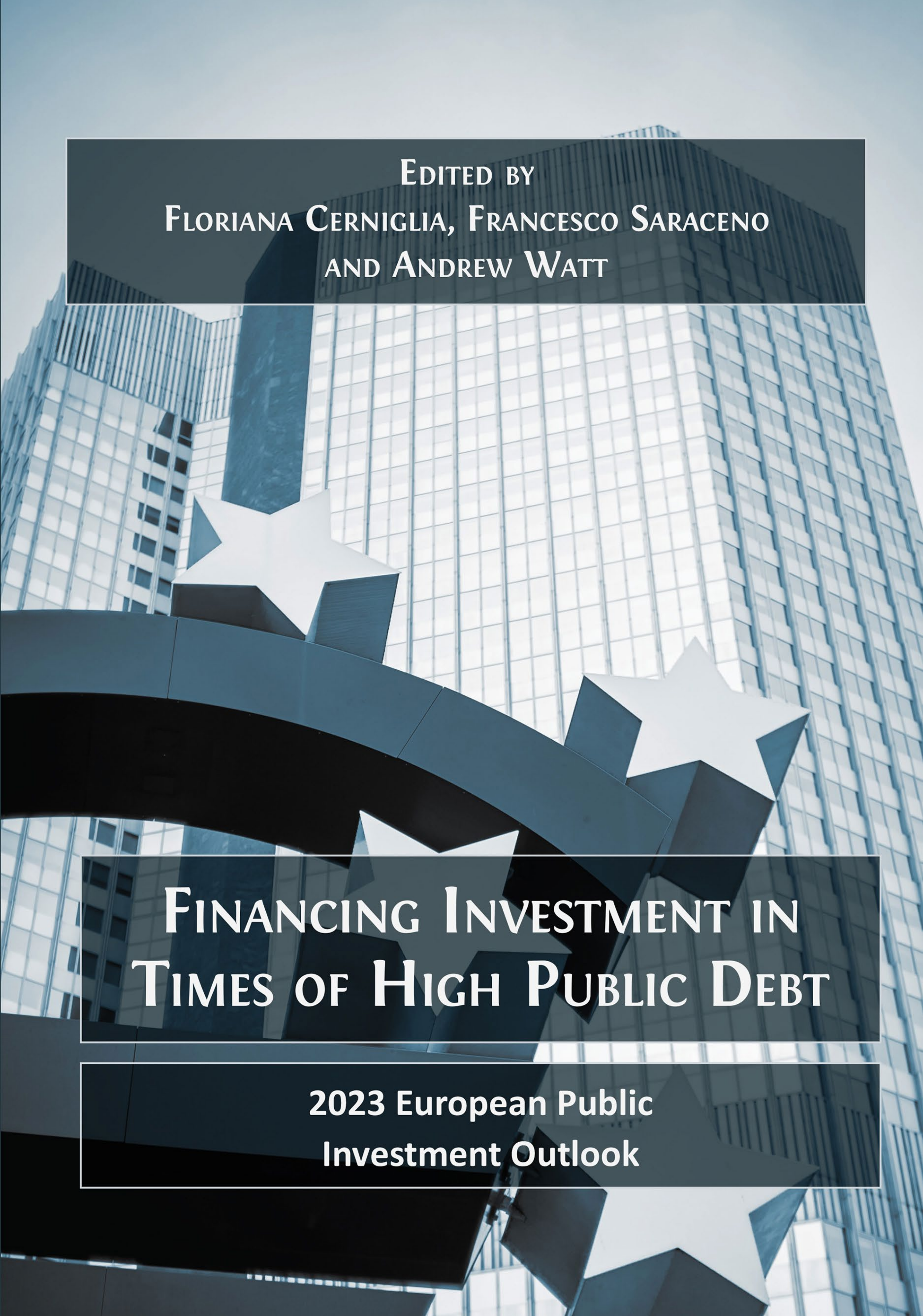

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and Andrew Watt

Financing Investment in Times of High Public Debt

2023 European Public
Investment Outlook

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7. From Crisis to Crisis, Can Europe Count on National Promotional Banks as Silver Bullets?

Laurent Zylberberg

The great financial crisis of 2008–2009 was a game changer for National Promotional Banks and financial Institutions (NPBIs) in Europe, with the COVID-19 pandemic and the Ukraine crisis reinforcing this shift. The 'Juncker Plan' shed a light on the investment gap and demonstrated that a dynamic European policy was possible. Thanks to the InvestEU programme, actors at the European level, such as the European Investment Bank (EIB), and the national level (via NPBIs and Financial Institutions) thrived in their specific role of fostering essential long-term investment throughout our continent. With this in mind, we need to have a different look at certain tools within practical accounting rules by integrating both positive and negative externalities.

7.1 Introduction

For many years, Europe has been experiencing a succession of crises that are sometimes limited to the continent or that reflect global developments. Many economists, including Schumpeter and Kondratiev, have explained that these crises can result from the conjunction of cycles and, thus, from evolutions of the economic model (Portier 2015). However, the instruments for responding to these crises are not indifferent to existing economic and societal models. At comparable economic levels, European countries will not provide the same response as those in Asia. Without erasing the differences in the processes of the legitimization of states and their instruments (Badie 1982), the dynamics generated by the construction of Europe had converging effects in the countries that compose it. One of these effects, the rise of National Promotional Banks and financial Institutions (NPBIs) as investment actors, has become increasingly prominent as the European Union implements investment policies aimed at reducing the gap with other parts of the world. These players, who occupy a specific place in the European economic model, have many differentiating elements but, overall,

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have enough strong common characteristics to gradually become one of the driving forces behind the implementation of European policies. This European specificity is a particularly important asset at a time when public actors and, in a comprehensive way, public action regain legitimacy. The COVID-19 crisis has drawn attention to the role of NPBIs as a 'shock absorber' for individuals and businesses, even as they also provide essential countercyclical elements. These actors in the European economy cannot act, however, if they are not differentiated from their respective Governments; they must maintain a public status and serve the general interest. Moreover, NPBIs shall also not be likened to private actors while acting in a competitive framework. Several key developments are still needed to give them the means to make full use of their capacities (Zylberberg 2020).

7.2 A Particularly Difficult Economic Environment for the European Union

7.2.1 Europe has been Facing Increasing Investment Needs for Many Years.

As the economist Pierre Jaillet has pointed out, long-term investors are essential 'to find a path of growth that is equivalent to or little less than that of the pre-crisis and to keep public debt on a sustainable trajectory' (2012: 169), but what type of investments are we speaking about? Whether we speak about productive investments, like the ones related to the renewal of the production tool—its modernization to achieve productivity gains and investments related to environmental adaptation (such as security and research and development or pure financial investments like primary and secondary debt, bond, and equity markets)—there is still the risk of missing out on many investments which can be described as social or the economic purpose of which is indirectly linked to the production apparatus. For example, social infrastructures that includes investments in health, education, and affordable housing are in a relative blind spot. Others not directly linked to investment in economic apparatus are altogether left out from the categorization seen above. This investment vision, therefore, can be misleading as demonstrated in the report by the former European Commission Chair, Romano Prodi and the former French Economy Secretary of State, Christian Sautter (Prodi 2018).

When simplified, the background noise indicates that private investment will naturally be directed towards profitable productive investment or financial investment, whereas public investment should be confined to social investment without the use of a viable economic model. This distinction misses the numerous interactions between the different types of investment. It neglects the study of externalities, whether positive or negative, and ultimately leads to a rigid and time-bound categorization of economic actors. The temporality factor, which distinguishes between short-term and long-term investment, however, is essential for understanding and guiding the behaviour of investors, whether they are public or private.

Against this background, the European Investment Bank (EIB) makes the same observation every year: how Europe is lacking investment compared to the USA. This differential is even more striking if we focus on productive investments, whereby the gap is nearly 4 points! (Figure 7.1).

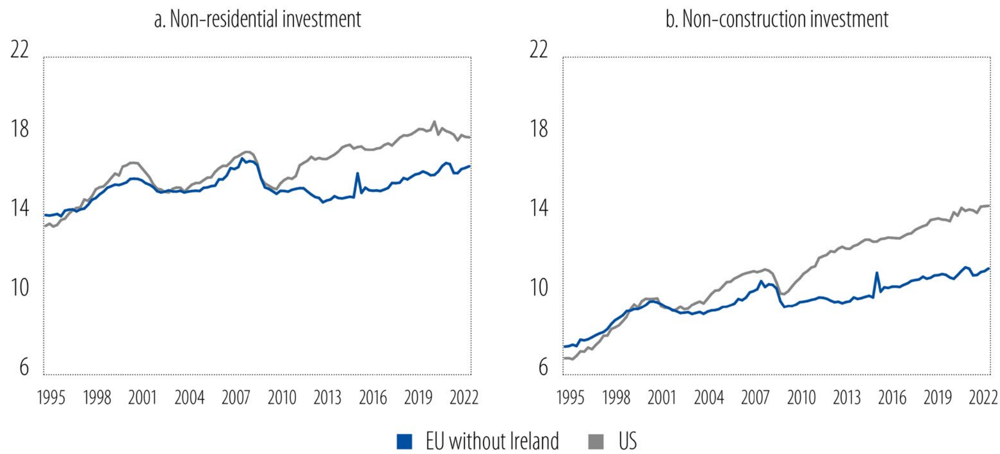

Fig. 7.1 Rest of Productive Investment in the European Union Compared to the United States since the Global Financial Crisis.
Note: Non-construction investment includes investment in machinery, equipment, and weapon systems, intellectual-property products, and cultivated biological assets.
Source: Eurostat and OECD national accounts statistics.

The financial crisis of 2008–2009 marks a clear separation of this trend. Investment in the USA reached its pre-crisis level in 2011, while, in Europe, it was necessary to wait ten more years for a return to the same level. In 2014, the European Union, faced with the acuteness of the problem, launched the 'European Fund for Strategic Investments' (EFSI). Unofficially known as the 'Juncker Plan', its objective was for the European Union to catch up with the same investment trend as it had experienced during the recovery that followed the previous crises of 1993–1997 (Le Moigne 2015).

In this regard, the Juncker Plan marks not only an economic but also an ideological turning point in the way the European Union looks at the role of public actors in investment. European actors are beginning to turn their backs on a system in which competition rules and the monitoring of public aid are the alpha and omega. By focusing on the ability of public investment to leverage, the Juncker Plan highlights the strength of public investors (including EIB and NPBIs).

7.2.2 These Needs are Part of Successive and Sometimes Simultaneous Crises

The 2008–2009 financial crisis resulted in a GDP with severe constraints on investment. But what stood out in this crisis was the difference in the recovery between the USA and the European Union, as shown in Figure 7.2.

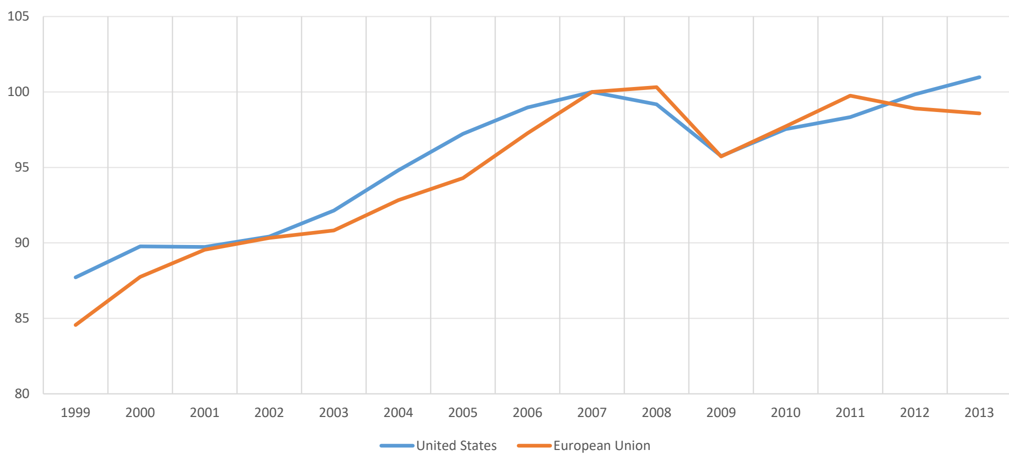

Fig. 7.2 Real GDP Per Capita: European Union versus United States (index 2007=100). *Source*: World Bank.

This differential in GDP per capita has resulted in a corresponding weakening of investment.

How can one explain such a difference between Europe and the USA? The crisis of 2008–2009 was triggered in the USA by the real-estate boom of previous years. In Europe, if the real-estate boom was somehow mastered, the crisis was firstly a banking one and had long-lasting effects on the whole financial system (Jamet 2008; Figure 7.3).

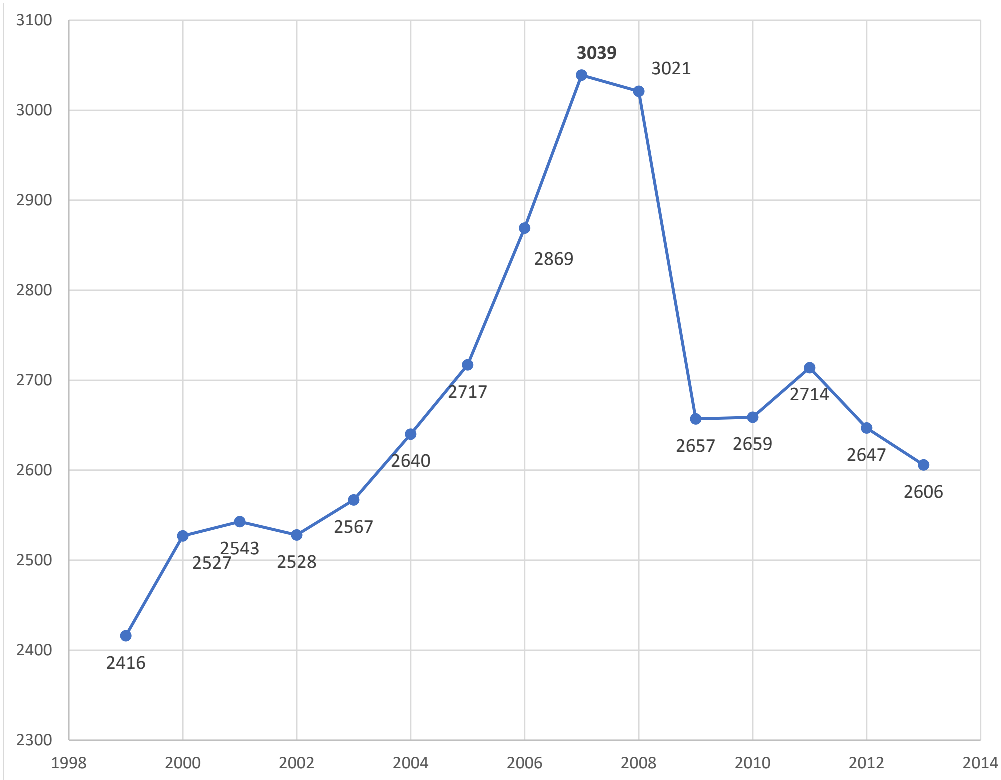

Fig. 7.3 Real Gross Fixed Capital Formation (EU 28, in 2013 prices, €bn).
Source: European Commission 2021.

This difference between geographical areas was alarming (Buti 2014), particularly in the way this lack of investment would induce long-term effects on the economy. Again, it is important to note that, while the USA was starting to raise its level of investment in 2011 (the lowest point having been reached in 2010), it was not the case in Europe. Lack of investment continued there until 2013, with a further significant decrease in 2011. This temporal disparity is largely due to differences in the financing of the economy between the two continents. We must remember that 'Banks are clearly the largest source of finance in the Eurozone (51%), unlike the United States, where bank credit would account for less than a fifth of the total financing of the economy' (CEPII 2015).

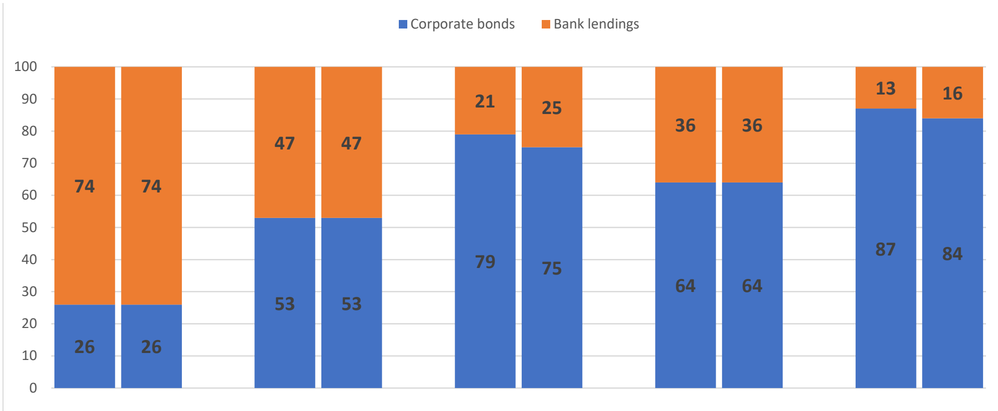

Fig. 7.4 Bank Lending versus Corporate Bonds (Corporate Bonds as a % of Corporate Borrowing in the USA, EU27, UK, France, and Germany).
Source: Panagiotis, A., H. Eivind Friis, and W. Wright (2022).

As financing schemes clearly diverge between USA and Europe, measures taken after the 2008–2009 crisis produced differing impacts. One response was the strengthening of banking constraints to avoid falling back into the mistakes of the past. These new rules have increased the robustness of the European-banking model. To sum it up in one sentence: considering the causes of the 2008–2009 crisis, the remedies have had adverse effects on the recovery of the European economy.

While these new mechanisms were being put in place to boost growth in Europe, the COVID-19 health crisis occurred, which was unprecedented in all respects in recent global-economic history. Although we have experienced major economic crises or global epidemics in the past, we have not, in recent times, experienced both simultaneously. The impact on GDP was immediate, as shown in Figure 7.5.

Beyond the direct economic effects of the COVID crisis, what has had a lasting impact on economies is a return to the forefront of economic-sovereignty issues. While the globalisation of manufacturing chains was taken for granted, the COVID-19 crisis highlighted sovereignty issues that had been being largely ignored. Even worse, issues arose in unexpected areas (such as surgical masks or aspirin) that were never identified as key components prior to this pandemic.

Fig. 7.5 Quarterly Real GDP Growth in % quarterly.
Source: OECD.

As the COVID-19 crisis came to an end, a new geopolitical crisis was breaking out in Europe that highlighted other, particularly energy-related, dependencies. One significant result of this compounding of crises is that NPBIs became the instruments of national sovereignty that were mobilised to act in various areas (ELTI 2023). Indeed, the invasion of Ukraine has had numerous, protean effects on European economies. We can mention a few of them: scarcity of energy sources, the economic impact of the sanctions put in place for companies working with Russia and Belarus, the hosting of refugees, etc. To cope with this economic shock, NPBIs were mobilised both in their traditional functions and, often, beyond their usual remits. They supported national economies through loans, some of which were subsidized; provided suitable financing for undertakings directly affected by the conflict, either via their commercial outlets or their own supplies; and launched emergency-housing programmes in neighbouring countries. They also undertook other actions to support Ukraine in budgets and in various donations.

In addition to these essential measures aimed at those most directly affected by the conflict, NPBIs provided help to other economies as they adapted to the new situation. Their interventions in the energy sector are a good example of their ability to respond quickly to immense needs. Europe's largest NPBIs, not to mention the EIB (or the 'European Climate Bank' as it likes to be called), were already heavily involved in the energy sector; they were at the heart of financing the energy transition, notably by funding renewable energies. The war in Ukraine posed new challenges that required focus on immediate needs. While maintaining their commitments to participate in the energy transition, NPBIs were asked to participate in the financing of very short-term solutions to address the end of the energy supply from Russia. Thus, the German NPBI (KFW) became the financier of the three new ports for Liquified Natural Gas (LNG) terminals in Germany, whilst the Italian National Promotional Bank (CDP) and its subsidiaries participated in the financing of a new terminal. In a country like France, where nuclear power plays a major role, Caisse des Dépôts (CDC) were tasked to examine the possibilities of financing the renewal of the nuclear-power plants.

Beyond energy, the entire scope of national and European sovereign financing was impacted by the Ukrainian crisis. Because NPBIs have both very large resources and the capacity to rapidly redirect these funds, they have been called upon to meet these new demands.

Environmental transition requires significant funding over a long period of time. On one hand, there is a need to change our production methods to achieve greenhouse-gas-emission neutrality by 2050 and, on the other hand, to adapt our economies to climate change. Although it is difficult to determine the precise requirements, with variations being quite large depending on the methods of calculation (Meltzer 2016; Li 2023), the order of magnitude amounts to tens of billions of dollars per year per European country. Two elements are clearly established. The first issue is linked to the temporality of the return on investment. Green investments need to mobilise actors coming from different parts of the economic spectrum. The co-ordination between them is quite difficult as, in terms of temporality, the expected return on investment differs from one actor to another. Secondly, the public sector alone does not have the means to meet the needs, but the private sector will not mobilise for profitability that seems either too low or too uncertain. A combination of the two is necessary, therefore, to achieve the required funding.

Indeed, beyond the amounts, the problem in the search for funding is the time differential between immediately identifiable needs and returns, which are sometimes hypothetical but always deferred. Moreover, Pisani-Ferry et al. (2023) have recently pointed out that a large part of these investments will not increase growth potential since most will be used to finance fossil-fuel reductions without increasing production capacity. Another challenge to the environmental transition is that efforts must be made in three directions: the substitution of capital for fossil fuels, the reorientation of technical progress, and, finally, in sobriety. The first of these will command the lion's share of investment efforts with, according to the authors mentioned above, 85% of the total amount. Sobriety in using energy for daily life will contribute for a mere 15% to 20% of the energy use. Households and companies have to adapt their behaviour in order to reduce the global use of energy.

7.2.3 The European Economic Environment is also Characterised by Other Penalizing Factors

A multitude of factors led to an increase in the financing requirements for the European economies. This situation is more shocking since two penalizing factors play a disabling role. The first of these factors is the return of inflation in Europe (Figure 7.6). After many years without increasing prices, we have now entered a new cycle, which may be limited in time, but, in any case, will have medium-term effects on the European economies (De La Rosière 2023). This is especially true for households wherein current expenditure is increasingly constrained (Cusset 2023).

This change in inflation has had a direct effect on interest rates. Of course, this allows long-term investments to regain attractiveness by differentiating themselves from short-term investments, and in time, will recover their value. Conversely, inflation- and interest-rate rises will have a delaying effect on borrowers who may fear that their debts will rapidly increase. It is also this logic that encourages precautionary savings (BPCE 2023).

In general, one of the main drivers of inflation is energy-price growth. There is a strong correlation between the price of energy, in its form of final consumption, and inflation (Pisani-Ferry et al. 2023). It is certainly possible to envisage a differential increase in the price of energy, since fossil-fuel sources would be used less as renewable-energy sources become more readily available. There will be complex mechanisms to manage if market mechanisms are left alone to decide the price of energy. Indeed, the fall in demand for carbon-based energy could lead to a fall in prices, or a smaller rise, while the uptick in demand for renewable energy coupled with a high entry-cost mechanism would make the latter, at times, less competitive. This logic invites public financial institutions to play a major role in directing financing towards investments with stronger positive externalities.

Even before this inflation rise, Europe had been experiencing a significant increase in its public debt relative to GDP since 2007. Admittedly, this increase is not specific to Europe and dates back a long time; however, debt represented 100% of world GDP in 1970 (De La Rosière 2022), while the International Finance Institute estimates that, in 2023, the global debt reached more than 305 trillion dollars, or more than 360% of the global GDP. It should be noted that this is the total debt, of which the public debt represents 40%. The most problematic aspect of this increase in debt, and particularly in public debt (and not just budgetary debt), is that it has not been directed towards investment (McKinsey 2021).

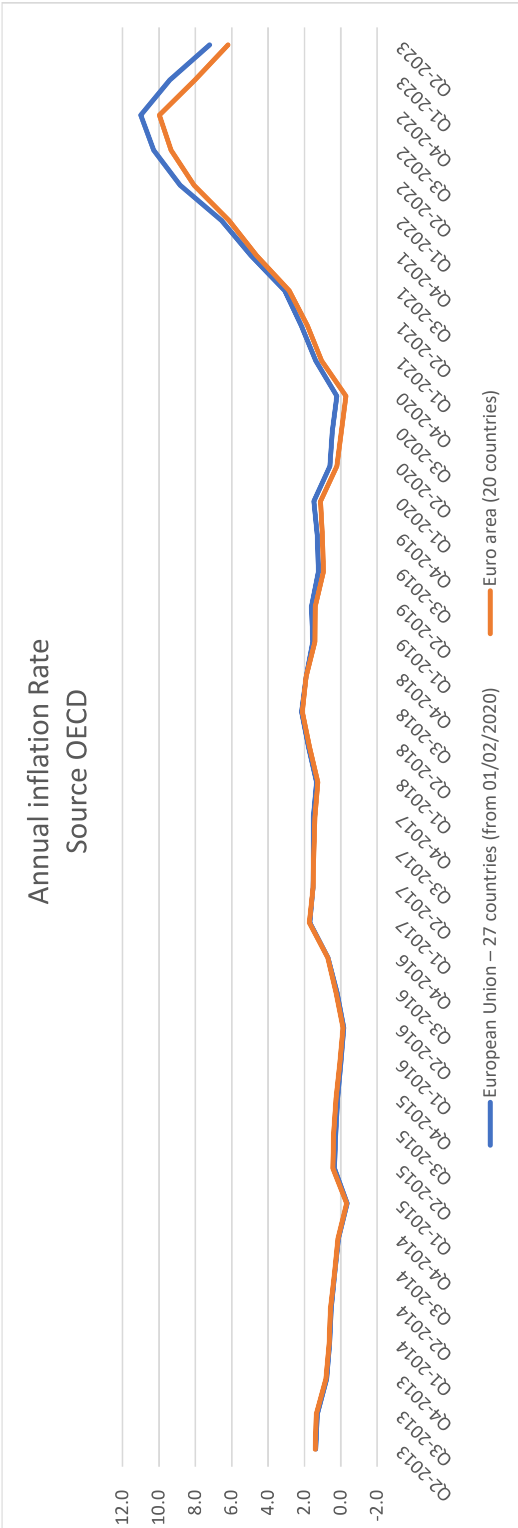

Fig. 7.6 Annual Inflation Rate.
Source: OECD.

In this context, we are witnessing a decrease in the capacity of governments to use the budgetary tool to intervene in the economy and, especially, to act as a catalyst for investment. According to the French National Statistics Office (INSEE 2022), of the five European Union countries with the highest debt in 2007, three (Italy, Greece, and Portugal) are still in the same group in 2021, and the two countries joining them, France and Spain, represent two of the biggest economies in Europe.

Since 2007, entities which have benefitted from low to very low interest rates are governments, for their budgetary needs, and private financial actors, for their short-term profitability. Debt rose sharply as low interest rates weakened the banking and financial system, encouraging the survival of non-viable enterprises and leading savings towards liquidity by discouraging the financing of long-term investments, that is, the classic Keynesian 'liquidity trap'. This unavoidable reduction in budgetary margins means that it is necessary to seek other sources of financing. Some authors (Cingolani 2017) argue for concerted action by the European Central Bank, the European Investment Bank, and the European Commission in order to support strengthened European programmes. These institutions would be financed by a grant component from the European budget and a loan component financed by monetary creation from the European Central Bank. This approach, developed before the rise in inflation and interest rates, seems difficult to implement for several reasons. Firstly, the intervention of the ECB implies the leaving-aside of countries of the European Union that are not members of the Euro. Secondly, it seems difficult to reconcile this action with another priority of the European Central Bank: to fight inflation. The temptation would be too great to reduce the creation of money by reducing participation in these programmes. Finally, such a plan misses out the growing role of National Banks and Public Financial Institutions as an essential link in European policies on the ground. Not being constrained by the budgetary rules of the States, NPBIs are able to attract savings and other private resources and to channel these, in alignment with European programmes, into long-term investments.

7.3 Assets to Meet These Major Challenges

7.3.1 A Dense Network of Strong, Robust NPBIs Anchored as Close as Possible to the Ground

Over the years, most European countries have developed national banks and public financial institutions (NPBIs). These institutions are very diverse in terms of size, resources, and goals. This is, of course, due to the varied nature of European countries and their own history. This variation attests to the very strong correlation between NPBIs and their own country; indeed, the structuring elements of the NPBIs are directly related to structuring elements of their country of origin. To take just a few examples, KFW in Germany was created in 1948 to finance the reconstruction of the country with funding from the Marshall Plan. The French Caisse des Dépôts was created in 1816, in a country broke and broken after the Napoleonic Wars, to mobilise savings and to finance infrastructure works on the eve of the second industrial revolution.

More recently, the fall of the Berlin Wall highlighted the immense financing needs of Central and Eastern Europe. To this end, three instruments were to be mobilised: the enlargement of the European Union to the East, the creation of the EBRD to finance the transition to the open-market economy via international financing and, finally, the establishment or reestablishment of national promotional banks—in some countries, this meant the creation of new institutions; in others, it meant giving back consistency to those that were on standby. BGK in Poland is a good example of the latter. Created in 1924 to finance local authorities, defence industries, and industrial development, this bank was put on hold between 1948 and 1989, at which point it resumed its activities to become one of the main Polish financial players. In other Central and Eastern European countries, new banking institutions were set up, such as MFB in Hungary, which dates to 1993, or SID in Slovenia and HBOR in Croatia, both of which were established in 1992.

The most recent of these financial institutions have often concentrated on three priority sectors: the financing of small-and-medium enterprises (SMEs), which have difficulty accessing funds from the commercial-banking sector; the raising of capital for start-ups, particularly for venture capital; and export financing. They also often contribute to the financing of three other sectors (infrastructure, local authorities, and housing) to a lesser, but equally significant, degree.

While discussions on the precise definition of NPBIs are ongoing (Marodon 2021), these institutions are defining themselves by their actions. As we know 'the proof of pudding is in the eating' (Engels 1975: 19). The combined members of the European Association of Long-Term Investors (ELTI), a consortium of NPBIs (more on this below), have made investment commitments amounting to more than €2,600bn. Decades ago, the French European founder Jean Monnet insisted that 'Europe will be forged in crisis' (Monnet 1978: 417). Those words could apply to NPBIs today as crises are revealing just how efficient they are as counter-cyclical actors.

In June 2020, a few months after the outbreak of the European COVID-19 crisis, an initial assessment of ELTI initiatives found that more were focused on grassroot measures adapted to local specificities (2020). These institutions were able to double the total amount of their funding between 2019 and 2020. What is remarkable is that this doubling includes not only loans but also direct capital investment. The protean character of NPBIs allows them to rapidly increase their volume of interventions and to modify the very nature of them. The 'Banque des Territoires', which brings together various entities of the Caisse des Dépôts in France, invested more than €2bn in 2022, representing more than three times the amount invested in 2018. The total portfolio is over €7bn for this institution. But the COVID-19 crisis also highlighted a capability to quickly mobilise huge amounts of funds for recovery schemes. In 2020, Caisse des

Dépôts launched an emergency recovery plan for a total of €26bn over a five-year period. The NPBIs remained active during the crisis that followed the invasion of Ukraine by Russia. As we know, this crisis has had a cascading effect on the entire economy: neighbouring countries have had to manage the direct influx of people, the direct impact of higher energy prices, and many other more-indirect effects.

In a market economy, public investors avoid crowding out other economic players, seeking, rather, to attract them by means of a leverage effect. Some players have set out rules to guide their investment in equity. The Caisse des Dépôts, for example, establishes their status as a minority shareholder by calculating the leverage effect on the global amount mobilised.

In fact, the concept of leverage poses formidable problems with definition and scope (Chelsky 2013; OCDE 2016). Many terms, such as 'catalytic effect', 'additionality', and 'mobilisation' are referred to indifferently even though they may refer to different realities. Do private savings become public money when invested by a public actor? Should a public institution's own resources be recorded as private when they have been capitalised by pure market mechanisms? Jeff Chelsky highlights the distinction between direct and indirect effects. Competition authorities largely consider the latter when assessing the effects of dominant market players, but an even more complex measure could be employed to assess the leverage effects. The World Bank measures all the catalytic effects in the environment of the operation. To take a trivial example, the capacity to attract private financing will be higher when supported by institutional actors with recognisably strong legitimacy and track records, such as the EIB or the largest NPBIs. Faced with these difficulties, the aphorism (attributed to Albert Einstein) 'Everything that can be counted does not necessarily count; everything that counts cannot necessarily be counted' may serve as a guide. An effective strategy to catalyse private funding will always have qualitative and quantitative dimensions, and we can add a third factor related to the additionality sought by public investment. In 2021, the Association Française de Gestion and Mazars (AFG 2021) pointed out that nearly half of respondents define contributions (ex-ante) and achievements (ex-post) as necessary elements for the analysis of change, but almost 60% agree that it takes five to ten years to have a relevant analysis. In other words, the allocation of funding based on additionality criteria require five to ten years to be analysed with some credibility!

7.3.2 A Dynamic Started with the Juncker Plan and the Role of the EIB

The Juncker plan marked a clear break in the vision of European financing. For many years, European funding had concentrated on subsidies and ensured that it did not interfere significantly with market rules. The investment deficit we have described above has appeared strong enough for European leaders to embark on a new path by mobilising the balance sheet of the European Investment Bank, while providing a guarantee from the European Union and relying largely on NPBIs for deployment in the territories. It should be noted that even before the outbreak of the COVID crisis, it was decided in 2018 to deepen the Juncker Plan by increasing the total amount of projects financed from €315bn to €500bn.

The initial aim of the Juncker Plan was to mobilise a relatively limited amount of financing (€15bn European Union guarantees and €6bn EIB contributions) to then exert a double-leverage effect. First, a multiplier of 3 with EIB Group financing, with a more usual 'risk-and-return' profile, and then a new multiplier of 5 with public and private financing. The expected leverage was, therefore, 15 compared to the initial stake.

This programme has succeeded in achieving its quantitative objectives by exceeding the €500bn total amount of projects, obtaining an interesting distribution at both the geographical and the sectoral levels (see Figure 7.7). The Juncker Plan's success is directly linked to the engagement of local NPBIs. Their mobilisation was key for launching the programme and identifying local needs. The very existence of a local NPBI was an enabler for enforcing the Juncker Plan in the best possible way.

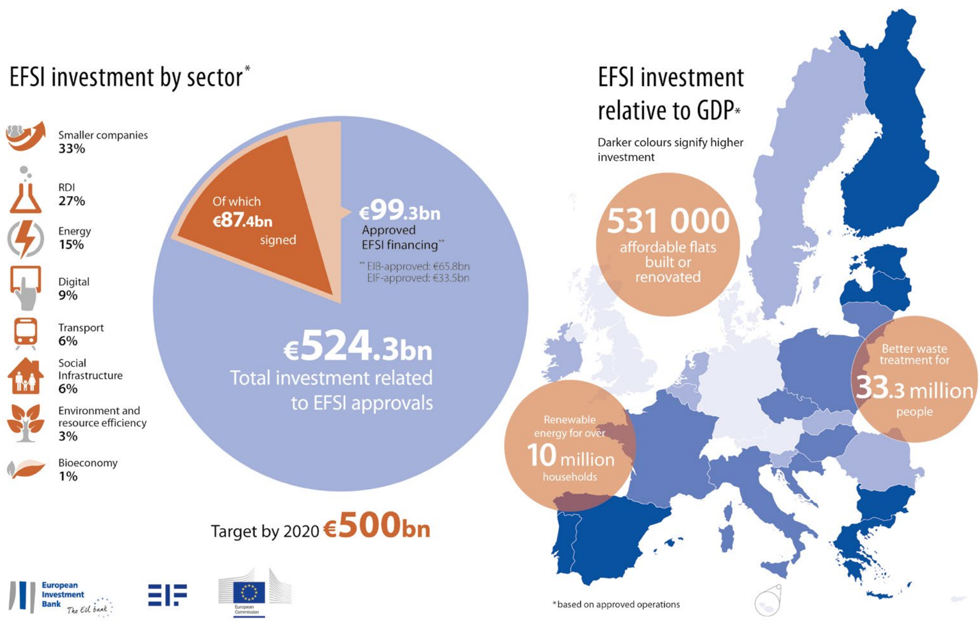

Fig. 7.7 EIB Group Figures (as of 31/12/2021).
Source: EIB (amounts in € are based on the exchange rate of the event (approval/signature)).

This success highlighted four key elements for the European economy:

- The need for investment was massive and the European market was, and still is, in a position to absorb considerable amounts of money without having a crowding-out effect on the private sector.

- The presence of an NPBI in a country is a formidable asset in directing investments towards projects strategic for Member States.
- Some sectors have benefitted greatly from these investments, particularly Small and Medium Enterprises (SMEs) and Mid-Caps, research and development, and the energy sector.
- Europe was able to set up this mechanism in a timely manner, going against the principles heralded in previous years—like State aid or competition rules—that led to the construction of a market in which immediate economic interventions were slowed.

Beyond the figures, the Juncker Plan has also brought significant changes to public financial actors. The EIB Group has been led to think beyond traditional lending and to transform its approach. Through the Juncker Plan, the EIB has recognized the logic of using long-term investments as well as of taking more risks than before (Griffith-Jones 2020).

In addition to this change of approach, which has been beneficial to the European economy, the EIB and other NPBIs have strongly developed their cooperation in this new framework. Their complementarity quickly emerged as a guarantee of the success of the Juncker Plan. EIB had the financial tools provided by the European Union but did not have the capillary network close to the ground that characterises most NPBIs. Conversely, even the most powerful NPBIs only had a limited European approach and, above all, did not have this access to European financial instruments. This complementarity did not erase the competition that might exist on certain projects or divergent modes of operation, however. In the end, the essential question was who would carry the final risk in a project involving all of these actors.

Overall, the Juncker Plan has been successful, but some elements could have been better developed.

Firstly, some sectors have generally been missed out by EFSI. Social infrastructure or transport have only marginally benefitted from the Juncker Plan. Social infrastructures are long-term investments by nature with limited returns whose positive externalities are undeniable; thus, they could have legitimately been fully part of the Juncker Plan dynamic. In the end, they represent only 6% of the financing (Prodi 2018). The situation for transport is different because these investments, with variable returns, often require direct or indirect subsidies. As EFSI did not offer this type of financing, another tool was adapted. The Connecting Europe Facility, which was built on the work of NPBIs since 2020 rendered those institutions responsible for identifying the projects to benefit from a European grant as well as investment from the local NPBI. Here, the leverage effect will be important and will make it possible to find funding in line with the projects.

The Juncker Plan also has a relatively greater impact on the EIB Group's risk model than on its products. The European Investment Bank is primarily a lending bank, unlike several European NPBIs, such as the Caisse des Dépôts in France and the Cassa Depositi e Prestiti in Italy. The European economy needs equity financing which is significantly harder to mobilise than loans. EFSI had the ambition to respond to this lack on certain projects—such as the financing of the Marguerite 2 infrastructure fund—but this part of the dynamic remains marginal. We cannot say that EFSI produced a structural shift of the EIB balance sheet in favour of equity, but it is true to say that EIB Group took more risks under EFSI via dedicated projects.

Finally, small projects (those under €50m) remain difficult to finance. They incur fixed costs of the same order of magnitude as larger projects, but their risks are more difficult to assess. To monitor such projects is costly in staff and other terms. Therefore, there is a natural tendency to finance larger projects. Furthermore, smaller projects are more difficult to identify. Developing thematic platforms would surely help to tackle this issue. By bundling different projects together, it becomes easier to reach the minimum critical amount and to propose a financing model. The risk profile of such a bundle is not easy to assess, however. Yet, this is where the detailed, local knowledge held by the NPBIs is a very important asset. To implement these field-based platforms, it would have been necessary for the EIB to establish a large-scale delegation capable of working with NPBIs, but this was difficult since EFSI was directly on the balance sheet of EIB. Otherwise, NPBIs should have been granted direct access to EFSI, but this case was not foreseen. To summarise: while small-scale projects have received a little more support than in the past, the Juncker Plan has not succeeded in making them a major focus of its deployment.

7.3.3 Enabling NPBIs to Make Full Use of their Potential

After the Juncker Plan in 2021, the European Union put in place new tools to allow a more direct involvement of NPBIs while keeping EIB as the main implementing partner. Having national and European actors working together covers both political and financial issues. One of the regular complaints about EFSI was that it was a little bit far from the ground. Because of the multiple intermediaries, the final beneficiary was often not aware that the loan benefitting them had resulted from the Juncker Plan. It was especially true for SMEs and Mid-Caps with the mechanism of guarantee for lenders. Including NPBIs directly in the loop was a major and positive change as they have a capillary network on the ground and a long history of cooperation for the implementation of European policies in territories (Zylberberg 2018).

After the Juncker Plan, the European Union launched the InvestEU programme in 2021 with the ambition of simplifying the multitude of existing programmes while facilitating access to actors other than EIB Group. Originally conceived in a context of growth, it also had to be adapted to the very significant recession resulting from the global economic shutdown due to the COVID-19 crisis. InvestEU differs from previous programmes in three major ways (European Commission 2021).

The first is that it brings together 14 previously dispersed specific programmes, each with different rules, under one single mechanism. This simplification facilitates the diversity of actors involved in their implementation and makes the overall investment policy of the European Union more visible.

The second change is about priority-setting. Under EFSI, there was a single envelope of funds for all projects, and the primary objective was to recover investment without setting sectorial priorities. Under InvestEU, four windows have been established, and each has a dedicated financial envelope. The four sectors are (1) sustainable infrastructure; (2) research, innovation, and digitalisation; (3) SMEs and medium-sized enterprises; and (4) social investment and skills.

Finally, InvestEU is a programme in which institutions other than the EIB may participate once they have satisfied the evaluation process—known as 'pillar assessments'. Entities eligible to become implementing partners include international organisations or their agencies; public institutions, including organisations of Member States; and, finally, private law organisations provided that they are entrusted with public-service tasks and that they provide adequate financial guarantees. This openness to NPBIs, as well as to institutions such as the EBRD or the Bank of the Council of Europe, is a major development insofar as it enlarges the potential partner pool for the European Commission. InvestEU recognises that European investment policies require complementarity between the European level and national levels: it is essential to have implementation partners who are closer to the ground and to the projects themselves.

Against this background, there is an increasing cooperation among NPBIs with an exchange of best practices and through joint positions without forgetting the establishment of the Marguerite 3 Investment Fund. Marguerite is a leading European infrastructure investor having managed three funds since 2010. It was created at the initiative of the European Investment Bank and five National Promotional Banks from Italy, France, Germany, Poland, and Spain, it has evolved into a fund manager with private investors and the support of EFSI and InvestEU.

The rise of the European Association of Long-Term Investors (ELTI) reflects this collective dynamic. This association brings together over thirty members of various sizes and balance sheets. It is important to underline that those new annual commitments of ELTI members increased by nearly 30% between 2018 and 2021, reflecting a particularly dynamic period of activity. Most of the amounts committed are in the form of loans, but some NPBIs do not refrain from intervening in the form of equity, which exerts a much greater leverage effect. Large groups are also emerging at national level. The Caisse des Dépôts, which includes entities such as BPI France and La Poste Group with Banque Postale, represents an aggregate balance sheet of more than €1,300bn. Regional cooperation can be seen in the '3 Seas Initiative', also known as the 'Baltic, Adriatic, Black Sea Initiative' (BABS). Further evidence of a move towards financial partnership is political scheme that has transformed into an investment fund with nine first-level sponsors. The main funder is BGK in Poland, but other NPBI partners in the scheme are Altum (Latvia), SID (Slovenia), BDB (Bulgaria), HBOR (Croatia), and VIPA (Lithuania). These public financial institutions work alongside the Estonian Ministry of Finance, banks, and guarantee agencies (such as EximBank in Romania and Hungary).

7.4 One Step Beyond...

With its large and widespread network of NPBIs, Europe already has the necessary tools to act. However, over many years, public finance has had to face headwinds from two directions: some proponents of the market economies regard the institutions as intruders in the economic game, and some actors in the public sphere consider NPBIs as potentially illegitimate actors that would be at the service of the public interest without necessarily being dependent on governments (Attali 2022). Today, things seem to have evolved. NPBIs are recognised as essential, but do they have the means to act as efficiently as they could?

From time to time, NPBIs must apply supervisory rules primarily intended for other, mainly commercial banks. They also have to abide by accounting norms wherein long-term funding is regarded as irrelevant; however, a long-term approach that includes positive externalities in investment calculations is a necessity to overcome short-term challenges.

A financial actor is, above all, a structure that will attract liquidity in order to transform it before it is returned, that is, before it has seen a loss or profit. This financial-intermediation mechanism varies according to the types of actors, yet the supervisory rules minimize these differences for legitimate reasons. This transformation impacts both the level of risk and maturity. Thus, liquid or short-term liabilities will become long-term assets. This change is made possible by appropriate management strategies and by the existence of sufficient capital to cope with the eventual materialisation of the residual risks. During crises, any prudential requirements, which define the risk-management framework and the level of capital needed to address identified risk, have gradually been reinforced with the aim of strengthening the resilience of actors and the system. As we have already seen, these requirements may have reduced the ability to take risks. Even worse, we contemplate the emergence of what is called 'the overcompliance' in different domains. Applying prudential rules to different actors is not a simple task. The trivial thing is to distinguish the actors based on their playing field (banks, insurance companies, etc.) but this essentialist approach does not take into consideration some specificities. From a practical standpoint, this tends to ignore long-term investors like NPBIs. Their specificity as countercyclical agents is ignored as prudential rules lead to pro-cyclical behaviour. Nevertheless, it is also true that supervisory rules are aimed at making financial actors robust and resilient to prevent the recurrence of crises from the past. They are not tools of economic policy, although they can heavily influence it.

Prudential rules are structural elements of the strength of intermediaries and are therefore essential to enable patient investment. The risk-management system must therefore be based on an assessment of long-term risks and returns adapted to the specific characteristics of the players. Since some actors, like NPBIs, have objectives other than short-term financial profitability, these tools lead to a distortion between the indicators used and the purposes of the institutions. Faithful to their core business, regulators give absolute priority to financial ratios alone without considering the positive externalities sought by NPBIs.

Climate risk is a good example of this distortion, and it is worth noting that attempts are made to integrate it into risk assessment. Other elements could also be considered, such as the protection offered by a diversified, long-term investment portfolio. The same is true for the reference horizons of indicators which are often short term.

If a prudential framework is considered essential to the stability of the financing system and, thus, to the continuous functioning of the economy, some measures could promote a better orientation of savings towards long-term investment while maintaining a secure framework. In other words, there is a penalisation of equity investment which makes the key function of NPBIs—transforming liquidity into long term investment—more difficult at the very time it is the most needed.

The long term remains the poor cousin of accounting standards despite recurring alerts on this subject (Demaria 2016). It is worth pointing out that both accounting standards and prudential rules have, for the most part, pro-cyclical effects. Accounting standards lead to gregarious behaviour and leave little room for long-term strategies. Asset valuation is based on the concept of 'fair value', which is, in fact, increasingly akin to market value. Quarterly reports have short-term consequences for investor behaviour. International Financing Reporting Standard (IFRS) 9, introduced in 2018, further reinforced this trend. The increasing volatility of valuations are making it more difficult for financial players to devise long-term strategies. To avoid the perception of valuations as artificial or even misleading, asset-valuation mechanisms must be carried out continuously based on the concept of 'fair value'. As the market is a beauty contest at a given moment (Keynes 1936: 156), it can hardly apply to any long-term perspective. Rather, it fosters an appreciation which, without doubt, is close to the consensus at a given moment, but does not consider the future. This 'fair value' valuation, therefore, appears not only to be unsuitable for the management of long-term investments, but also acts as an effective deterrent of them.

In this context, it is becoming more important than ever to think about building a long-term accounting framework to avoid using a ten-decimetre ruler to measure the length of a highway!

The quality of information is crucial for making informed investment choices, but it is not enough. In a modelling-resistant environment where externalities are numerous, the need to be prioritized. It is up to the public authority, which alone has the necessary legitimacy, to shed this indispensable light. Putting priorities into perspective is part of an effort aimed at investors and, especially, savers. Sometimes, what makes products unattractive is a lack of financial education; however, more often, it is the lack of legible priorities that drives behaviour in these groups. The hierarchy of externalities, whether positive or negative, is key for establishing incentives. They are often put forward progressively without being placed in a global perspective. Clarifying political choices by establishing a hierarchy of externalities can only be done by politicians at the global level, thus proving that the European model makes sense. By establishing a venue for arbitration that bring together experts, politicians, and civil-society representatives at European level, an analysis grid could be proposed to characterise long-term investments. This grid could then be included as a governance instrument for European financial instruments. It could also serve as a basis for characterising long-term investments at national or European level.

The NPBIs have shown in recent times, marked by all these challenges, that they are in a position not only to play their full role as countercyclical actors but also to shape, in part, a new restructuring of our economies. In today's progression of the world economy, Europe has demonstrated its strong assets with these public institutions as well as highlighting their strong legitimacy. The challenge today is to fully mobilise their means to succeed in this transformation without their resources being taken up by governments concerned with either filling their budget deficit or financing short-term policies. To paraphrase a famous author, 'Banks and Public Financial Institutions of all countries, unite!'

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