

Keynote Speech by Commissioner Danuta Hübner

"Financial Engineering in EU Cohesion Policy"

**At the evening event "The Gate to the latest development in
Financial Europe"**

organised by the European Association of Public Banks

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20:05-20:30

Dear Mr Schoppmann, Ladies and Gentlemen,

I am very honoured to have been invited to this Conference of the European Association of Public Banks.

This is a very good opportunity to share with you my impressions on the financial and economic crisis and to review some new instruments that the European Union has set up recently to support Cohesion Policy.

The role that the partners in your association can play in this difficult period, both in terms of action and in terms of advice, is essential. Public banks have a huge knowledge of local conditions and are essential for growth and development, and this role is of particular relevance today in a time of extreme financial and economic uncertainty. As you know, developing regions is also our concern and this explains why I am convinced that joining forces can significantly help reduce the impact of the crisis on economic actors.

FINANCIAL CRISIS, COHESION POLICY AND SMEs

What initially was a sub-prime problem in the US, became a banking and then a financial crisis exacerbating structural weaknesses and the cyclical downturn in some European countries. It has now turned into a recession in major industrialised economies and into a slowdown in emerging economies. Let me emphasise that this is not only cyclical but seems to also reflect structural weaknesses of the economies.

While before summer the idea of "decoupling" was fashionable, when we discussed if the economic cycles in the US, Europe and Asia have become increasingly detached from each other, the financial crisis has taught us the contrary. Never before have global markets been so interdependent, never before was the risk of contagion as pronounced, never before had the notion of corporate social responsibility become as meaningful as today.

The financial crisis has provoked a credit crunch and the expected deleveraging will further restrict available credit over a prolonged period. It is not surprising that SMEs are particularly affected, both directly and indirectly. The tragedy is that negative

effects of scarce and more expensive finance, combined with declining demand, are already affecting even flourishing industrial sectors and healthy companies.

Even if we know today the reasons of this crisis, it does not mean that we master the remedies. What we know is that it will not be easy to solve and that the major challenge today is to restore confidence in the banking industry.

Restoring confidence in a system that has malfunctioned is a difficult job. It requires that corrective action is taken at all levels, be it corporate, national, international, public or private. It also requires that adequate regulatory measures are taken quickly but overregulation should not be a choice either. The revision of Capital Requirement Directive has been recently adopted by the Commission and is in the legislative pipeline. Next week the Commission will come forward with new proposals on rating agencies and financial supervision [part of Lisbon package]. It also requires that an international framework is approved to avoid dangerous behaviours as much as possible. In this context, the commitment of the G20 to support international cooperation to restore confidence and achieve much needed reforms in the world's financial systems is really welcome. Most importantly, this commitment is cast into a concrete action plan with a clear timeline and a follow-up meeting scheduled for April.

Paradoxically, this global financial crisis may become a big opportunity to strengthen the cohesion and competitiveness of the European Union, to promote change and remove barriers which are often mainly technical, political or cultural. Due to the very difficult circumstances that Member States have to face, options that were unconceivable a few months ago have become acceptable today. Fortunately, the Euro is a reality and a factor of stability. Imagine what might have happened to some countries if they would not have been members of the Eurozone!

The other major challenge is to prevent the recession from becoming long-lasting and deep. There is wide agreement among European Heads of State that only a large economic stimulus package, implemented in a concerted way, can achieve this. Therefore, the Commission has just proposed an ambitious economic recovery plan, amounting to €200 billion or 1.5% of EU GDP, which the European Council will discuss tomorrow. In this package, the Union's Cohesion policy plays an important role. We are proposing a targeted set of modifications to speed up and facilitate the implementation of cohesion programmes. I will come back to some of them later.

The EU's Cohesion Policy invests in the real economy. With an impressive total of EUR 347 billion allocated to Member States and regions for the period 2007-2013, some 70% of this amount (or 250 billion euro) are allocated to Lisbon priorities. The largest bulk of Cohesion Policy investments supports the productive capacity of businesses, access to finance for SMEs, human capital and priority public infrastructure. Thereby, Cohesion Policy does not only boost short term demand but incites structural change, thus laying the foundations for future endogenous sustainable growth in the medium term. It also provides a powerful element of stability in current conditions, as allocations will remain stable and funds may be disbursed until 2015. These characteristics may prove essential to restoring confidence to local economies and leveraging additional funds.

Let me emphasise here that even in a downturn investments in the knowledge economy should remain a priority for public and private spending. Although it might be tempting to delay or even cut planned R&D and education investment, experience of past downturns shows that this is counterproductive in the long term. We all know

that our competitiveness depends on productivity growth, which in the long run depends entirely on innovation. Therefore, private and public-sector investment in high-tech and in innovation in all industries, including the service sector will be prove essential to ensure long term growth. Those countries which had this foresight in past downturns laid the basis for their strong position in innovation and thus competitiveness.

As you know, a distinct feature of Cohesion Policy is that it is never the sole source of financing but only co-finances investment. In other words, it levers in important additional investment from various sources, including national and regional budgets as well as matching funds from the private sector. Needless to say that at the current juncture all measures that increase the leveraging of public spending are particularly welcome.

Yet, this will become more difficult, as the economic downturn compounds the impact of the financial crisis and puts private finance and public budgets are under extraordinary pressure. This will not only limit the private sector's readiness to invest in risky areas like innovation, but will also make it increasingly difficult for public authorities to maintain their level of funding.

In this context, which we did not anticipate when designing them, our Cohesion Policy tools to improve leverage, come in handy. In the past, EU Cohesion policy funds were disbursed almost exclusively through grants. But – in an important cultural shift – we have decided to complement this traditional approach with new tools. As you certainly know, the quality of spending is a very topical issue in public finance. And similar concerns about made us think about ways to improve the effectiveness and efficiency of Cohesion Policy spending.

With this in mind, we designed several new instruments for the period 2007-2013, the financial engineering instruments JEREMIE and JESSICA and the initiatives JASMINE and JASPERS providing technical assistance. They have a "J" in common standing for 'joint', meaning that - the Commission works in partnership with the European Investment Group (EIB, EIF), the European Bank for Reconstruction and Development and, more recently, KfW, the German development bank. And all partners involved share the commitment to delivering an effective cohesion policy.

Financial engineering can achieve more thanks to its revolving nature. JESSICA and JEREMIE help transforming grants into recyclable forms of finance, for instance loans, equity investments, guarantees and their combination. They also promote the use of instruments that can lever additional capital from other potential sources, including the private or the public sector. Thanks to the trust investors have in EU co-financed operations – in normal and hopefully also in crisis times, it is possible even with small grants to lever in additional investment.

Now, what are these four initiatives?

JESSICA

JESSICA provides funding for sustainable urban development. Only cities which are attractive for citizens and investors can fully exploit their role as engines for growth and be a hub for development. And often this requires considerable investment. While urban development and rejuvenation is very costly at the outset, such investments can earn a lot of money in subsequent phases. Using revolving funds instead of grants is therefore a much more efficient option.

JESSICA's main purpose is to create Public Private Partnerships to implement urban projects able to generate revenue and pay back the initial investment. Urban development funds may be channelled either via an existing financial institution or through a new entity created in partnership between public bodies, banks and other investors. In this way, the banking sector is expected to assume an important role in the JESSICA initiative by co-funding urban projects.

Although JESSICA is still in the development phase in which tailor-made feasibility studies are carried out to identify potential areas of investment, we expect it to have a significant impact in the near future as the number of agreements is on the rise.

For example, the German Land **Saxony**, Polish **Wielkopolska** region, **Galicia** in Spain and **Portugal** are about to implement JESSICA. The EIB will assume the task of the JESSICA Holding Fund. Also, in the German Land **Brandenburg** a JESSICA fund should be operational in the very near future based on the collaboration with the '*Investitionsbank des Landes Brandenburg*' (ILB), which is the regional promotional bank.

Memoranda of Understanding will be signed still this year or early next year with other Member states and regions, after **London** (1 Dec) for instance also with **Greece** (12 Dec) and **Andalucía** (17 Dec) and the **North West of England** in January 2009.

These promising first achievements make us confident that JESSICA provides valuable solutions to concrete problems.

JEREMIE

JEREMIE is our second financial engineering instrument (Joint European Resources for Micro to Medium Enterprises). JEREMIE is about improving access to finance for SMEs and to support business creation. Already in normal times, access to finance is often quoted as a major obstacle for new or small firms. As I said before, the expected prolonged deleveraging in the banking sector implies that innovative ideas or business start-ups are likely to face severe financing difficulties over a longer period. Yet, SMEs are a vital part of the European economy, accounting for 58% of Europe's output, 66% of total private sector employment and 99 % of all businesses in the EU. Almost all net job creation originates in SMEs.

Although Cohesion Policy has a long record of supporting SMEs, JEREMIE introduces repayable and recyclable funding as a new feature. Another important feature is that we recommend the use of holding funds to which a part of a Member State's Cohesion Policy allocation will be transferred. The tasks of the holding fund will be assumed by specialised financial institutions like the EIF or other institutions, which bring in the required experience and expertise, ensuring an effective flow of funds to intermediaries such as venture capital funds, loan funds, guarantee funds or micro-credit providers. These selected financial intermediaries in turn provide finance to SMEs in the form of equity, loans and guarantees or any combination of these.

In short, JEREMIE will contribute substantial added value since it will 1) recycle public money, 2) provide a significant leverage effect for scarce public money bringing in loan capital and private funds, 3) make the Commission Services, the EIF, national and regional public authorities and administrations, financial institutions work together, pool their resources and expertise to provide SMEs with better access to finance.

JEREMIE began with a series of evaluation studies at regional or Member State level to assess the potential demand for such an approach and possible methods to make it a reality. These studies were provided free of charge to interested Member states or regions. They also proved useful to raise awareness among the national and regional authorities, the financial sector and potential beneficiaries about this tool.

36 of these studies were completed in 2007 and 20 more will be available by the end of 2008. JEREMIE is now in the process of becoming reality in a number of Member States and regions. Greece, Romania, Latvia, Lithuania, the region of Languedoc-Roussillon and Campania have decided to implement JEREMIE using EIF as the holding fund, while a number of other countries and regions, for example Hungary, Wales, use other institutions as the JEREMIE holding fund. Slovakia will implement an original mixed model which will include both the EIF and national institutions.

The amounts already available in holding funds are impressive: today's EUR 603 million are likely rise to more than EUR 1 billion in the weeks to come. Indeed, discussions are continuing with a number of countries like Bulgaria, Slovenia, Cyprus, and regions like Marche and we expect the number of JEREMIE holding funds to increase in the coming months. We are confident that JEREMIE will become active in about fifteen Member States in the near future.

As you know, the European Investment Fund is heavily involved in the development of JEREMIE. It brings much needed skills and knowledge into the implementation of Cohesion Policy. The expertise and experience the EIF has built up over many years in all Member States has a major impact on the effectiveness of this new instrument.

MICRO-CREDIT

While JEREMIE can be an important instrument also for the expansion of the micro-credit sector because resources can be channelled through micro-credit providers, we think that it needs to be complemented with other measures that I will elaborate now.

Before the crisis we estimated that an additional 700,000 micro-loans could be disbursed in Europe if we had the intermediaries, the capital and an improved environment. But I believe that this figure could be much higher, depending on the fallout from the crisis. Even if these figures are only estimates, it means that a huge number of individuals in Europe are waiting for a micro-loan to start a business.

You may ask why the Commission, and in particular DG REGIO, has developed a specific initiative on micro-credit. This is because we believe that developing micro-credit in the European regions requires more than just finding ways to increase the provision of capital. It also requires that action is taken at different levels to help people start up new enterprises with reasonable confidence.

Currently, the micro-credit market lacks transparency and is often ill-advertised. Such obstacles might be felt even more strongly at the regional and local level. Yet, Europe cannot afford to miss out on potentially great ideas and business start-ups. That is why action at these levels is so important for regional and local development.

An important precondition is, of course, that Member States adapt their legal and institutional frameworks and promote further entrepreneurship to improve the micro-credit environment. This important aspect is highlighted in the Communication on micro-credit that the Commission adopted in November 2007.

However, one thing must be clear: our aim is not to create a layer of financial non-banking intermediaries which would compete with existing banking institutions. On the contrary, our objective is to create complementarities and synergies between all actors in the field: banks, savings banks, non-banking institutions, networks, local partners, etc. to achieve really sustainable development.

JASMINE

At a major conference in Nice on 10 September 2008 I announced a new instrument to promote wider access to micro-credit, namely a technical assistance facility called JASMINE (Joint Action to Support Micro-Finance Institutions in Europe).

The objective of this facility is to provide technical advice and financial support to micro-credit lenders and to promote best practices in this field. This will help micro-credit providers to reach a high quality standard that will make them more credible in the financial market.

JASMINE will help develop the business plans of micro-credit institutions, providing advice on technical issues and advising on requirements regarding their seed and operating capital. JASMINE will also channel different forms of funding to micro-finance institutions. Overall, the task of JASMINE will be to help micro-finance institutions to improve the quality of their operations, to expand and to become sustainable.

The concept will be tested during an initial three year pilot phase to identify best practices in the field before launching operations at a larger scale. To do so, the pilot phase will encompass 15 to 20 selected "model" micro-finance institutions. Our partner, the EIF, is currently identifying co-financing partners and designing the financial products.

We are on track for JASMINE to become operational in the first months of 2009. I am pleased to tell you that the European Parliament strongly supports this project and is willing to financially contribute to this initiative.

JASPERS

Finally, let me shortly introduce the eldest of the siblings. JASPERS is a technical assistance instrument to help national administrations in the new Member States to prepare large and complex infrastructure projects. Experience with the pre-accession instruments, especially ISPA, brought a significant capacity gap to prepare such projects to the fore. The Commission was conscious that the greatly increased amount of assistance which would become available after accession represented a challenge of a different order and required appropriate support.

JASPERS also supports the establishment of public-private partnerships by advising Member States on how to structure them. Developing PPPs is complex and the environment is unique to each country. If successful, this facilitates enhanced use and further development of financial engineering instruments.

JASPERS has been in operation since 2006 in the twelve new member states and it has proved very useful and successful. JASPERS operates from three regional offices in Warsaw, Vienna and Bucharest, with a staff of 58 experts. To date JASPERS has completed over 80 assignments which are providing a major input into future project preparation.

CONCLUSIONS

Ladies and Gentlemen, let me now come to my conclusions. The current situation requires that action is taken at all levels to prevent the recession from becoming long and deep. This is our short term goal. At the same time we must uphold our focus on longer-term economic, social and political priorities. We must continue structural reforms, we must put people first and guarantee social cohesion, we must stick to the energy and climate package, which offers a million of new business opportunities and will create plenty of "green-collar" jobs. If we manage to pursue these objectives with determination, I am convinced we will emerge stronger from the crisis.

This is also the leitmotiv of the EU Economic Recovery package, which I mentioned in the beginning. To conclude let me highlight some of the concrete actions and legislative changes in Cohesion Policy with regard to financial engineering instruments:

1. The Commission proposes changes to the legal provisions in order to further facilitate the contracting with EIB and EIF. In addition, in-kind contributions could be declared as eligible expenditure in all cases, either where creating or contributing to a financial engineering instrument.
2. Second, the Commission intends, together with EIB, to significantly expand the use of Jaspers facility. Therefore the Commission proposes an increase of 25% in its technical assistance capacity from 2009 onwards. This will raise the total number of experts to more than 70, to assist new Member States in the preparation of major projects.
3. Third, the Commission works closely with the EIB and EIF to assist Member States to fully use the possibilities offered by JEREMIE to promote entrepreneurship. Furthermore, the Commission, in close partnership with the EIB group, encourages Member States to strengthen the business environment for micro-credits.
4. Fourth, in order to enhance the implementation of JEREMIE and JESSICA, the Commission, in co-operation with the EIF, the EIB and the Member States, will launch early next year two specific networking platforms as a forum for exchange of information, guidance and good practice.

I know that developing the use of financial engineering instruments in Member States and regions is a challenge, in particular in this period of uncertainty. But I truly believe that we need to join our forces to finance real economic activity.

Public banks are prominent actors on the financial and regional scene. I do believe they you have an important part to play in overcoming this crisis as you know your regions and your enterprises best.

Ladies and Gentlemen, I look very much forward to deepening our co-operation.

Thank you for your attention.