient equity funding rather than debt

We support the various proposals that have been made to transform liquidity assistance provided to firms during the Covid-19 crisis into equity by means of public money (see, for example, Thiemann and Voberding 2021).

The Covid-19 pandemic resulted in serious liquidity problems for many firms due to the sudden lockdowns. Many of these businesses were profitable before the pandemic and experienced financial trouble due to reasons beyond their control. Without liquidity assistance schemes, many of these undertakings were at risk of bankruptcy. At the European level, the Commission adopted a temporary framework consisting of a series of measures to relax state aid rules so that governments could support national businesses through the crisis by means of tax subsidies. National promotional banks and the EIB have also enacted measures to provide liquidity assistance, for instance via the Pan-European Guarantee Fund and the European Investment Fund's COSME Loan Guarantee Facility and InnovFin SMEG (Mertens et al 2020).

The gravity of the ongoing situation suggests the need for greater involvement by the EIB and for the transformation of liquidity assistance into equity. While liquidity assistance programmes were successful in avoiding an immediate extreme wave of firm defaults, they also resulted in firms accumulating large amounts of debt, which will likely become an issue in the future. Thus, Thiemann and Volberding (2021) envisage a €500 billion convertible-loan programme financed by the EIB and based on a set of criteria established ex ante to determine companies' eligibility on the basis of, for example, ecological footprint or other social considerations as well as specific conditions for the conversion of debt into equity. The EIB would operate with the help of national development banks to extend these loans and provide technical assistance to companies at the local level. In case of protracted economic hardship due to the pandemic fallout, loans that cannot be repaid would be transformed into equity in the company and the ownership transferred to the EIB or to the EIF, which has already built expertise in equity investment since the EFSI.

5.2 The EIB's accountability

The accountability framework of the EIB inevitably affects its lending policy. The current intergovernmental accountability of the EIB instead of accountability to the EP harms the democratic legitimacy of the EIB, and the EU at large. Democratic accountability towards the Parliament gives MEPs the opportunity to question the lending policy and sway it to be more policy-led and socially impactful. In addition, as mentioned above, it is argued that stronger democratic accountability leads to higher output legitimacy (Benedetto 2020, 229; Stephenson 2017, 1146), so that a higher degree of democratic accountability is able and necessary to justify a more political role for the EIB.

As a first step to address this issue, we propose an inter-institutional agreement between the EIB and the EP, focused on accountability mechanisms (see also Ban and Seabrooke 2016, 39). Such an agreement could ensure that EFSI standards on accountability are also applied to the rest of the EIB's activities. These standards have already been implemented in practice in recent years and would simplify the working arrangements between both institutions by providing one single, consistent accountability framework. As this solution largely formalises what is already practice between both institutions, it does not lead to a significant additional burden on either actor. Yet it would make it a legal duty for the EIB to answer to MEPs, thus making the accountability mechanism more reliable.

As an inter-institutional agreement still implies voluntary co-operation between two bodies at the time of negotiation, a long-term aim should be to establish a more robust accountability standard on a solid legal basis. The reporting duties of the ECB, laid down at Treaty level, could serve as a model for such a mechanism. However, reaching this level of accountability would require amending several Treaty provisions.

As such a thorough Treaty change is difficult to imagine in the current political situation, perhaps a more straightforward alternative solution could be to change only the position of the EU within the EIB: the EU could become a full member, that is, a shareholder of the EIB alongside the EU member states, as proposed also by the EP itself in its annual reports on the EIB between 2010 and 2014.[4] In this case, the EU share would be an EU 'asset' (Art. 318 TFEU), bringing EIB activities under the discharge procedure with which the EP controls the financial conduct of all EU institutions, agencies, and bodies on a yearly basis (Art. 319 TFEU, Art. 260-262 Financial Regulation). This gives the EP controlling rights and obliges the addressees of discharge decisions to react to its reports. Making the EU an EIB member would fully insert the bank in the EU's financial accountability framework (see also Kramer 2015, 276).

5.3 The EIB's funding: increase EIB capital

The EIB statutory lending limit of 250 percent of its subscribed capital currently undermines the ability of the EIB to expand its core lending activities. Therefore, we propose to convert the capital reserves that the EIB has accumulated through profits over the years into paid-in capital.

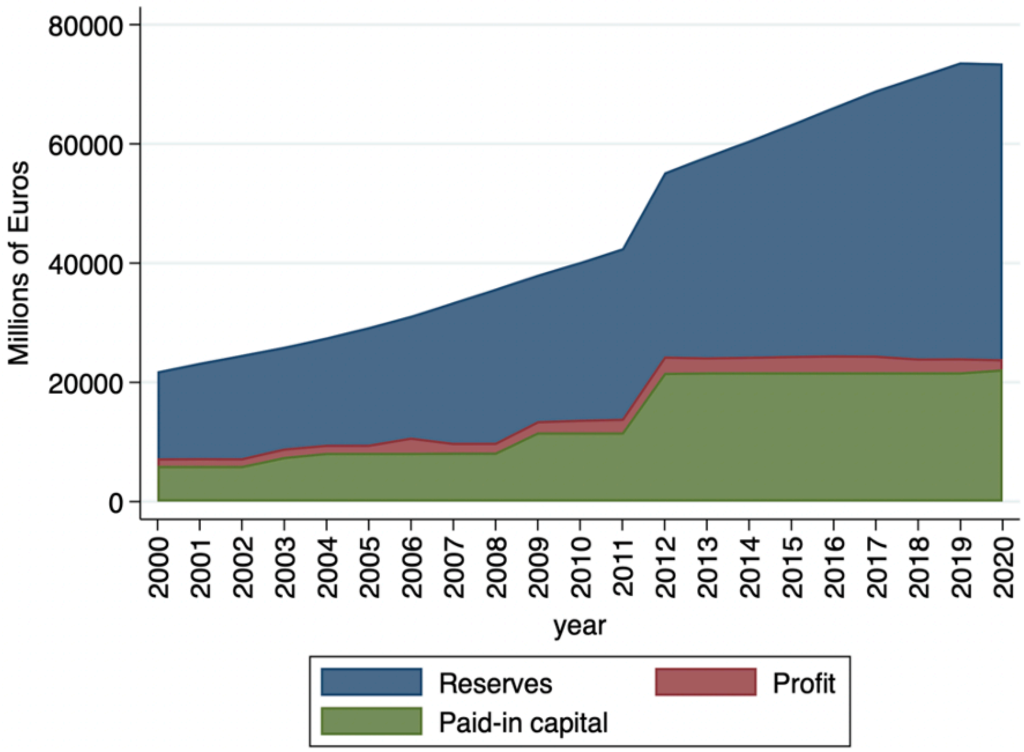
Furthermore, we suggest in particular for all EU member states to agree to allocate this new equity to the EU, making the EU a new member and shareholder of the bank.[5] The proposed conversion would mean an immediate capital increase that, depending on the exact implementation, could add more than 125 billion euros to the EIB's lending capacity without any additional financial commitment by EU member states. At the same time, such a conversion would be budget-neutral for the EU when it pays in the entirety of its subscribed capital (cf Kramer 2015, 46). This would result in an EIB membership of the EU without any further liability, and it would come with accountability benefits as described previously. The feasibility of converting accumulated profits into EIB capital was proven in 2020, when after Brexit the UK's share of paid-in capital was replaced by an equal amount from the EIB's own reserves (EIB Financial Report 2020, 7).

As of 31 December 2020, the EIB has accumulated as much as €49.6 billion in profits as reserves on its balance sheet (Figure 7). Its reserves have grown continuously due to the relatively low-risk profile of EIB lending and has increasingly grown out of proportion to the capital of its shareholders: even the biggest shareholders of the EIB – France, Germany, and Italy – hold only €46.7 billion each in subscribed capital. Compared to the overall subscribed capital of about €249 billion, the accumulated profits amount to almost 20 percent. The accumulated profits are more than double the €22 billion paid in by all EU member states combined.

4 European Parliament resolution of 6 May 2010 on the European Investment Bank's annual report for 2008 (2009/2166[INI]), recital 5; on the 2009 Annual Report of the European Investment Bank (2010/2248[INI]), recital 13; European Parliament resolution of 29 March 2012 on the European Investment Bank (EIB) – Annual Report 2010 (2011/2186[INI]), recital 106; European Parliament resolution of 7 February 2013 on the 2011 Annual Report of the European Investment Bank (2012/2286[INI]), rectial 13; European Parliament resolution of 11 March 2014 on the European Investment Bank (EIB) – Annual Report 2012 (2013/2131[INI]), recital 81.

5 Currently, only the EU member states are shareholders of the EIB. This is due to Article 308 (2) TFEU, which lays down that '[t]he members of the European Investment Bank shall be the Member States'. In addition, this is fixed in Article 3 of the EIB Statute. Article 308 (3) TFEU lays down that the EIB Statute can be changed using a simplified amendment procedure by a unanimous Council decision. However, this is not possible for Article 308 TFEU itself. Consequently, our reform proposal would only be feasible in the context of an admittedly difficult Treaty reform, possibly in the context of the Conference on the Future of Europe, which may lead to such a reform. However, it would be a very small and targeted, surgical amendment, which may be easier to accomplish than a thorough reform.

Fig. 7: EIB equity composition, in million euros



Note: data obtained from Bankfocus, supplemented by data from the EIB annual reports.

How much additional lending can be achieved by converting reserves to EU capital? If we assume that all of its reserves are converted into paid-in EU capital, our proposal would immediately increase the EIB total lending capacity by €125 billion (€50 billion x 2.5).

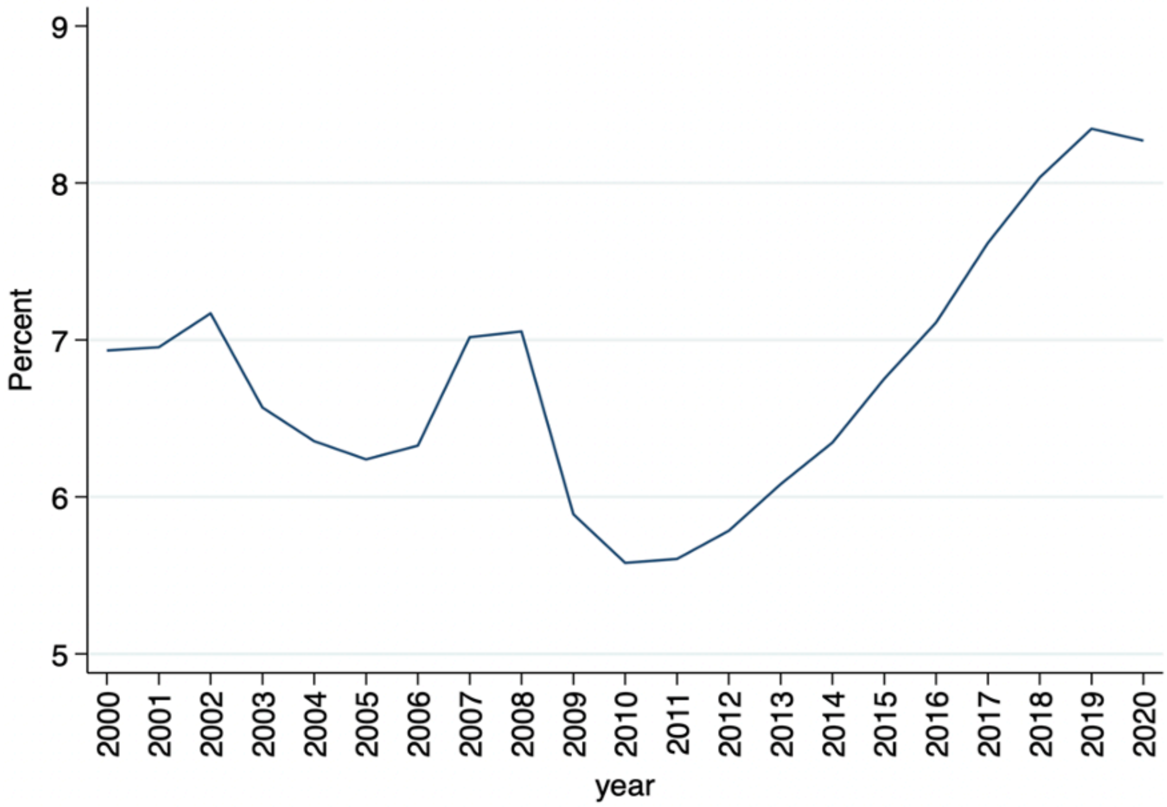
However, the EIB benefits from a triple-A credit rating partly because of its accumulation of reserves. If it encounters unexpected losses, its ability to repay its debt will not be affected due to the high amount of retained profits. If there are no accompanying measures securing the triple-A status,[6] a mediating proposal could be to only convert part of its accumulated reserves to ensure its future triple-A credit rating (although having the EU as an official shareholder may also assure the financial markets that the EIB debt can be always considered without default risk). Figure 8 shows that in 2019 its reserves were at an all-time high of 8.3 percent of total outstanding loans, compared to between 5.5 percent and 7.1 percent between 2000 and 2015.

Thus, instead of converting all €50 billion of reserves, converting only €17 billion of reserves into EU paid-in capital will bring the EIB back to a 5.5 percent reserves to outstanding loans ratio, while adding more paid-in capital than the combined subscribed shares of the Netherlands and Finland. This conversion would raise the EIB's statutory lending capacity by €42.5 billion while certainly not harming its triple-A credit rating.[7]

6 An example could be a more explicit collaboration between the EIB and the ECB.

7 Clearly, if the EU were an official shareholder, the EIB would be able to operate with lower reserves and higher leverage without its triple-A credit rating being questioned. Thus, our estimated 17 billion euro of reserves that can be converted without endangering the triple-A credit rating of the EIB is a very conservative estimation.

Fig. 8: EIB reserves relative to outstanding loans



Note: data obtained from Bankfocus, supplemented by data from the EIB annual reports.

Our proposal would first of all increase the capital of the EIB at a time when investment is needed due to the Covid-19 pandemic and the EIB's statutory lending limit has been almost reached. Second, it would integrate the EIB more coherently into the EU framework: currently the Commission in particular plays an important role in the EIB governance (especially in the operative Board of Directors) but it does so as an alien element within the structure, which otherwise consists only of shareholder (member states) representatives. Making the EU a shareholder would turn the EU into an equal among equals, and also give it access to the Board of Governors, which takes the most fundamental decisions in the EIB governance, and which is currently reserved to EU member states only.

Third, the newly introduced EU EIB capital could be a mechanism to structurally deal with accumulated EIB profits in future. Situations will continue to arise in which there will be a particular need for an abrupt expansion of EIB investment. Therefore, we envision that those future profits should not automatically be added to the EU's EIB capital continuously, rather there should be a specific crisis mechanism which allows the Board of Governors or, alternatively, the Council, to raise the EU capital by the amount of profits accumulated in the meantime whenever the sudden need for investment arises. Taking such a decision in a comparatively uncomplicated procedure would immediately give the EIB the opportunity to invest two and a half times the profits put aside since the last capital raise.

CONCLUSIONS

6. CONCLUSIONS

The European Investment Bank is currently in the process of turning itself into the ‘EU’s Climate Bank’, which is in line with progressive policy goals. This entails changing its financing and risk assessment policies and means a thorough overhaul of its business model. This ongoing transition, as well as the current post-Covid situation of the EU economy and internal market, provides an opportunity to progressive policymakers to review the role of the EIB in the EU more profoundly.

This window of opportunity should be used. The European Parliament specifically should push for opening a new chapter in the history of the EIB.

First, the EIB lending should become more impactful through the introduction of more progressive lending criteria. This lending should, second, not be provided only or primarily in the form of loans, but also as equity, especially to SMEs. Third, such a modified lending model should not be left uncontrolled in the hands of a singly body, but should be accompanied by firm accountability mechanisms. Specifically, the European Parliament should not let the EIB escape its scrutiny, and at least conclude with it an inter-institutional agreement on accountability. A more robust accountability relationship, however, could be achieved through our fourth proposal: by way of a targeted Treaty amendment, the EU should be turned into a shareholder of the EIB by converting retained profits into EU capital. This would bring the EIB under the full democratic control of the European Parliament, while significantly enhancing the EIB’s lending capacity, both at the current point of time and structurally during future crises.

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