**COUNCIL OF THE EUROPEAN UNION**

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**NOTE**

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| from | : | COUNCIL (Ecofin) |
| to | : | European Council |
| Subject | : | Final Report on the European Action for Growth |

Delegations will find attached the Final Report by the Ecofin Council to the European Council on the European Action for Growth, as adopted on 25 November 2003.

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Encl.:

*European Action for Growth*

**Final report by the Ecofin Council to the European Council**

Building on its interim report endorsed by the October European Council, the Ecofin Council herewith submits its final report on the European Action for Growth Initiative. Strengthening the long-term growth potential of the enlarged European economy is a key goal. The Council considers that the Growth Initiative will provide a useful contribution to achieving that goal as part of the Lisbon strategy, and therefore recommends to the European Council to endorse the Action as outlined below.

## 1. *The strategic framework*

The Council considers that the Growth Initiative is an important step in the implementation of the Union's Lisbon reform agenda to improve competitiveness and the Union's growth potential through higher investment in both physical and human capital. It is an integral element of the implementation and follow-up process of the EU's common strategy based on sustainable public finances, economic reforms aiming at a higher employment rate, and well-functioning capital, product and labour markets. In line with the guidance by the European Council in October, the Initiative will be implemented in respect of the Broad Economic Policy Guidelines (BEPGs), the current Financial Perspective ceilings, and the firm commitment of sound public finances within the Stability and Growth Pact.

## *2. Selection of investments*

The Initiative will cover material as well as immaterial investments in two broad areas: the trans-European network infrastructure (TENs) including transport, telecommunications and energy, and innovation and R&D.

On trans-European network projects, the European Council invited the Commission, the EIB and the relevant formations of the Council to establish, without prejudice to the priorities identified in the Commission proposal, a "quick-start programme" identifying a list of projects in an enlarged Union based on transparent criteria, along with assessments of (i) their significance for the integration of the internal market in an enlarged Europe, (ii) their economic and financial viability, (iii) their impact on growth and (iv) the leveraging effect on private capital.

Working together with the EIB, the Commission has now proposed a quick-start programme of projects meeting the following criteria: (i) high level of maturity; (ii) trans-frontier dimension; (iii) impact on growth and innovation in the enlarged EU; and (iv) benefits to the environment.

Necessary non-financial action should be taken by all parties involved to design and ensure actual implementation of the quick start programme so that the EIB along with other actors can proceed with the financing of the identified projects, subject to the Bank's statutory requirements.

The October European Council highlighted the importance of significantly improving the flow of funding for innovative enterprises and new entrepreneurs. On innovation, R&D and skills related projects, the Council therefore stresses the importance of selecting projects that facilitate the creation and development of innovative companies and help to take full advantage of the Union's R&D effort, which support the capacity of the Member States to respond to the human capital, skills and life-long learning needs of a modern economy, based on their economic and financial viability, as well as their ability to mobilise private sector resources. The Council invites the EIB and EIF in particular to give specific attention to funding of innovative SMEs operating on the technological boundary, business start-ups, high-tech firms and micro-enterprises.

Be it trans-European networks or innovation and R&D, the Council considers that the conditions and criteria for selecting possible growth enhancing investments set up by the European Council should be strictly applied. The investment should not crowd out private sector financiers, but help attract the private sector to commit capital.

The EIB and the EIF are invited to consider the projects identified and continue to base project appraisal and selection strictly on sound banking and industry practice and procedures, in particular their economic and financial viability, for only well-defined projects with a true European dimension taking into account regional balance. The strengthening of TEN, innovation and R&D activities by the EIB group should be in line with its key goal of fostering economic and social cohesion. Absorption will be determined by the availability of projects that meet the above mentioned criteria. The EIB and the EIF should assist poorer countries to prepare viable projects.

### *3. Specific features of the Initiative*

The Initiative rests on a close collaboration between the Member States, the Commission and the EIB in the implementation of the quick-start programme. All actors have to play their role in order for the initiative to succeed. The Council recommends to the European Council to endorse the following specific features of the Initiative:

#### *a) EIB contribution*

**Trans-European network projects**

– Enhance EIB support for the financing of TENs, through the establishment of an up to 50 billion euros senior loan facility for the period 2003-2010;

– Improve the range of financial instruments available to increase the private sector leverage in the financing of TENs:

 (a) long-term EIB loans with extra long maturities of up to 35 years (and appropriate grace periods),

 (b) guarantees by the EIB for investment grade projects during their construction phase,

**Innovation and R&D**

- Mobilise 40 billion euros from 2003 to 2010 within the EIB's Innovation 2010 Initiative (i2i) (resulting in 50 billion euros from 2000 to 2010);

- Develop new funding arrangements within the EIB to foster the development and market introduction of new technologies, including grouped loans for specific research activities, technology platforms, and simplified lending procedures for midsized firms ('midcaps'), the extension of maturities, capital grace periods to match the cash-flow characteristics of projects, and in exceptional cases the maximum permitted EIB loan amount for 'leading edge' research and innovation including by corporates;

- Step up the provision of venture capital to innovative SMEs by the European Investment Fund (EIF) through the release of an additional 500 million euros from the Bank's operating profit for venture capital operations, and stepping up the Fund's guarantee and advisory activities.

Covering both broad areas of the Initiative, an additional allocation of 250 million euros to the Bank's Structured Finance Facility for financing up to 2.5 bn euros of new projects to provide senior and subordinated debt, and guarantees, mezzanine finance and quasi equity.

**Securitisation**

The European Council has invited the Bank and the Commission to develop instruments aiming at leveraging private capital, in particular through the securitisation of existing assets, and examine which assets could be used for such purposes. The EIB for its part proposes to collaborate with major European institutions to increase the flow of funds into suitable infrastructure projects. Whilst those institutions seek a diversification of the maturity (long-term investments) and risk profiles of their investment portfolios, investment by major institutions (private and public pension funds, and life companies) to infrastructure is often hampered by restrictive legislation in the Member States. The Bank is therefore prepared to establish, and manage, specific co-financing mechanisms – "Securitisation Trusts" -, which will allow public and private institutions to co-invest in investment grade infrastructure PPP projects that the EIB is financing, and attract additional private finance through the securitisation of their infrastructure assets.

The Securitisation Trusts would be flexible co-financing structures under which the EIB could participate and/or organise and manage infrastructure securitisations. Separate Securitisation Trusts could be established per country and/or per sector as circumstances require. The EIB has statutory limits as to the areas of activities it can cover (projects, infrastructure). The Council invites the Bank to develop such Securitisation Trusts, in collaboration with the public authorities and public and/or private sector financial institutions, and within the limits of the EIB Statutes and subject to Eurostat rules work with the Member States as they seek to mobilise resources by bringing infrastructure assets to markets. The final decision on the implementation of such securitisation schemes should be taken by the governing bodies of the EIB. The Commission, in its report, also underlines the potential importance of securitisation as a means of increasing the available pool of resources from financial markets and suggests a similar approach to that discussed by the EIB to help develop the market.

**Financing framework**

Protecting the EIB's AAA rating is of utmost importance, through the application of best banking practices in the selection of projects of acceptable credit quality, and a careful accumulation of outstanding loan portfolios.

Regarding the implications of the Initiative on the Bank's capital, the EIB considers that the lending figures envisaged under the Initiative (50 billion euros for TENs and another 40 billion under i2i) are consistent with the current Bank's multi-annual planning as provided by the 2002 decision on the timing for capital increases (i.e. no increase before 2008). The amounts mentioned above are, according to the Bank, also compatible with the objective of maintaining the ability of the Bank to self-finance (in terms of paid in) the next capital increase. The Council considers that both decisions, i.e. no capital increase before 2008 except for the consequences of the enlargement, and to ensure that the Initiative will not affect the accumulation of the Bank's reserves should be fully respected. In this respect, the necessary long-term reconstitution of reserves might be eased by the continuation of appropriate risk pricing by the Bank.

However, for given capital, a significant additional headroom would be provided under the statutory revision proposed by the Bank in connection with the proposed change of its Statutes. If such revision came into force, the Bank's management estimates that it would provide an additional headroom of up to 70 billion euros of lending between the ratification of the change in the Statute and 2008, without bringing forward the next capital increase, part of which could be allocated to the Initiative.

***b) EU contribution***

The Council takes note of the actions at EU level envisaged in the Commission report aimed at reducing the non-financial barriers to project implementation. In particular, with respect to the financial aspects, and while respecting the current Financial Perspectives, the Commission is invited to redirect expenditure where appropriate towards growth-enhancing investment in physical and human capital and knowledge. It should take advantage of the mid-term review of the Structural Funds to allocate the performance reserve in 2004 as far as possible to further Lisbon related activities. This should be agreed in advance with the Member States. Possible implications for the EU budget (through the Structural Funds, the TENs budget line, the Sixth Framework Programme) should not go beyond previously existing obligations - and not preempt the negotiations on the next Financial Perspectives. The Council takes note that the Commission has proposed the possibility of a higher rate of Community co-financing for TENs, for example in specific cases which are cross-border or cross-natural barriers.

In addition, the Commission is examining the possibility of developing a specific Community debt service guarantee instrument to cover certain post-construction risk in TEN transport projects. The objective of such a guarantee is to accelerate the conclusion of financial packages. Its focus would be on the risks of traffic/revenue shortfalls during the initial period of the post construction phase of projects. The guarantee would partially cover shortfalls measured relative to an agreed break-even base scenario during an initial period of the post-construction phase. A portion of the total revenue risk would be borne by the private sector. The Commission is currently studying whether such an instrument is a workable response to the needs of market operators and testing whether Member States would be willing to share in the risks by providing guarantee matching.

The Council invites the Commission to prudently continue exploring this option and, if appropriate, make a proposal. Possible risks would need to be clearly identified so as to control the commitment on the EU budget as well as the impact on Member States' budgets. Issues to be resolved before any commitment can be made may inter alia include: (i) the funding of the instrument and the building up of resources, (ii) appropriate risk diversification and budgetary risks (recourses to the Community budget for losses over and above an earmarked "liquidity cushion" can not be excluded unless the amounts set aside cover a substantial part of the guarantee exposure[1]), and (iii) its administrative implementation (who would assume the role of risk assessor, possible conflicts of interest, methods for selecting projects, etc.).

The Council also considers that the methods of cooperation between EIB financing, Structural Funds, the TENs budget line and the Sixth Framework Programme should be streamlined and intensified, so as to improve the combined use of such financings by systematically exchanging early information on all upcoming priority projects, exploring early on co-financing possibilities and the best way of combining loan and grant finance. Co-operation agreements between the Bank and the different Community funds would be a useful framework for encouraging a more harmonized approach and thus facilitating co-financing.

***c) National contributions***

The Member States are invited to act rapidly to eliminate technical, legal and administrative obstacles to the implementation of TEN projects, notably their cross-border sections. The Initiative assumes the part financing of projects from national budgets. The precise impact will initially depend on the quick-start projects that will be decided by the European Council. However, the focus of the Initiative is to optimise the use of *existing* public resources, and the leverage provided by private capital markets.

[1] In comparison with the provisioning mechanism of the Community guarantee covering EIB's external lending it would not be possible to assess risk on a portfolio basis, as the number of projects/loans will be too low. Each proposal would probably have to be assessed and provisioned separately. The risks intended to be covered would be such that they exceed the appetite of commercial guarantors. A guarantee would have to be substantial enough to avoid a situation where the temporary relief offered would only constitute a deferral of bankruptcy.

Thus, public spending on physical and human capital under the Initiative should be financed essentially through expenditure restructuring and not via an increase in overall public spending. Any possible increases in spending on physical and human capital should be consistent with the Stability and Growth Pact and its requirement of a "close to balance or in surplus" position. Budgetary implications stemming from the provision of possible loan guarantees and related contingent liabilities falling due should be recognized.

For the evaluation of the impact on national budgets it will be important to know precisely whether a public-private partnership project forms part of government accounts or not. A task force convened by Eurostat has examined the accounting treatment of PPP schemes and is preparing guidelines within the framework of the ESA 95 manual on deficit and debt for the assessment of risk-sharing between the private and the public sector to ensure transparency including the recording of government guarantees in national accounts and the treatment of securitisation arrangements. The main principles of the proposed approach are set out at annex. The Council takes note of these principles, and invites Eurostat to conclude work on the guidelines quickly so that all the actors in the financial Community can benefit from a predictable framework.

The European Council already invited the Member States to report to the Spring 2004 European Council on initiatives in preparation or implementation at national level to increase growth and growth potential which could enhance the positive impact of the Initiative. A number of Member States already have taken steps to mutually reinforce the Initiative.

In response to this request, the Commission, through the Ecofin Council, is invited to report to the 2004 Spring European Council meeting on progress made in regard of the improvement of the quality of public expenditure.

***d) Private sector participation***

The mobilisation of private resources to finance qualifying projects is the key angle of the Initiative. Private sector involvement in projects is directly related to the prospect of a suitable revenue stream and an acceptable and appropriate risk-sharing. The private sector and public sector should respectively be responsible for bearing the risks which they are best placed to manage. The leverage effect can not be defined ex ante, but depends on the characteristics of each project.

The non-financial framework conditions for PPPs, TENs and innovation and R&D projects should urgently be improved. The Council takes note of the intention of the Commission to outline proposals by June 2004 in a green paper on regulatory issues associated with PPPs. The Council urges the Commission in this green paper to focus on measures to improve the structural and regulatory environment conditioning the involvement of private sector capital in PPPs, TENs and innovation and R&D projects, and follow-up the green paper with appropriate legal proposals by the end of 2004.

In order to secure private sector funding in this Initiative, the Council invites the Commission to explore, in collaboration with the International Accounting Standard Board (IASB), the special financial aspects related to the accounting treatment of infrastructure projects with a back-loaded revenue profile.

***e) Evaluation***

The Council invites the Commission, and the Bank, to provide a mid-term evaluation report on the Initiative on the basis of the Lisbon strategy, at the latest by 2007, on the basis of the following criteria: (i) growth effects; (ii) impact on the internal market and cohesion in the enlarged EU; (iii) mobilisation of private sector capital, (iv) acceleration of the implementation of TENs and innovation and R&D projects; (v) progress in reducing regulatory barriers.

***4. Recommendations to the European Council***

**The Ecofin Council invites**

- **The European Council to endorse the European Action for Growth Initiative, in full respect of the BEPGs, the Stability and Growth Pact, the Financial Perspectives and the agreed framework for the EIB's capital (no increase before 2008 and the self-financing of subsequent capital increases).**
- **Member States and the Commission to act rapidly to eliminate technical, legal and administrative obstacles to the implementation of PPPs, TENs and innovation and R&D projects and improve the non-financial framework conditions for these projects.**

- **The relevant actors to take the necessary steps to ensure implementation of the quick-start programme to be adopted by the European Council, so that the EIB and other relevant actors can provide appropriate financing taking into account the economic and financial viability of projects.**
- **The EIB to implement the financial instruments aiming at leveraging private capital, and to develop Securitisation Trusts, and within the limits of the Bank's Statutes work with the Member States as they seek to mobilise resources by bringing infrastructure assets to markets.**
- **The Commission, in co-operation with the Member States, to continue prudently studying the possibility of developing a specific Community guarantee instrument for certain post-construction risks in TEN transport projects.**
- **The relevant accounting bodies to come up with clear and definite financial guidelines within which these projects can be undertaken.**
- **The Commission, and the Bank, to provide a mid-term evaluation of the Initiative by the end of 2007.**

**Annex**

**The statistical treatment of public-private partnerships**

In February 2003, the Commission set up a Task Force, in co-operation with experts from the National Statistical Institutes (NSIs) of Member States, Acceding Countries, the ECB, and the EIB, to clarify such statistical treatment and to develop the necessary technical guidance regardless of legal provisions relating to PPP ownership. The Task Force has recently concluded its works and consensus appears to rally on several key principles:

- to distinguish two types of PPP: those where the contractor raises revenue direct from users of the asset (e.g. tolled road); and PPPs where the contractor charges the government. For the former, any asset is assumed to be fully owned by the contractor. For the latter, full ownership is attributed to the party most exposed to risks and rewards of asset ownership during the period.

- PPP assets should not be classified as a government asset whenever the non-public partner will bear, in any case, construction risks and one of the two following risks: (i) availability risk (depending on the performance of the partner); and/or (ii) demand risk (relating to the behaviour of final users of the assets). Other aspects to take into account are: the effect of the call of some guarantees granted by government; the classification of the unit in charge of the project as regards its autonomy of decision in respect of government; and the final allocation of the assets in some specific cases.

- if the PPP asset is considered as government asset, capital expenditure (for new asset or for significant refurbishment) will be recorded as government expenditure, with a negative impact on government deficit/surplus. As a counterpart, government will incur as new debt recorded at the same time of the expenditure.

- If the PPP asset is not considered as government asset, capital expenditure has no impact neither on government deficit/surplus nor on government debt. Regular purchase by the public partners of services from the private one will qualify as government expenditure all along the life of the contract.

The Task Force will submit its final report, for consultative opinion, to the next Committee for Monetary, Financial and Balance of payments statistics (CMFB) in January 2004. Later, a final decision will be taken in time before the official deficit and debt notification on 1st of March 2004.