



## Financing utilities: How the role of the European Investment Bank shifted from regional development to making markets



Judith Clifton\*, Daniel Díaz-Fuentes<sup>1</sup>, Julio Revuelta<sup>2</sup>

University of Cantabria, Department of Economics, Av. Los Castros sn, Santander 39005, Spain

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### ABSTRACT

In the face of continuing financial and economic crises, the European Investment Bank (EIB) has been criticized for being overly-conservative in its loans to Europe. Critics in particular have called on the EIB to vastly increase its investment in utilities as a counter-cyclical measure. To take stock and, in order to evaluate the role of the EIB in financing utilities over time, we compile and analyze an original database of all EIB utilities project loans from 1958 to 2004. We find the EIB started out by functioning as a regional development bank, prioritizing utilities finance in its members' poorer zones; however, energy crises in the 1970s marked a shift whereby the logic of EIB finance to utilities became more politically-oriented. By the 1980s, utilities projects supported by the EIB were intimately related to those required for the Single Market. The origins of the EIB's current conservative approach to utilities loans was born in the 1970s and fully consolidated by the 1990s.

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### 1. Introduction

Utilities represent a considerable challenge from the financial viewpoint. They generally require massive capital investment involving sunk costs, whilst the financial decision is often accompanied by relatively high regulatory and economic risk, as well as issues of asymmetrical information, incentives, externalities and transaction costs (Florio, 2013). Financial shortages for long-term investment purposes are particularly important, because utilities tend to be capital-intensive and have long maturities. These are some of the major reasons why private sector initiatives alone have often been insufficient to finance the development of utilities around the world. Initiatives from the public sector have also been necessary.

International Financial Institutions (IFI) have assumed an important role as part of public sector efforts to support utilities finance in the post-war period. Indeed, one of the main reasons to create IFI was to facilitate the finance of utilities, for reconstruction, development, growth or cohesion purposes. The pioneer IFI in this

respect was the International Bank for Reconstruction and Development (IBRD), founded in 1944, later, to be known as the World Bank<sup>3</sup>; after which a string of regional financial institutions or developments banks were established, including; the European Investment Bank (EIB) (1958), the Inter-American Development Bank (1959), the African Development Bank (1964), the Asian Development Bank (1966) and the European Bank for Reconstruction and Development (1991). Most of these institutions are based on intergovernmental cooperation among lenders and borrowers and function in a similar way to the World Bank but at the regional level.

Despite the fact the EIB was created as a regional IFI, it actually overtook the World Bank in 1994, as regards the volume of loans to projects in general, and to utilities projects in particular (EIB, 1994; World Bank, 1994). Since then, the EIB has maintained its position as the world's most important financier of utilities projects. In this light, it is surprising that there is a lack of scholarly work on the role of the EIB in financing utilities. General histories of the EIB are available, including both official publications (EIB, 1978, 1998) as well as scholarly accounts (Licari, 1969; Bussière et al. 2008; Coppolaro, 2009). But Robinson (2009) was right when he referred to the EIB as Europe's "neglected institution". Studies of EIB finance exist, but most of this work is limited to analyzing one sector at a given moment in time. As examples, Griffith-Jones et al. (2011) examined EIB loans to Small and Medium-sized Enterprises; Pinder (1986) and Pinder et al. (1995) focused on the finance of regional development and transport; and Tuijnman (2009) studied loans to education. But these studies do not provide an

\* Corresponding author. Tel.: +34 942201287.

E-mail addresses: [judith.clifton@unican.es](mailto:judith.clifton@unican.es) (J. Clifton), [daniel.diaz@unican.es](mailto:daniel.diaz@unican.es) (D. Díaz-Fuentes), [julio.revuelta@unican.es](mailto:julio.revuelta@unican.es) (J. Revuelta).

<sup>1</sup> Tel.: +34 942201624.

<sup>2</sup> Tel.: +34 942202060.

<sup>3</sup> For ease, we use the term World Bank to refer in particular to the activities of one of its five institutions, the International Bank for Reconstruction and Development, IBRD.

over-arching perspective on EIB finance. Much more is known about loans by the International Monetary Fund (IMF) and the World Bank than the EIB.<sup>4</sup>

Hence there is a lack of understanding about the role of the EIB in financing utilities. This omission has become more acute during the ongoing financial and economic crises. The EIB has been criticized for assuming an overly-conservative posture towards lending in the crisis. Both the popular press (Financial Times, 2012a; 2012b) as well as the scholarly community (Lesay, 2010; Kaul, 2012; Griffith-Jones et al. 2012; Griffith-Jones and Tyson, 2013) have called on the EIB to adopt bolder decisions by increasing the scale of its lending to finance higher risk activities, particularly, to utilities, as a countercyclical policy to assuage the current economic context, specifically towards those countries most negatively affected by the crisis. At the theoretical level too, the ongoing financial and economic crisis is generating a revitalization of economic theory on the role of public investment for growth (Lin and Rosenblatt, 2012; Cortuk, 2013; Lin et al., 2013).

The main aim of this paper is to start to fill this knowledge gap by analyzing the EIB's contribution to financing utilities over the long-term. To the best of our knowledge, this article represents the first attempt to reconstruct and analyze all loan data for utilities over the life of the EIB. To do so, we extracted data from the *Annual Reports* available in the historical archives of the European University Institute, Florence, Italy. Our analysis spans the period between 1958, the year the EIB commenced lending, to 2004, the final year that this data is publicly available.<sup>5</sup>

Our analysis of the EIB's contribution to utilities finance is framed using key economic history literature (particularly, Hausman et al. 2008; Millward, 2005). Accordingly, we would expect to see an initial period, from the creation of the EIB to around the 1970s, characterized by a "golden age" as regards the role of IFI in financing utilities, due to their inherent advantages in offering long-term and low interest loans in an age of financial shortages. We would then expect a new phase to be ushered in, characterized by financial globalization and excess liquidity in capital markets, Stiglitz's (2003) "roaring nineties". In this period, the availability of excess private capital led some scholars to question whether IFI were still important (Klein, 1998) whilst others came to their defense, claiming they were still important, in their providing technical expertise (Rodrik, 1995) and economic stability, engaging as they did in counter-cyclical lending when necessary (Stiglitz, 1998, 120).

To anticipate our findings, our analysis of EIB utilities finance broadly fits into this pattern. We identify a first phase, between 1958 and 1972, where the EIB functions predominantly as a bank to promote regional development in the poorest regions in the European Economic Community (EEC). A key strand of this work was the financing of public utilities projects in the Mezzogiorno, Southern Italy, by far, the poorest region of its Member States. This lending practice was disrupted from 1973, due to the oil crises and the collapse of the international monetary system. EIB finance is associated in this period with promoting a new energy paradigm and as acting as a "sweetener" for new accession Member States. Then, from the middle of the 1980s, a new lending pattern emerges. EIB lending becomes

more closely aligned than ever with the objective of consolidating the Single Market project. In this period, utilities projects are prioritized across all Member States – particularly those on the geographical periphery of the Single Market – to further their integration into the market. At the sectoral level, finance is targeted predominantly towards the Trans-European Networks (TENS) – particularly road and railway transportation – as well as those sectors put up for liberalization through sectoral Directives and, often, privatization, particularly, telecommunications, electricity and gas. In this period, we describe the logic of EIB loans as that of a "market-maker". In sum, EIB finance was initially guided by regional development objectives in the early period, was disrupted and converted in a political one associated with the new energy paradigm, and, finally, emerged as a market-based logic, bolstering the Single Market project.

The rest of this article is organized in the following way. Section Two provides an analytical framework setting out the changing ways in which utilities have been financed over time, grounded in recent economic history literature, before briefly discussing the background to the creation of the EIB and its lending prerogatives, as established in its Statutes (EIB, 1957). We also describe the methodology of data collection. We then turn to the three phases of EIB lending. Section Three analyses the first phase of EIB finance from 1958 to 1972; Section Four describes the transition period, chronicling the EIB's changed role in responding to new policy priorities. Section Five examines EIB lending in the most recent period, from 1985 to 2004, showing its turn to market-making. We conclude with some observations about the real and potential role of the EIB in the ongoing crisis.

## 2. Analytical framework

Tapia (2012) observed that the availability, access to and nature of finance is a key factor in understanding how utilities develop. In the recent period, important studies have provided insight into the complex and changing ways by which utilities have been financed over the longer term. Millward (2005) analyzed the changing role of public and private initiatives in the development of energy, transport and telecommunications across Western Europe during the nineteenth and twentieth centuries. Hausman et al. (2008) tracked the role of international private and public finance as the world was electrified from the end of the nineteenth century to the present. These the scholars coincide that the expansion of utilities can be organized roughly into three, major "waves" as regards involvement of public/private actors in utilities finance (Clifton et al. 2011). In the first wave, during the nineteenth century, much utility development was characterized by the pioneering role of private sector initiatives, which was supported in turn by the public sector, principally as a regulator (Millward, 2005). A second wave emerged, gradually, from the end of the nineteenth century, accelerating after the Second World War. In this period, it was the turn of the public sector to rise to dominance in utilities development, both in regard to their finance and management. Finally, triggered by the collapse of the international monetary system and the oil crises during the 1970s, a third wave emerged. Again, the private sector reinstated itself as the prime protagonist in the promotion of utilities finance. Clearly, these are overall, impressionistic, waves of public/private involvement in utilities and, typically, public and private initiatives worked together in multiple and complex forms throughout the two centuries. Nevertheless, we will use this overarching framework to uncover the role of the EIB as a financier of utilities across the period.

The EIB was established in the Treaty of Rome in 1957 and created in 1958, well into the second wave of utilities development where public initiative was ascendant. Its members were the EEC "six": Belgium, France, the Federal Republic of Germany, Italy,

<sup>4</sup> Examples of this literature include Bird and Rowlands (2001), who identified institutional, economic and political determinants of IMF loans at the global level; Harrigan et al. (2006), who analyzed the political and economic factors guiding IMF and World Bank loans across North Africa and the Middle East during 25 years from 1975; and Morrison (2011), who studied the determinants of World Bank loans to the world's poorest countries between 1977 and 2005.

<sup>5</sup> European University Institute archives on the EIB are at: [http://www.eui.eu/flora\\_abue/jsp/ahue/view\\_fonds.jsp?recordId=archive%3AARCH\\_ACCESSION%3A7325](http://www.eui.eu/flora_abue/jsp/ahue/view_fonds.jsp?recordId=archive%3AARCH_ACCESSION%3A7325).

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