

European Investment Bank lending in the transport sector - Corporate benefits

For more detailed information and references see the full report entitled:

Lost in Transportation: The European Investment Bank's bias towards road and air transport

http://bankwatch.org/documents/lost_in_transport.pdf



The European Investment Bank (EIB), the European Union's 'house bank' and the world's largest public bank, gives loans and guarantees on a not-for-profit basis using funds contributed by member states. Between 1996 and 2005 the bank provided loans of over EUR 112 billion for transport projects. This factsheet shows undue benefits for the private sector from the EIB's transport portfolio and makes recommendations for avoiding these in the future.

EIB loans benefit a range of private companies connected with the transport sector, from airlines to car manufacturers and construction firms. Since financing from the EIB provides political backing for projects, it should avoid supporting sectors with a particularly high environmental or social impact. However, **the EIB does not have any policies limiting or halting financing for any industry sector, no matter how harmful. Nor does it have any mechanism for excluding underperforming companies or those convicted of corruption.** In addition, some public-private partnership (PPP) cases supported by the EIB indicate that excessive profits are being made, raising questions about the EIB's ability to ensure that the public interest is being served.

Air transport

Due to the lack of VAT on air tickets, the lack of fuel tax, duty free allowances, and low Air Passenger Duty, it has been estimated that **there is an annual subsidy of EUR 13.7 billion for the aviation**

industry in the UK, while according to T&E, an NGO specialising in transport and environmental issues, **aviation's exemption from fuel taxes alone is worth around EUR 35 billion per year across the EU** based on the level of road tax. In spite of this the EIB is financing the expansion of the air industry, with airports, airlines and aircraft manufacturers all benefiting from public money. Between 1996 and 2005 the EIB lent approximately EUR 16 billion for air transport and EUR 1.5 billion for aircraft manufacturing.

Airport companies

Although many airport companies are at least partly owned by governments or local authorities, several private companies have also benefited from EIB loans.

Hochtief: Athens International Airport

Hochtief Airport, an arm of German construction company

Hochtief, has benefited from EIB loans via its part-ownership of Hamburg, Dusseldorf and Athens airports. The construction of Athens airport received almost EUR 1 billion from the EIB. The tender process was criticised by French company Dumez, and questions have been raised by MEPs about the real construction costs compared to the total project costs, as well as the European Commission's classification of the airport company as public in order to make it eligible for cohesion funding.

Hochtief Airport has the right to run the airport for 30 years, virtually ensuring guaranteed profits. The airport has been criticised by the International Air Transport Association, which states that service is good but too expensive, with the regulated target rate of return of 15% ensuring monopoly profits for the airport operator at the expense of its captive customers. There are no direct incentive-based price caps, so there are no incentives for improving efficiency, and if monopoly profits are not made in one year charges

may be raised in order to recoup shortfalls. The case raises questions about the value for money of the new airport, and shows that the EIB's processes for evaluating the efficiency of its investments need to be improved.

Airlines

Airlines have benefited from EIB loans for the purchase of new aircraft to either replace or expand their fleets. Given that the industry has until recently been dominated by state-owned or privatised airlines, it is mostly these companies that have benefited, eg. British Airways (EUR 909.5 million 1996-2005) and Iberia Airlines (EUR 1.057 billion). In 2005, however, the EIB gave its first loan to a low-cost airline, paving the way for more such loans. Low-cost airlines are particularly controversial as they are seen as the most obvious example of an industry that does not pay its external costs and is encouraging people to fly more.

easyJet

In 2005 the EIB provided a EUR 98.6 million loan to low-cost airline easyJet to expand its fleet with up to 42 new Airbus aircraft. Given that in 2004-5 easyJet's pre-tax profit was GBP 67.9 million (EUR 101 million), it is difficult to imagine that this investment could not have been financed from other sources such as commercial banks. The justifications given for the loan were 'regional development' and 'transport project of common interest', however there is no inherent reason why regional development should result from the expansion of easyJet. Benefits will accrue to the small percentage of the population who use easyJet's services, but mainly to the airline's shareholders, while taxpayers will continue to pay for the external costs of aviation.

Aircraft manufacturers

EADS/Airbus: Airbus, owned by EADS, is currently the subject of a trade dispute at the World Trade Organisation, in which the US has made a complaint about EU and national subsidies for the company. Apart from a EUR 700 million loan to EADS in 2002, from 1996-2005 the EIB mainly provided loans to Airbus via airline companies. **Loans totalling 2 879.8 million were made to various airline companies for purchasing Airbus planes, and although it is unknown how much Airbus made as a result of these deals, a minimum of 112 Airbuses were purchased as a result of EIB loans.**

Why would a company with so few competitors need so much public money, and in particular, as it already receives so much state aid, why should it need financing from the EIB, a bank mandated only to provide loans when there are no other sources available on reasonable terms? Even Airbus' former CEO Noel Forgeard agrees that plenty of financing is available: "We do not need them [UK export credit guarantee agency] if they behave like a bank — there are plenty of banks that will finance our deals".

Construction companies

In any individual project there is no way of knowing which companies will win contracts, but overall the sector gains when any infrastructure is built, and the bigger the better. It is questionable, however, to what extent public money should support the construction industry's profits considering the sector's corruption scandals, eg. the Lesotho Highlands Water Project in which several European companies have been accused of paying bribes to a Lesotho official, and Lahmeyer International, Spie Batignolles/

Schneider and Impregilo, as well as Acres International of Canada, have been convicted. While Lahmeyer has been barred from receiving World Bank funds for up to seven years, all of the companies remain free to benefit from EIB loans and are likely to do so (Lahmeyer for example has been involved in at least seven projects financed by the EIB).

Cash for contracts? Hungarian motorways and Strabag

Austrian construction company Strabag has been involved in the construction of two Hungarian motorways financed by the EIB: M0 and M35 as well as other motorways in the country (M1, M5). The company has also featured in the motorway scandals that have hit Hungary in recent years.

In 2004, the Hungarian Competition Council fined several motorway construction companies, including Strabag, a total of around EUR 28 million for engaging in cartel behaviour during tender processes. In September 2006 Strabag was accused by Austrian MEP Hans-Peter Martin of channelling money to the governing parties of Hungary through intermediaries in connection with the M5 motorway.

Cartel offences in Slovakia

The Hungarian events were accompanied by Strabag and a number of other companies being excluded for five years from public procurement in Slovakia after being found guilty of cartel offences connected with the construction of the D1 motorway and fined around EUR 10 million (around EUR 38.6 million in total for all the companies involved). The EIB signed a EUR 30 million loan for the relevant section of the D1 in 2004, though it is not known whether it was ever disbursed.



Rising costs, falling ceilings: Sofia Airport

The Sofia airport project, part-financed with a EUR 60 million loan from the EIB, was split up into two parts, with an EIB loan and ISPA grant mainly financing the new terminal. Strabag won the tender for the terminal, with NACO B.V. from the Netherlands as a design and engineering consultant. Strabag's work has been the subject of considerable controversy:

- The new terminal was finally opened on December 27, 2006, nearly two years late.
- In November 2003 an extra EUR 4.67 million was added to the original cost of EUR 110.6 million for the terminal after it was discovered that the local geology required a more expensive construction technique.
- In summer 2004 Strabag asked for additional costs because of a rise in steel prices.
- In late 2004 the company was blamed for the poor quality of the new paving on the taxiways and at the new terminal. It is not clear whether Strabag or its subcontractors carried out the work.
- In February 2006 Strabag was reported as demanding an additional EUR 15 million for the project, although the Bulgarian government was also fining Strabag for not completing the project on time.

→ In the same month, a newly-built roof caved in at the terminal. It is not clear whether Strabag or its subcontractors carried out the work.

The case illustrates the potential for both excessive demands and corner-cutting by construction companies and the need for a mechanism for excluding under-performing companies from future contracts.

For more on the Sofia Airport case, see Bankwatch's full report

Car manufacturing

Despite EU transport policy stipulating a massive shift towards public transport, cycling and walking, the EIB continues to support car manufacturing more than any other industry sector. A hefty 31% of the EIB's funding for industry between 1996 and 2005 (approximately EUR 9.6 billion) went to the car industry and in Central and Eastern Europe this share reached 63%.

While the European car industry is subject to fierce competition from manufacturers from other parts of the world, and giving favourable EIB loans to the industry is one of the ways in which the EU can help to maintain jobs, questions arise as to whether it would

not be better to use public money to support jobs in industries and services with more public interest credentials.

The EIB has financed several companies which are not reaching their voluntary targets on CO2 emissions, such as Volkswagen and Skoda, showing that, overall, **financing has not been targeted towards those companies making progress towards improving their efficiency.** There are also notable cases where financing has been used for the development of luxury vehicles with neither low fuel consumption nor low emission levels, for example:

→ In 2003 the EIB provided Landrover with a EUR 250 million loan to develop two new versions of existing models.

→ In 2002 the EIB provided Jaguar with a EUR 300 million to develop the Jaguar X350.

PPP - Public-private partnerships

PPP is a general term describing different types of private sector involvement in work that has traditionally been carried out by the public sector. The main common feature of PPP arrangements is that some degree of risk is transferred to the private sector – construction risk (for infrastructure), availability risk (mainly for services) or demand risk (for example on toll-roads, bridges or tunnels where part of the private partner's income is dependent on the number of users). By the end of 2003 the EIB had signed loans for PPPs worth EUR 13.7 billion for transport projects, making up 93% of the Bank's PPP investments. Most of these were for motorways, tunnels and bridges.

Controversy about transport sector PPPs

Excessive profits: In the UK, where PPPs have been frequently

used, construction firms traditionally receive rates of return of 1.5-2% on contracts but expect margins of 7.5-15% for PPPs, and if they are equity holders in the project company they may expect 10-20%. This increase is said to reflect the risk transfer to the private sector, but it is open to debate whether it is proportionate and how much risk is actually transferred.

Value for money: Central to the success or failure of PPPs is an analysis on whether a PPP option represents good value for money compared to public procurement. However this is not always carried out with the diligence it deserves and **the EIB does not normally independently assess the expected value for money from PPP compared to public procurement.**

Teething problems or Corporate welfare scheme? London Underground PPP

In 2002 and 2003 the EIB provided loans totalling EUR 1.3 billion for the modernisation of the London Underground. London Underground Ltd. operates the system, while two engineering consortiums, Metronet (made up of WS Atkins, Balfour Beatty, Bombardier, Seeboard and Thames Water) and Tube Lines (Amey and Bechtel) are responsible for infrastructure modernisation – an arrangement condemned by the then London Transport Commissioner as “unsafe, inefficient and prohibitively expensive.” The companies won 30-year contracts worth GBP 15.7bn and in 2002, the UK government Select Committee on Transport, the Environment and the Regions concluded: “It was not possible to establish that the PPP offered value for money”.

The companies are paid less if they do not meet availability targets, but these are not ambitious. The UK parliament’s Transport Committee delivered a damning

verdict on the work done by the end of 2004: “All the infracos [infrastructure companies] needed to do to meet their availability benchmarks was to perform only a little worse than in the past. On most lines, they did not even manage that.”

In 2003 the two companies were fined a total of GBP 32 million for not reaching their targets, yet were still awarded GBP 12 million in bonuses for good performance. During the first full year of the PPP, combined operating profits were at 13%. Tube Lines made a pre-tax profit of GBP 41.6 million in the year to March 2004 and Metronet made a pre-tax profit of over GBP 50 million.

The project has been poorly designed in terms of public interest: The need to implement a PPP arrangement has never been adequately proven, questions about the efficiency and safety of the management structure remain, and the PPP contract appears to enable the infrastructure companies to make large profits with too little risk transferred onto them.

Poor demand forecasting (lower than expected infrastructure usage) can have opposing outcomes: In the Herrentunnel case, a road tunnel in Lubeck, Germany, supported with a EUR 80 million EIB loan, the toll fee was raised to try to cover losses, thus making users pay for the poor planning. However in other road projects, active attempts are sometimes made to encourage an increase in traffic levels in order to increase income, which contradicts the need to reduce emissions. It is therefore questionable to what extent payments should be made to a PPP company for road projects on the basis of demand.

Should the EIB support PPPs at all?

The EIB should only lend for

PPPs, as for other projects, when other financing is not available on reasonable terms. However in the bank’s own evaluation of PPP projects, it was found that only one out of ten projects could not have happened without EIB involvement. Concerning EU policy there is no reason why the EIB should not be involved in PPP projects. However, there are a number of conditions which need to be met for PPP to be a useful tool in transport financing.

Recommendations

1. The EIB must halt investments into the aviation sector.
2. Loans should only be given to the car industry for R&D for more efficient, cleaner and safer technologies, not for manufacturing.
3. The EIB must ensure the transparency of its projects and strong public scrutiny over them.
4. The EIB must develop criteria for excluding underperforming companies and those which have been convicted of corruption.
5. In PPP projects, a thorough and fair analysis needs to be made on whether a PPP represents the best value for money compared to public procurement.
6. The EIB must be more rigorous in applying EU standards in projects outside of the EU
7. The EIB needs to interpret Article 18 of its statute literally, ie. it must not finance any project able to be financed by other sources at reasonable rates.

For a full set of recommendations, check out Bankwatch’s new report on the EIB’s lending to the transport sector.

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