National Development Banks and the Rise of Market-Based Protectionism in Europe

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Abstract: National development banks (NDBs) are tasked with promoting the economic interests of national governments. In an era of increasing European integration, why have European NDBs not only survived, but actually expanded in both number and scope in the past 30 years? I argue that European governments have increasingly utilized NDBs as a way to compensate for the declining supremacy of national economic policymaking. Instead of directly intervening in the economy, European governments have retooled existing NDBs to serve as indirect conduits that serve national economic priorities. Consequently, the total balance sheets of NDBs have risen steadily since the early 1980s. In addition to the rising prominence of NDBs, the policies of the EU have also influenced how and which programs NDBs support. Traditionally, NDBs supported large-scale industrialization and infrastructure programs through a variety of direct financing measures. However, as the regulatory power of the European Commission, and particularly that of DG Competition, have increased, NDBs have come to heavily rely on market financing in order to avoid violating State Aid rules. Emphasis has also moved towards programs that accord with EU policy objectives, namely small- and medium-sized enterprises (SMEs), green technology, and innovation promotion. Therefore, even though EU integration has circumscribed the ability of governments to directly support national economic interests, governments have adapted NDBs to indirectly implement national economic policy via market-based mechanisms.

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Introduction

In recent decades, national development banks (NDBs)[2] have played a critical role in the development and promotion of European economies. Officially tasked with supporting projects that the private sector is either unwilling or unable to finance, NDBs have supported a wide range of programs that aim to ameliorate market failures. These have included large-scale infrastructure projects, the provision of funding for small- and medium-sized enterprises (SMEs), regional redevelopment programs, and climate change initiatives. In recent decades, these NDBs have not only survived but thrived, more than tripling their collective 1980 balance sheets by 2015. That is, governments have channeled a growing amount of financing through these NDBs to achieve national policy objectives. This expansion is even more remarkable when considering that over the same period the European Union has increasingly circumscribed national policy tools through greater regulatory harmonization and stricter state aid rules. How can we reconcile these apparently diverging trends?

I contend that these two phenomena are intimately intertwined. As European economic integration has deepened, and the supranational authority of the European Union and its regulatory bodies expanded, European national governments have fewer policy tools available to them. Direct state ownership of industry has been discouraged or banned; industrial policy has waned; strong free trade agreements have limited the use of financial subsidization and tariff barriers; and even indirect subsidies are circumscribed by anti-competitive regulations. As these traditional interventions are increasingly prohibited, European governments have lost flexibility in implementing national economic policy. National governments, however, have not sat by idly.

[2] As will be discussed later, there is substantial variation in the classification of national development banks. More recently within the European Union, the moniker "national promotional banks" has been more widely used.

Even though old methods of economic policy became obsolete, new forms have appeared in its place. In particular, I argue that national development banks have been deliberately reformed—and in some cases, revived—specifically to provide opportunities for greater national control over economic policy. NDBs have become flexible tools for national governments to subsidize preferred industries, compensate for market failures, and promote national exports. Moreover, given the neoliberal proclivity of the European Commission, it is no surprise that these interventions have increasingly relied on market-based financing. For instance, NDBs have increasingly turned to international capital markets to raise funds, and projects are frequently implemented through on-lending programs in partnership with commercial banks.

To a certain extent, this phenomenon has been documented by scholars examining the tension between supranational forces and national economic sovereignty in open economies. For instance, Clift and Woll (2012) have argued that in an era of triumphant market liberalization, politicians face a paradox: "Their political mandate is to pursue the political economic interests of their citizenry under conditions of complex economic, legal and regulatory interdependence where large parts of economic governance are no longer exclusively within their control" (308). Clift and Woll analyze this phenomenon through the prism of economic patriotism, defined as "economic choices which seek to discriminate in favour of particular social groups, firms or sectors understood by the decision-makers as insiders because of their territorial status" (2012, 308). Yet there are other ways in which politicians could decide to support national objectives. Shonfeld (1965) documents the rise of long-term industrial planning in post-WWII Europe, arguing that the government guides the development of private enterprise without ever assuming government ownership over the enterprise. Other potential tools include greater indirect subsidization for national industry, protective tariffs, or quality requirements.

While the role of the financial sector in mediating this tension have been addressed, national development banks (and all policy banks, for that matter) have received scant attention. This is made all the more surprising given the increasing role NDBs have played in national economies. What little scholarship exists on European NDBs has either examined their functions following WWII, or it has emphasized the impact of the Global Financial Crisis on reviving their importance. For example, a few studies have posited that the 2008 Global Financial Crisis has renewed government interest in promoting national development banks, particularly because of the countercyclical role they can play during economic downturns (Bertay, Demirguc-Kunt, and Huizinga 2012; Rudolph 2009).[3] Wruuck (2015) notes that not only were many European NDBs engaged in countercyclical activities, but many also adopted additional financial activities beyond their original scope. The advantages of NDBs following the financial crisis has been documented outside of Europe as well. De Luna-Martinez and Vicente (2012) have conducted the only large-scale survey to date of these institutions, concluding that, despite their heterogeneity, NDBs across the globe have served an important role in implementing governmental economic policy in infrastructure spending and industrial promotion. Similarly, Culpeper (2012) concluded that NDBs were an effective tool to combat the deleterious effects of financial sector liberalization in developing countries, particularly after 2008.

These studies have rightly concluded that national development banks can serve important investment and countercyclical roles in times of financial duress. However, I contend that they misinterpret the longer trajectory of state-sponsored protectionism because they omit the historical context of NDBs. In short, I argue that NDBs can be seen as serving a similar purpose to other non-tariff barrier protectionist measures. By channeling subsidized financing

[3] It should be noted that both studies do not distinguish between national development banks and other publicly owned banks.

through state-backed NDBs, governments are able to effectively support national economic priorities without violating the laws and norms of open market economies. In this context, the recent Global Financial Crisis is not a watershed moment, but rather the most recent juncture that provoked governments to respond. In this paper, I will argue that governments started to incrementally reorganize their NDBs in the 1980s as they sought to gain more authority over domestic economic policy. As the pressures of globalization and European integration heightened, the pressure to find alternative mechanisms mounted. NDBs served this end. Governments reformed NDBs to become more financially independent, and pushed them to support new programs such as SME financing. More importantly, these reforms emphasized a shift away from traditional state-backed initiatives and towards ones that harnessed marked-based financing. As the European Union pushed for greater integration and, crucially, DG Competition began asserting its role as chief enforcer of the common market, the use of NDBs increased rapidly. Today, NDBs play not only an integral role in the promotion of national economic interests, but also have gained conditional acceptance at the European level with a robust new partnership with the European Investment Bank (EIB).

Consequently, national development banks serve as a microcosm as to the ways in which European governments have responded to the macroeconomic changes in the global economy and in response to greater European integration. The rest of paper is as follows. First, I provide a theoretical context of state-support for national economic policy with an analysis of the history of NDBs, their functions, and how they related to national promotional strategies. Next, I document the changes in the global economy and European integration in the 1980s and 1990s, providing a detailed account of how governments retooled NDBs to serve their interests. Third, I analyze the shift in the 2000s and the post-financial crisis, primarily focusing on how a

strengthening DG Competition has altered the behavior of NDBs. Finally, I conclude with some challenges and prospects for the future.

Integration, Economic Liberalism, and National Development Banks

In recent decades, scholars and practitioners alike have been quick to assess the preponderance of free market liberalism in the global economy (Levy 2006; Strange 1996; Yergin and Stanislaw 2002). The steady increase in tariff-free trade and free trade agreements, the rapid privatization of state-owned enterprises across formerly socialist countries, and the proliferation of current account liberalization highlight the victories of this perspective (Megginson and Netter 2001; Simmons and Elkins 2004). Private actors have also ascended to important positions within the global economy, allowing them to exert pressure in issue areas from trade policy to international regulatory bodies (Hall and Biersteker 2002; Mattli and Büthe 2011; Scherer, Palazzo, and Baumann 2006; Sell 2003). International institutions have served to reinforce this trend. For example, the World Trade Organization (WTO) has systematically dismantled a majority of the tariff barriers and institutionalized a dispute resolution mechanism that allow nations to sue non-compliant member-states (e.g., Subramanian and Wei 2007). Bilateral investment treaties (BITs) have given rise to the private arbitration of ICSID and, in most cases, the ability of private corporations to bring lawsuits against a government (Salacuse and Sullivan 2005). Regional free trade agreements, such as NAFTA, have deeply integrated trading partners. Even though the recent Global Financial Crisis has increased the salience of protectionist measures (Aggarwal and Evenett 2010; Kee, Neagu, and Nicita 2011), the international liberal order has persevered.

If the international economy has served as a role model of open-market integration, then the European Union (EU) has been one of its most unwavering supporters. Central to the project of European integration has been a strong commitment to open market economics. From its inception as a coal and steel community in the 1950s, it was widely agreed upon that political integration necessitated a level economic playing field. Without the assurance of cooperation from newly-integrated trade partners, there was a substantial risk for a proliferation of beggar-thy-neighbor policies. Since then, national governments have been subjected to EU economic integration policies; tariffs between member states have been eliminated, state subsidization of industry and commerce rendered illegal, and strict spending and deficit limits imposed. The EU's regulatory institutions, namely DG Competition, have aggressively pursued policies to achieve a deep level of integration. Faced with the pressures of both globalization and European integration, European governments have endured a gradual reduction in autonomy over domestic economic policy making (Pierson 1996). Yet while their ability to directly enact their preferred economic policies has diminished, European states have not been willing to completely relinquish influence. Other mechanisms have developed that allow for governmental support. For one, the EU as a whole has become more aggressive in protecting member states from globalization. The European agriculture sector has been the best documented, but other industries ranging from the entertainment industry to high technology have also benefitted from a relatively protectionist EU-level policy program (Messerlin 2001; Meunier 2005; Potter and Burney 2002).

However, as noted above, sometimes the pressure arises from the EU itself, revealing strong cleavages between states. Even prior to strong European integration, states constructed industrial policy to guide the development of private enterprises—and, by extension, the national economy—without having to directly own the firm (Shonfield 1965). Katzenstein (1985)

highlights the strategy of small European states through their democratic corporatism. In the ensuing decades, contestation over monetary policy, subsidies, and regulatory standards were additional manifestations of this tension between liberal economic forces and national policy. More recently, Clift and Woll (2012) highlight the incentives of national governments to enact policies that promote what they term economic patriotism. That is, politicians engage in policymaking that "shape market outcomes to privilege the position of certain actors," which in practice results in the support of national industries (308). This propensity to favor one's own nation over others has been well-documented, and is a theme that persists across time and space (e.g., Bhagwati 1989; Eichengreen and Irwin 2010). Consequently, it is unremarkable that European governments have supported national protectionist policies in agriculture, stock exchanges, housing financing, armament cooperation, and even the financial sector of the City of London.

How European governments respond to these economic forces, and in particular what explains temporal and geographic variation in responses, has been the subject of much scholarship. Some scholars have noted that the impact of European integration within the domestic sphere depends both on institutional capacity and the amount of change required to meet those goals (Duina 1997; Hanf and Soetendorp 2014). Other scholars have preferred explanations rooted in institutional compatibility or opportunity structures, or some combination of the two (Börzel 2002; Cowles, Caporaso, and Risse-Kappen 2001; Risse, Cowles, and Caporaso 2001). There also exists constructivist arguments that argue for either changes in the beliefs of domestic policy makers or for the influence of social pressure (Checkel 2005; Lewis 2005; Schimmelfennig 2000). In an effort to provide a more comprehensive framework for understanding how EU regulatory pressures explain the varying responses of national

governments, Knill and Lehmkuhl (2002) document three mechanisms— institutional compliance, changing domestic opportunity structures, and framing domestic beliefs and expectations. According to them, only in cases where moderate change in domestic arrangements is necessary is there adaptation; in all other cases, domestic structures persist.

Yet given the immense size of NDBs, and the expanding role they play in the domestic economy of many European states, it is surprising that NDBs have been largely omitted from scholarly analysis. Both the size and number of NDBs has increased dramatically over the years. The limited scholarship on European NDBs has either focused on specific country histories (R. E. Cameron 1953; Grünbacher 2005; Harries 1998; Hertner 1994; Teichova 1994; Van der Wee and Goossens 1991) or the role of NDBs in a revival of state power following the Global Financial Crisis (Bassanini, Pennisi, and Reviglio 2014; Wandel 2016; Wruuck 2015). A number of other studies have pointed to the numerous successes European NDBs in providing countercyclical financing, revitalizing underperforming regional economies, and promoting investment in innovation and green technology (Mattauch et al. 2014). These studies, however, provide no theoretical guidance as to how we should interpret the revitalization of NDBs, let alone how to characterize their ascent. There is also no systematic contextualization of why NDBs developed along similar lines nearly two decades prior to the onset of the Global Financial Crisis. Even more crucially, these studies also omit an important component in understanding NDBs—why have NDBs, which were viewed as secondary policy tools from the 1960s through 1980s, become the economic policy tool of choice amongst European governments today?

I contend that only if we examine NDBs within the historical context of a shifting European Union environment can the shift towards increasing NDB authority be understood. Using the theoretical framework of Knill and Lehmkuhl (2002), an unyielding domestic demand

for autonomy in economic policymaking combined with an institutionalizing European Commission would possibly preclude any domestic adaptation. However, I argue that NDBs can serve as a creative adaptation. NDBs had existed in most countries since the end of the Second World War with mandate that reflected the old style of state-support. Oftentimes NDBs were the principle tool to implement industrial policy and, less frequently, were shareholders in state-owned enterprises. As will be detailed in the next section, regulatory changes to the EU in the 1980s provided an opportunity for NDBs. Politicians realized that repurposing existing financial institutions would have two advantages. First, the majority of NDBs already existed, obviating the costly process of creating new institutions. Second, states could comply with EU regulations on State aid through the semi-privatization of NDBs. While direct state support was often prohibited, indirect financing was more difficult to regulate. NDBs quickly became an effective vehicle to pass on state benefits through market operations. Therefore, in the wake of increasing liberalization, European governments have gradually developed a strategy to protect national economic interests through support of NDBs.

National Development Banks in Historical Context

At least on the surface, the definition of a national development bank is intuitive—it is a government-owned financial institution that engages in domestic economic activities to promote national development goals. In practice, however, scholars and practitioners alike have disagreed as to what formally constitutes a national development bank. Even within Europe, NDBs form a highly heterogeneous group, with substantial variation in ownership structure, development mandate, and financial strength (c.f. de Luna-Martínez and Vicente 2012). For the purposes of this paper, I define a national development bank as a bank with (1) at least 50% of the equity

owned by the national government, (2) a long-term investment horizon, (3) a mandate to promote both economic and non-economic (also referred to as social) objectives, and (4) a national, rather than regional or subnational, scope.[4] These criteria emphasize institutional design and stated objectives rather than the particularities of operation. This definition also helps elide minor discrepancies between NDBs and other state-owned policy institutions—namely national promotional banks.

NDBs have historically played a very important role. While the term "national development bank" was coined only after WWII, the concept of a government-backed financial institution dedicated to spurring the domestic economy evolved concomitantly with the modern nation-state. Central governments consolidated power, and economic development became a natural extension—and priority—of their authority. The rise of industrialization in particular sparked the creation of state-backed financial institutions to provoke, guide, and intervene in the domestic economy. Continental European powers explicitly sought to catch up with rapidly industrializing England in the 1800s, but the need for ever larger amounts of coordinated capital injections into factories and infrastructure outpaced the capacities of the private market. This discrepancy between supply and demand of investible capital presented a market failure, and prompted governments to become actively involved in the development of the financial sector. The most famous analysis of the role of banking in the process of industrialization is that of Alexander Gerschenkron. While Gerschenkron identifies numerous factors that affects the ability of a "backwards" state to industrialize, the banking sector plays a central role during critical stages in the industrialization process. He views industrialization as a linear process that

[4] This definition is a modified version of one posited by World Bank economists José de Luna Martínez and Carlos Vicente (2012) in their survey of national development banks. They define an NDB as "a bank or financial institution with at least 30% state-owned equity that has been given an explicit legal mandate to reach socioeconomic goals in a region, sector, or particular market segment."

originated in England and spread thereafter to more “backward” countries in Europe, arguing that the more backward an economy is, the greater is “the part played by a special institutional factors designed to increase supply of capital to the nascent industries and, in addition, to provide them with less decentralized and better informed entrepreneurial guidance” (Gerschenkron 1962, 353). NDBs were created, by and large, to serve these purposes of government-coordinated modernization.

National development banks existed in a variety of forms from the 1850s through the Great Depression, but in each manifestation the goal was the same: finance projects that were underprovided by the market (R. Cameron 1961; R. E. Cameron 1953; Diamond 1957; Paulet 1999). Shifts in the global economy ultimately changed the purpose and operations of NDBs in the post-WWII era. NDBs maintained their original purpose of mitigating the market failure in financing, but their scope broadened dramatically. In Europe, NDBs were revived to finance reconstruction efforts in infrastructure, utilities, and factories. They also became responsible for activities outside traditional public works, and supported projects in social housing, SME financing, and agricultural development. Given the paucity of investible capital, most financing was channeled from the United States through the European Reconstruction Program (ERP), popularly known as the Marshall Plan. KfW in Germany was founded in 1949 specifically to expedite reconstruction using these funds. Emphasis was placed not only on large-scale capital and infrastructure projects, but also social programs as well (Crena De Iongh 1950). In short, the entire raison d’etre of NDBs was to ameliorate market failures when the private sector was unwilling or unable to provide financing. As the contours of what constituted a market failure shifted—in this case, away from mass industrialization projects and towards smaller-scale development and social objectives—so did the operations of NDBs. Yet despite their economic

and social objectives, NDBs remained a relatively minor institution. Industrial policy and direct state ownership of industries and banks frequently obviated the need to prioritize the utilization of NDBs.

Whether or not NDBs have been effective is an entirely separate question, and one that economists have grappled with for decades. State-owned financial institutions, a larger category to which national development banks belong, generally have a lackluster track record for remaining financially solvent, maintaining good credit ratings, reducing high arrear ratios, and staying adaptable to changing market conditions (Berger et al. 2005; Lin and Zhang 2009; Mian 2003). Direct government ownership of banking institutions is also correlated with increased corruption (Barth, Caprio Jr, and Levine 2004). Moreover, there is little systematic evidence to suggest that state-owned banks provide greater profits than commercial peers, promote financial sector development, supply more credit, or lead to increased economic growth (La Porta, Lopez de Silanes, and Shleifer 2002; Micco and Panizza 2006; Yeyati, Micco, and Panizza 2007). Specifically regarding NDBs, these institutions have faced criticisms that they are ineffective in promoting economic development, or that they crowd out private financing by offering below market interest rates. Numerous examples following the Global Financial Crisis in 2008 further highlight the susceptibility to political interference.[5] These findings seem to corroborate the assumption that government ownership is both less effective than private banks and more likely to be the targets of political interference.

National Development Banks and European Competition Policy: 1951-2000

[5] In particular, the Russia's VEB and Brazil's BNDES have both encountered serious problems stemming from extensive political interference.

With a background of national protectionism and the history of NDBs at hand, this section explores the interaction between NDBs and the nascent European competition policy. In the early years, few NDBs even existed in Europe, and NDBs served as only secondary intermediary financial institutions. The earliest of the European institutions, KfW, was established purely for the purposes of German reconstruction, and focused on rebuilding the German housing stock and industry (Harries 1998). For the next few decades within Europe, NDBs played a minor role to other government interventions in the market. State ownership of enterprises, which was still relatively widespread until the early 1990s, government participation in the banking sector, and industrial policy largely guided national economic policymaking. A weak competition agency lacked both the capacity and the mandate to significantly impact the operations of NDBs, and NDBs carried on uninterrupted. By the 1980s, however, shifting political coalitions and economic integration pressures prompted the ascent of DG Competition, profoundly impacting the way in which NDBs operated. As the pressure mounted, government began subtly reforming NDBs to fit within the changing parameters.

The Early Years of NDBs and European Integration

While the activities of national development banks might have been limited, early European integration enthusiasts were cognizant of dangers posed by state support for industry. Everybody recognized the future integration of a single European market necessitated a robust competition policy. In 1950, the French Minister for Foreign Affairs Robert Schuman announced a concept of European integration that created a de factor solidarity between partners. Known later as the Schuman Declaration, this promoted the creation of a common market for coal and steel along with the establishment of a public authority to regulate these markets. French

businesses and politicians originally supported the competitive regulations in order to avoid a buildup of German industry. Others supported a common competition policy to establish a modern, efficient, and economically integrated European market (Leucht 2008). However, throughout the 1950s, these nascent attempts at regulating interstate competition were heavily influenced by high-level political lobbying and bargaining (Warlouzet 2010, 7). Despite a suspicion of state support, the fledgling institutions did not officially legislate a regulatory body.

The 1957 Treaty of Rome established the European Economic Community (EEC), and reflected an ordoliberal doctrine that emphasized free market dynamism with limited public interventions (Gerber 1998). A strong competition policy, they argued, also helped prevent the reemergence of industrial cartels. The result of the negotiations, however, were unclear. The newly established European Commission appeared to have less formal authority than the previous High Authority, but the scope was far wider, and the implementation of Articles 85 and 86 of the treaty regarding competition rules were to be determined at a later date. The negotiations in 1960 and 1961 were dominated by a group of staunch ordoliberals. The result of the negotiation was the adoption of Regulation 17/62, which had an enormous impact on the trajectory of European competition policy. In particular, the regulation established a notification system whereby all agreements had to be reported to the Commission. If the EC suspected anticompetitive practices, it could launch an inquiry and ultimately rule on the validity of the support: “the Commission gained a virtual monopoly of power both in terms of information and of decision-making” (Warlouzet 2010, 10). This marked the beginning of a centralized institution for competition policy at the supranational level. Moreover, the new institution intimately reflected the values of ordoliberalism and embedded liberalism and, according to some, became the standard-bearer for an ideal type of perfect competition (Allen 1983).

In short time, it became clear to the Competition Commissioner von der Groeben that the institution would be unable to handle the increasing number of notifications. His solution was to implement block exemptions, "whereby the Commission would be able to exempt certain types of agreements, *en bloc*, from the prohibition against restrictive agreements" (Warlouzet 2010, 12). However, disagreements amongst European states prolonged the implementation until 1965, and block exemptions were only permitted in 1967. Following the changes, DG IV (currently known as DG Competition) was flooded with notifications. Instead of adjudicating each case separately, DG Competition has instead preferred deciding precedent-setting cases, such as *Grundig-Consten*. Nevertheless, the Commission still faced a series of challenges to its authority, and it was not until the 1970s that DG Competition would regain its influence. Competition from large US MNCs, as well as a heightened monetary and oil crisis, propelled fears of inflation. Using the pretense of consumer protection and inflation reduction, DG Competition was able to expand its mandate (Cini and McGowan 1998; Warlouzet 2010), though subsequent changes did not strongly effect the operations of development finance or national development banks. A protracted debate on the Merger Regulation, for instance, highlighted the inability of DG Competition to generate momentum for its policies.

Nevertheless, despite its formal successes, in practice the early competition policy was far less robust. There were still many opportunities for states to continue to illiberally intervene in the economy. The reason was simple: states and large businesses simply did not want immediate liberalization. European governments were becoming wary of the increasing power of American corporations, which had been rapidly growing throughout Europe via mergers and acquisitions. Persistent economic stagnation and weak labor markets provoked states to actively engage. The leniency of the DG Competition in its regulatory role was obvious; large industrial

restructurings and capital infusions from the British, French, and German governments was all but ignored in the 1960s and 1970s (Buch-Hansen and Wigger 2010, 27). The flexibility was also enshrined in the way anti-competitive practices were defined. Interventions were adjudicated based on "public interest" criteria, permitting for the use of alternative factors like macroeconomic stability and employment considerations (Dumez and Jeunemaitre 1996). Moreover, Akman and Kassim (2010) argue that there is also a fair amount of myth-making within the context of early competition policy, positing that ordoliberalism provided a much less robust ideology than previously assumed. Competition policy therefore lacked the ability and the mandate to intervene in uncompetitive practices. NDBs were effectively ignored.

The impotence of competition policy was, however, indirectly responsible for the lack of NDBs—there simply was no reason that governments needed to intervene with a financial institution. Most of the early development banks were tasked with coordinating investments by the state-owned banks to support industrial policy. Germany's KfW focused on implementing the federal government's industrial policy, which emphasized SME financing and the securing of raw materials abroad for industrial conglomerates. Spain's ICO was established only in 1971 to coordinate these state banks and indirectly support the Spanish industrialization program, and reformed to become a modern development bank only in 1991. Italy's CDP, while founded in 1850, was reformed beginning in 1983 to have organizational and financial independence from the Italian government, though it still commanded only a very small balance sheet. In short, NDBs were insignificant players because they provided no advantage over the traditional strategy in which the government would directly intervene.

The 1980s and 1990s: The Ascent of DG Competition and the Pressure to Reform

The promotion of a strong competition policy—which was laid out in the original documentation of the Rome Treaty—gained traction following the Single Market program. After all, opening borders to transnational trade but concurrently subsidizing national industry would only serve to resurrect those barriers. Arising from obscurity in the 1980s, DG Competition began to assert its power to prohibit cartels, agreements, mergers, and state aid. Central to this strategy was the increasing usage of precedent-setting court cases. As a result, from 1985 under the leadership of the newly-appointed Competition Commissioner Sutherland, challenges to state aid were aggressively brought before European courts (Buch-Hansen and Wigger 2010). Equally important, DG Competition gained the important responsibility of regulating mergers between corporations (McGowan and Wilks 1995). Finally, there was also a triumph of efficiency criteria to judge economic transactions; other criteria, such as employment or social benefit, were gradually ignored.

The rising strength of DG Competition can be attributed to a number of factors. First, European industrialists grew increasingly frustrated with Europe's stagnating economic situation. They banded together in 1983 to form the European Roundtable of Industrialists (ERT), an organization that lobbied for greater openness and integration, a quality they admired about the US domestic market (Buch-Hansen and Wigger 2010). This revealed a marked change from businesses' previous reluctance to support competition. Second, a changing ideological and political environment that reflected the spread of neoliberalism took hold. The influence of Reagan and Thatcher drove free-market economics to the forefront amongst the Anglo-American countries, and this had a secondary effect in Continental Europe (Buch-Hansen and Wigger 2011). Third, the presidency of Jacques Delors spurred a revival of European institutions, gaining the support of affiliated institutions like the ECJ and non-state actors like MNCs. During

this period, block exemptions were expanded and new issue areas were incorporated into DG Competition's policy mandate, such as state aids. The Commission seized on this opportunity to promote the completion of a single market, couched in the language that competition between private enterprises was good for economic growth (Warlouzet 2010, 17).

In the 1990s, DG Competition looked to expand upon its newly-established authority in merger control and "drew up ambitious plans at the start of the 1990s to inject the spirit of competition into the public utility sectors, specifically those relating to transport, telecommunications and energy-sectors which historically had been exempt from competition rules" (McGowan and Wilks 1995, 153). Changes in the political climate, which became more hostile to deeper integration, made the timing of DG Competition's proposals temporarily unattainable. Shortly thereafter, numerous factors made the expansion of DG Competition possible once more; first, the Single European Market (SEM) entered into force; second, a new Competition Commissioner was appointed; third, there were discussions on revising the old merger threshold and strengthening the legal recourses for DG Competition; and finally, a revived interest in free trade agreements (McGowan and Wilks 1995, 153). The relatively rapid expansion of power came at a cost. DG Competition was soon inundated with cases to review, and a serious backlog developed. Proposals were floated to decentralize implementation to national courts; this was appealing to both reduce the workload of the commission and devolve authority away from Brussels. Nevertheless, it was decided to keep authority within DG Competition in order to maintain harmonization across the EU. Attempts by Germany and the United Kingdom to bring six antitrust cases back into the domain of domestic courts by invoking Article 9 were all rejected (McGowan and Wilks 1995).

More pertinent to the operations of NDBs was the development of the State aid regime in the 1990s. While regulations of state aid had been written into the Treaty, state aid enforcement was weak until the mid-1990s. Smith (1998) argues that three factors explain why DG Competition was able to gain influence. First, the increasing reliance on the language of Community rules and impartiality attempted to depoliticize the functions of DG Competition. Second, rules of the European Court of Justice on state aid cases reinforced the ability of DG Competition to suspend aid, demand information, and obtain compensation. In particular, four precedent-setting court cases clarified the ability of DG Competition. For instance, the 1984 Intermills judgment declared that "all forms of aid could be subject to state aid rules, including not only direct subsidies, but also loans at below market interest rates, loan guarantees, tax and social security contribution relief, and direct provision of capital by any level of government on terms different from those that would be applied by a market investor" (Smith 1998, 67). Finally, the role of DG Competition was reinforced through the language and actions of NGOs and civil society. What resulted was a much more independent and hostile environment for state-owned entities.

These shifts in the 1980s and 1990s certainly had a profound impact on how governments related to the European Commission, but how has this affected the operations of NDBs? In short, NDBs were also affected by the same ideological constellations that produced a more robust DG Competition policy. The neoliberal market restructuring put pressure on governments to shed state-owned enterprises, independent of new regulations. However, a changing DG Competition was also an important factor in precisely how these changes propagated. The 1984 Intermills decision had a particularly important impact, as it demonstrated that state financial support could

be broad. Therefore, in order to maintain NDBs, they need to be reformed into semi-private entities that remained separated from the government.

The actions of Germany's KfW provides a good illustration of the changes. KfW may have be founded as a financial agency to channel ERP funds following WWII, but by the late 1950s the institution had already assumed additional roles in promoting the domestic economy, securing export and import markets abroad, and supplying aid to developing countries (Harries 1998). In the early 1980s, KfW's business model of relying on government-supplied financing and channeling funds through other institutions was in crisis. Instead, KfW turned to the international capital markets to raise funds and in 1988 established the KfW International Finance Inc in the United States. However, KfW also faced an existential threat. In a joint meeting with the Development Bank of Japan, in which both banks are struggling to redefine their roles, one participant bemoans the challenges of the Washington Consensus: "Now in the world's advanced countries, a movement aimed at "small government" can be detected, with the US and England at its core. Progress in this area is evidenced by the movement toward deregulation, the privatization of public industries, and redirection in the role of public financing" (DBJ 1988, 12). In particular, changes to state aid regulations forced KfW to change its business model. Beginning in the early 1990s, the German government was increasingly unwilling to subsidize the operations of the institution for fear of intervention from the European Commission. As such, German politicians pressured KfW to raise its own fund from the market. The reliance on market sources of revenue also persuaded KfW to finance its projects with new financial instruments, and KfW experimented with mixed-financing and first tranche-loss instruments. It also implemented new market-based funds to support the SME sector.

The German government further realized the potential of KfW to exploit a loophole in European statistics. Both the lending and borrowing activities of many NDBs are decided from at least an arm's length from the government. That is, as long as the financing decisions do not require explicit government endorsement for projects. The benefit of this system is that, by and large, the financial activities are not included in the government sector in national accounts because they fall outside the scope of the EU Stability and Growth Pact. This allows governments to channel funding to projects within the scope of State Aid regulations, yet these investments do not count against the 3% debt-to-GDP ratio. Therefore, if a government provides funding for an SME funding scheme, they can provide either direct funds or guarantees to the NDB without increasing the national deficit. In the 1990s, Germany used this strategy to partially privatize state-owned enterprises like Lufthansa, Deutsche Telekom, and Deutsch Post. KfW, with financial backing from the Federal Government, purchased the government's share at market prices and became the new owner. In turn, the Federal Government was able to take SOE debt off its accounting books and received a large, one-time cash transfer on its 1994 national account. While KfW's decisions on the management of these formerly SOE shares were taken at an arm's length from the Federal Government, in practice KfW informally coordinated with the government. Germany was the first to use the off-the-books tricks to maintain control over SOEs without relinquishing authority.

Besides KfW, other NDBs in Europe went through a similar restructuring. In 1971, Spain established the Instituto de Credito Oficial (ICO) to serve as the coordinating agency for the state-owned banks. Throughout the 1970s and early 1980s, ICO played a relatively minor role in the Spanish economy. However, as the pressures of DG Competition and European integration accelerated, the Spanish government reformed ICO in 1988, and the IC changed from being an

independent body to a state-owned credit institution. In order to comply with the EC law, ICO "stopped receiving funding exclusively from the Treasury and started to finance itself mainly from capital markets."[6] During the reforms of 1991, ICO obtained operational autonomy in order to avoid DG Competition regulations. Italy's Cassa Depositi e Prestiti (CDP) was founded in 1850 and in 1924 put under the control of the Italian Treasury. In 1983, the CDP was changed into a government entity with "separate legal personality and full regulatory, organisational and financial independence, engaged in activities of general economic interest."[7] CDP was restructured again in 2003 and today serves as a mechanism for state-sponsored investments in strategic industries and, as will be addressed later, an off-the-book balance sheet for government projects and bad debts.[8]

A New Era: European Regulation and NDBs since 2000

The previous era of dynamic interaction between the competition agency and the NDBs was defined by governments reforming NDBs to fit within the framework of an evolving State Aid regulatory framework. This process was gradual, iterative, and relatively collaborative. However, beginning in the early 2000s, the dynamics shifted. First and foremost, DG Competition had gained significantly more regulatory power, particularly over issue areas in which NDBs were operating, meaning that it could more aggressively enforce regulations. This led to an additional round of NDB restructuring, but also influenced the way in which states were allowed to financial support their own NDBs. Second, the onset of the 2008 Global Financial Crisis revived a Europe-wide interest in expanding NDBs.

[6] See: https://www.ico.es/web/ico_en/what-ico-is
[7] See: http://www.cdp.it/en/company-profile/mission-and-role/history-of-cdp.html
[8] Sylvers, Eric and Guy Dinmore. "Italy's CDP steps out of the shadows." The Financial Times. 19 November 2012.

The Early 2000s: The Reordering of NDBs

European member states had often provided certain public banks with statutory guarantees; that is, the government would financially back the institution with a bail-out if it ever became financially insolvent. German law had provided these through a guarantor liability (Gewährträgerhaftung) for its state-owned financial institutions. These laws ensure that these financial institutions remain fiscally stable and are protected from market disruptions. As a result of their government guarantees, they often have higher credit ratings and therefore have lower borrowing rates on the capital market, usually 0.25-0.5% lower than their commercial banking peers. The added security of these guarantees also made these public banks more attractive to institutional investors and the interbank business. Included in these public credit institutions were the local savings banks (Sparkassen), state banks (Landesbanken), and the national development banks (primarily KfW).

As early as 1995, discussions regarding the applicability of EU competition law to the German banking sector took shape. Commissioner van Miert first voiced his concerns in 1996, but provoked a strong negative reaction from German politicians. In June 1997, a declaration on the "Public Credit Institutions in Germany" was adopted as an annex to the Amsterdam Treaty, at the request of the German government. In 1999, the European Banking Federation filed a complaint against the *Anstaltslast* and *Gewährträgerhaftung*, and the Commission decided against the government guarantees of public banks. The European Council and German government entered into consultations in 2001 to find a solution, and ultimately adopted a declaration on public law credit institutions in Germany, also known as the Amsterdam Declaration. The European Council concluded that all agencies regulated by public law were not

immune to state aid regulations, and are therefore subject to oversight from DG Competition. Exemptions to this rule could be granted, but only if the operations are in the "general economic interest" of the European economies (Moser and Pesaresi 2002). Since the liability guarantees provided a specific advantage for the operations of these financial institutions in a way that was not consistent with the objective of the public interest, member state governments were not allowed to financially back them. The Commission maintained that there exist exemptions for institutions that provide financing that either promote the general economic welfare of the European economies or provide financing for already exempted categories (Winckler 2001, 444). A four year grace period was implemented, and any investment with that guarantee in 2001 was grandfathered in until 2015 (Moser and Pesaresi 2002, 10). As a result, Germany was forced to relinquish its state guarantee of public banks, in an outcome known as *Verständigung I.*

The next year, the German government and the EC entered into consultations to limit the guarantees of the promotional banks. Two new issues surfaced: "Firstly, a subsidiary obligation (Nachschusspflicht) in some Länder for owners of savings banks to provide institutional security funds (Institutssicherungsfonds) with financial means, and, secondly, State guarantees to so-called free savings banks" (Moser and Pesaresi 2002, 10). On March 1st, 2002, the Commissioner announced conditions under which the German government could continue to provide support to the promotional banks. First, the investments could not discriminate under Community law, and were required to abide by the regulations of public procurement and state aid. Second, investments could be made in a range of areas predetermined to be in line with competition regulations, including in SMEs, risk capital, environmental programs, technology promotion, innovation, infrastructure, and housing, and these investments must be directly related to their public promotional task (VÖB 2014, 30). Other exemptions include co-investments with the

European Investment Bank, the granting of loans and other financing to government and special purpose associations of public legal form (öffentlich-rechtliche Zweckverbände), and export financing outside the EU, so long as it adheres to WTO rules. In short, the German government could maintain its guarantee so long as bank activity remained promotional and non-competitive. This agreement was later termed *Verständigung II* (VÖB n.d.).

The agreement between the EC and German government had a substantial impact. Within Germany, this required the restructuring of state-owned banking sector. Many of the formerly state-backed banks were reorganized into state promotional banks, governed by the same principles of the *Verständigung.* Others opted for a commercial banking route, but the majority of these became overleveraged during the 2008 financial crisis and were subsequently closed. Second, the decision strengthened the role of DG Competition, setting an important precedent for European competition regulation. Candidate countries for the EU were also required to adhere to these principles of state-ownership in the banking sector. It also contributed to the harmonization of economic policymaking. As a report from DG Competition states, with this ruling the "Commission extended its attention to *less visible State interventions* in the form of state guarantees to banks which constitute *operating aid*" (Moser and Pesaresi 2002, 4, emphasis original). This also represents a shift from the ad hoc treatment of European actions to one that focuses on the structural functions of member states' financial systems. Finally, the landmark case prompted other countries to reassess their relationship with their own NDBs.

2008: The Global Financial Crisis and Expansion of NDBs

The Global Financial Crisis transformed the landscape of development finance once more. In the aftermath, the European Commission recognized the need to stimulate investment to

spur economic growth. Exacerbating the problem was the fractured nature of European policymaking, which had limited the synergy between EU and national government policy. European Union leaders had long recognized the need to harmonize national economic policy with those of the EU, with their first attempt in 1958 when the European Investment Bank (EIB) was established to serve as the EU's nonprofit, long-term policy bank. Despite the size and history of the EIB, the institution has long suffered from bureaucratic complexities and chronic underfunding. Its inclusive governing structure meant that investments must be approved by consensus, limiting the flexibility of the institution to respond to new situations within short time horizons. The EIB also becomes a point of contestation between EU member states, who each try to direct funding towards investment projects in their own economies. Without the guarantee that a country's funds will be used for projects in their home country, governments have been reluctant to provide more funds. Instead, the EIB played only a secondary role to national development banks.

In an effort to enhance cooperation in investment after the Global Financial Crisis, the EU sought to coordinate activities of the EIB with those of national development banks, particularly in the areas of climate change and the environment, innovation, and social and human capital development (European Commission 2015). It was hoped that cooperation between these financial institutions would lead to complementary investments that would stimulate a European-wide economic recovery. The EIB started the European Fund for Strategic Investment (EFSI) to fund private investment projects across the EU. The principle funding for EFSI would come from a EUR 16bn guarantee from the EU budget (of which it will provide half), and an additional EUR 5bn from the EIB, giving the EFSI a total risk absorption capacity of EUR 21bn. This initial capitalization could then be leveraged, at a conservative estimate of 15

times, magnifying the original investment into 315 billion EUR in investment. It should be noted that EFSI, in congruence with previous European economic policies, relies heavily on markets to raise and distribute funds, first because these funds can generate financial leverage, and second, the financial viability requirement "ensures that scarce resources are allocated to efficient uses" (European Commission 2015, 12). In addition, national development banks are permitted to contribute to the general fund, in a co-investment platform, or the project level. Since any contribution to the general fund cannot be earmarked for use in a specific country, governments have preferred the latter two options via their national development banks.

As part of this program, the EU also recognized the need for national financial partners to supply capital and provide local knowledge of industry. Large development banks already existed in Germany, France, Italy, and Spain. For EFSI, these banks have provided a substantial amount of financial resources. As of October 2015, institutions from France, Germany, Italy, Luxembourg, and Spain have committed over EUR 33bn. These funds will be used to implement the Junker Plan in complementary support of the EIB, usually in risk capacity, in the areas of ABS transactions and securitization, technical assistance, venture capital, equity and mezzanine investment projects, and public-private partnerships in infrastructure and social projects (Abel-Koch 2015). However, these investments can only be used to co-finance projects within their respective countries.

Countries without an NDB frequently do not have a development bank partner to either provide government financing for EIB-supported projects, nor a mechanism to implement new ones. To this end, the European Union promoted—though did not require—member states without a promotional bank to establish one. The economic rationale for a development bank mimicked those of other countries: "The principal economic rationale for a promotional bank is

that market failures may lead to less investment and, thus, slower future growth than would be economically efficient, and that an institution with a public mandate is better placed than private operators to overcome these market failures" (European Commission 2015, 3). In order to guide the establishment of new banks, the European Commission provided a list of governing principles. These were intended to maximize societal welfare while minimizing the potential negative side effects that had plagued previous development banks, including sustained financial losses to the government, political interference, market distortion, and the crowding out of private sector financiers. Instead, NDBs would be embedded within a strong legal and regulatory framework that would guard against market-distorting investments. The EC highlighted five particular points. First, new NDBs should have a clear mandate in its operations and sectors, and should engage on a level playing field with commercial banks. Second, an *ex ante* assessment of which market failures are to be addressed by the bank helps keep the operations separate. Third, selected projects should be economically viable and with sufficient profitability to maintain operations without the need of government funding. This also requires high standards of transparency, prudential supervision, and a high degree of independence. Fourth, the operations and mandate should be reviewed from a committed related to, but separate from, the government. Finally, the NDBs should operate with sound risk management strategies that avoid the riskiest investments (European Commission 2015, 5).

These principles were important in the establishment of a set of new banks, such as the UK's Green Investment Bank, the British Business Bank, the Portuguese Development Financial Institution, and the Latvian Single Development Institution. In each case, the charter of the new development bank was assessed by DG Competition to ensure adherence to State Aid regulation. The European Central Bank also signaled its support for long term financing, and has stated that

it strongly supports the development of capital market options for SME financing. In a policy bulletin, the ECB explains that one way to provide more "SME credit could be to draw on the public sector's role in resolving market failures that go beyond information asymmetries" (ECB 2014, 95) They argue that national development banks already serve in a limited capacity, but that harnessing their comparatively low funding costs and local market knowledge could be helpful, especially if there is greater integration amongst them.

Even with prudential regulation and a strong mandate, the EC stopped short of officially endorsing the widespread establishment of NDBs. For one, the EC noted the limitations of such institutions. In its report on development banks, they explicitly argue that "establishing [a national development bank] is not a substitute for necessary reforms" (European Commission 2015, 3) That is, development banks cannot serve as a replacement for structural policies and reform, such as improving legal systems, streamlining administrative procedures, or reducing the costs of doing business. Establishing new development banks also presents a paradox for the European Union. While NDBs are frequently the easiest way to generate financial support from member states, these institutions also reinforce the institutional differences amongst them, and often precludes the strengthening of the EIB. If financial resources are channeled through NDBs, even for European-wide programs like the EFSI, then the long-term goals of greater financial integration are undermined.

In addition to the European-wide funding changes, DG Competition implemented a far-reaching overhaul of the competitive regulations. Begun in 2012, the State Aid Modernization (SAM) was designed to update the activities of DG Competition. According to Joaquin Almunia, the former head of DG Competition, there were three reasons for the reforms: to ensure that state aid rules support Europe 2020 objectives; to prioritize enforcement in the internal market; and to

streamline decision-making processes (Almunia 2012). The driving principle remained the same; EU State Aid rules are "designed to ensure that the interventions of [NDBs] are well-targeted to remedy market failures and thereby contribute to economic and financial development, while at the same time not distorting markets, crowding out private operators or keeping companies alive that would otherwise have exited the market" (European Commission 2015, 5–6). However, SAM focused on facilitating the timely disbursement of state support that is well-designed and targeted at commonly-held market failures, obviating the need for a possibly lengthy review process. The streamlined regulations no longer required *ex ante* approval in three categories: investments that are in line with *de minimus* regulations, included in a block exemption regulation, or approved under specific state aid guidelines.

Central to the SAM is the new General Block Exemption Regulation (GBER) that "simplifies aid granting procedures for Member States by authorising without prior notification a wide range of measures fulfilling horizontal common interest objectives" (DG Competition 2014c, 1) The EC hopes that two-thirds of all investments will qualify for GBER, and up to 90% in subsequent years. The GBER has streamlined exemptions in three important ways. First, more categories are eligible for exemption, such as innovation aid. Second, new forms of exempted within existing categories have been added. These include risk finance aid, investment aid for research infrastructures, and new financial instruments for energy and environmental aid. Third, exemption threshold have been raised. For instance, the threshold for notification within investments in R&D and innovation has doubled from EUR 7.5m to EUR 15m per enterprise. For SMEs, it has increased from EUR 1.5m to EUR 15m per SME that covers the full development cycle of a business of 7 years (DG Competition 2014c). Similar increases have been implemented for promotional schemes as well. To ensure compliance, the EC has also

implemented new rules for transparency as aid awards will become public at the individual project level.

Outside of GBER, the thresholds for policy review has been raised. For instance, the DG Competition announced new compatibility conditions above the 15m GBER threshold as long as "the aid measure is granted in cases where market failures have been convincingly demonstrated" (DG Competition 2014a, 2). In particular, funding for research and development, as well as innovation, are largely exempted from the new rules. According to the Commission, this "will enable, among others, R&D-intensive companies and companies in industries with high upfront investments costs to access the necessary amount of finance right from their creation, through a sequence of investment rounds, without being constrained by the current restrictions on maximum annual tranches" (DG Competition 2014a, 2). The new regulations outside of the GBER widen the scope of allowed R&D and innovation financing. More aid will be allowed for innovation clusters and pilot projects, and if the project is implemented within the framework of EU Joint Undertakings (a public-private scheme), then the threshold rises to EUR 20m (DG Competition 2014d). The regional aid regime was also modernized to strengthen its effectiveness, mainly by prioritizing SMEs and other locally-based enterprises (DG Competition 2014b). In the area of risk finance, the new guidelines also lift the old restriction of a 70% equity stake to allow a wider range of financial instruments, such as quasi-equity, loans, guarantees, or hybrid financial instruments (DG Competition 2014a). Finally, clearer guidelines were presented on topics such as SOE privatization (European Commission 2012).

The example of the changes to the regulations of SMEs is instructive. The European Commission has long sought to bolster the environment in which SMEs reside, citing that because of their small size, they are often underfunded by private banks. This underfunding is

exacerbated during economic downturns, as SME funding is disproportionately affected. In order to ameliorate this market failure, the EC has promoted numerous policies, such as the Europe 2020 Strategy, the Small Business Act, the Single Market Act, the Action plan for SMEs, and the communication on long-term finance for Europe (Cattrysse 2014). The main objectives of the reform focus on four main goals—simplified rules, extended scope of eligible target undertakings, increased flexibility in the use of financing, and an expansion of eligible forms for aid. In order to implement these goals, several changes were made to the EC regulation. For instance, the new rules allow for annual investment tranches of up to EUR 2.5m, instead of the previous limit of EUR 1.5m. Inclusion was also expanded to more mid-sized companies, which were previously prevented from receiving funds, and expanded to incorporate SMEs before their first commercial sale (primarily seed and start-up companies). The state can also provide funding through mechanisms other than equity financing, such as debt financing, guarantee, counter-guarantees, and leases. Finally, the new rules also expanded the qualified financial intermediaries. Under the old rules, only risk capital measures that were part of a profit-driven private equity investment managed on a commercial basis; this left out government-financed partnerships and limited investments to equity stakes. The new rules allow for more flexibility, including public-private partnerships, so long as the appropriate regulations to ensure that the benefits are not interfering in the market are in place. In short, these new regulations enhanced the flexibility for states to support their SMEs. In the process, the regulations certainly expanded the reach of the market, by permitting public-private partnerships as well, but also guided the policies of European states. These regulations effectively incentivize states to support their SMEs, perhaps even to the extent of establishing one of their national development banks to coordinate the funding schemes. As Barbara Cattrysse explains, "[t]he objective of the risk

finance State aid rules is to encourage Member States and private investors to provide on a risk sharing basis repayable financing at preferential conditions to SMEs, so as to help them become more competitive at a global level" (Cattrysse 2014, 697).

Perhaps most interestingly, the EC recognizes the role of these exemptions: The risk finance State aid rules are particularly suitable in times of budgetary constraints since the co investment by private investors is necessary, public money has a leverage effect in channeling additional resources towards the attainment of public policy goals, which is further multiplied by the returns on the aided investments which can be recycled and reused once again. By necessarily involving financial intermediaries, the professionalism of the private sector is built in the deployment of risk finance measures, in particular in the selection of economically viable target undertakings, which in turn can ensure that the risk finance measure generates returns on the aided investments" (Cattrysse 2014, 697).

Overall, the state aid modernization program highlights two important facets of EU policy. First, EU development policy is heavily reliant upon market-based financing, and recent reforms have only reinforced these policies. SAM was particularly effective at enhancing this trend. The revisions relaxed the policies on financial instruments, allowing for funding to be channeled through loans and risk guarantees, but also through public-private partnerships. The focus on exemptions of innovation, R&D, and SMEs also highlight the disproportionate weight that the new sectors have. The emphasis on fixing market failures, or at the very least retooling economically depressed regions, similarly reinforces the desire to seek corrections to the market. Second, NDBs continue to serve as the primary mechanism for state aid. Whether it is funding for SMEs, regional revitalization programs, or capital for R&D, state financial institutions often are the conduits. The SAM, which places greater emphasis on reporting and mechanized

investments schemes, favors implementation through government-backed institutions. The GBER is also best implemented through institutions that have close links with policymakers. Perhaps more interestingly, the Global Financial Crisis fundamentally changed the perspective of the European Union towards NDBs. Instead of serving as a pariah of state interventionism, NDBs have gained institutional advantages from the EC to serve as the official conduits. While DG Competition still strictly regulates when and how NDBs are able to intervene, it is also indicative of the EC's acknowledgment that a robust promotion of the free market cannot entirely preclude national investment mechanisms.

The results have not been uniformly positive. The EIB still has significant funding shortfalls, and NDBs have been reluctant to fully cooperate in projects that do not have assured investments in their home countries. NDBs have also exploited additional loopholes. Italy's CDP, for instance, has become a vehicle for offloading bad debts of state banks, and bpifrance has similarly supported the activities of the French government in providing financing to key sectors, namely SMEs and innovation. Observers have questioned whether this is a thinly-veiled attempt at state intervention, as bpifrance has invested heavily in French enterprises formerly owned by the state (Bräuninger 2015). ICO is the primary vehicle for the Spanish government to support SMEs and the internationalization of Spanish firms abroad, and the government has proposed strengthening ICO's position as the central state aid implementing agency.[9] Even in an environment of economic cooperation, national governments still reign supreme.

Conclusions and Future Directions

[9] http://www.thespanisheconomy.com/stfls/tse/ficheros/2013/noviembre/131220_EstrategiaEconomica_Diciembre_2013_en.pdf

This paper has endeavored to chart the history of national development banks in relation to the influences of European integration and DG Competition. By tracing NDBs back to their original creation, I believe that we can find answers to contemporary questions of how NDBs operate and why they have become a prominent policy instrument. In short, NDBs evolved from relative obscurity in the post-war era to saviors of the financial crisis because of incremental shifts in their objectives and operations. Beginning in the 1980s, governments reformed NDBs to comply with increasingly strict regulations from DG Competition. NDBs developed new policy domains, such as the promotion of SME financing, they turned towards the market to both raise and distribute capital, and they assumed roles in lieu of older government programs. By the eve of the Global Financial Crisis, NDBs were already well-positioned to assume new roles and replace both private and government investors. They have done so with the utmost enthusiasm.

It is ironic that in an era of increasing globalization, greater European integration, and a dominating presence of free-market ideology that NDBs—institutions that represent a distinctly national authority—have thrived. In many ways, this is to be expected. Politicians are only accountable to national constituencies, giving them little incentive to further cede power to the European Union. Finding alternative ways to reclaim control is inevitable. However, the manner in which NDBs have been summoned to serve this purpose was not predetermined as a variety of other policy tools could have been implemented. In this way, the histories of DG Competition and NDBs are intimately intertwined. As DG Competition circumscribed the abilities of governments to intervene, NDBs adapted their operations to fit these requirements.

The future impact of European integration and DG Competition on the trajectory of NDBs remains to be seen. As Europe's economic growth has continued to stagnate, it is safe to assume that both the European Union and national governments will find common ground in

government-backed investment programs. National governments have been increasingly reluctant to cede greater authority to Brussels. Empowering NDBs to implement policy helps reinforce national control. The European Investment Bank for its part has been pushing greater harmonization, and could augur a growing influence of the EIB to promote European-wide development projects. NDBs have proven successful partners in financing the Junker Plan, a strategy that, if implemented properly, could substantially increase the provision of funding for SMEs, innovation, and green technology.

Yet despite the growing influence of DG Competition and other EC regulatory institutions, challenges remain in curtailing NDB authority. First and foremost, the increasing complexity of financial instruments has increased the workload of regulators. These new financial instruments often require more resources to be spent adjudicating whether a particular investment or promotional scheme violates existing state aid regulations because new financial instruments often provide subsidized funding implemented through commercial banks, who then on-lend to private contractors. Tracking where the funds go, and who receives them, can be as difficult as it is unclear. NDBs are likely to exploit these weaknesses. Second, new issue areas present challenges to existing interpretations of rules. It is widely accepted that direct subsidization of state-owned enterprises constitutes unfair interference. However, under SAM, new exceptions for environmental protection and cultural/heritage promotion present unprecedented cases, and new opportunities for NDBs to find workaround strategies. Third, there are questions about the ability of national development banks to cooperate with the EIB, and perhaps whether the EIB will eclipse the power of NDBs. So far, national governments have been reluctant to provide financing without guarantees that their funds would be used for projects in their own countries. For example, governments have promised funds to the EFSI via their

national development banks that are earmarked for use only in their own country. To date, 8 nations—Bulgaria, Slovakia, Poland, Luxembourg, France, Italy, Spain, and Germany—have pledged nearly 40 billion EUR, although none for direct use by the EIB. Finally, there are risks to the continued use of NDBs as extra-governmental institutions. The lack of oversight can lead widespread corruption problems. It can also lead to an inefficient use of funds without any accountability, and NDBs risk eroding their base of support if they stray too far from accepted practices.

In the future, I hope to improve this paper through improved documentation of precisely how NDBs responded to the changing pressures from DG Competition. For this, additional archival work and interviews with NDB executives would be illuminating. Comparing the experiences of other institutions, such as France's CDC, Italy's CDP, and Spain's ICO, could also help leverage differences in governmental strategies. This expanded case study selection would also assist in explaining geographic and temporal differences. In addition, in a future iteration of this paper I hope to better elucidate the conditions that explain variation in how European states utilize NDBs. Some EU members, such as Denmark, the Netherlands, and the United Kingdom, have largely avoided a rapid expansion of their state-owned financial institutions. A more encompassing theory of why states both choose and avoid to intervene through NDBs would enhance the paper's explanatory power.

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