

## The European Investment Bank and the ACP Countries: An Effective Partnership?

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### Introduction

The EU–ACP partnership is one of the most crucial in North–South relations, in both country coverage and the aggregate amounts of bilateral aid changing hands. The European Commission has become the world's fifth largest donor of development aid. EC resources for development come from three sources: the EU budget for non-ACP countries, the European Development Fund (EDF) for the 77 African, Caribbean and Pacific (ACP) states, and the European Investment Bank (EIB).

In 2002, the EU budget and the EDF contributed €6.5 billion to their various development partnerships, of which a large share (€2.4 billion) went to the ACP states. Together with aid from its member states the EU provides more than 50% of all aid going to ACP countries. Although the demands of EU accession in Central and Eastern Europe meant that ACP countries are no longer the primary beneficiaries of EU aid, the absolute amount of EU–ACP aid has increased substantially since the Yaoundé and Lomé conventions. The first Financial Protocol of their successor, the Cotonou Agreement, is for €15.2 billion over the five-year period.

The EIB is becoming an increasingly important actor in the provision of EU aid to ACP countries. The EDF remains the primary vehicle for EU aid to ACP countries, but its funding is largely grant-based, requiring constant donor replenishment,<sup>1</sup> and often focused on grants to the public sector. The EIB's co-financing requirements and syndication instruments means that its financial impact can spread beyond its relatively smaller allocation. The

Cotonou Agreement contains substantial language oriented towards private-sector development, intended in part to recognise the important role of markets and the private sector as a primary engine of economic growth – a major break with the 25 years of Lomé co-operation that were marked by exclusive government-to-government relations (ECDPM, 2001). The EIB's comparative advantage in financing private-sector investment implies that it is uniquely poised within the subset of European institutions to play a larger role in EU–ACP relations.

The EIB lends more than any other multilateral institution yet has so far operated under relatively little external scrutiny. Due to its expanding mandate under Cotonou, however, a systematic study of the EIB's mandates and instruments is in the interest of ACP countries. This chapter is a contribution to this study. Its scope is necessarily limited by the lack of publicly available information on the EIB's activities and the noted reluctance of many EIB officials to disclose such data (see later section 'Reforming the EIB–ACP investment nexus'). The study is intended to be a starting point for future work on the EIB and to provide some initial analysis of its roles, functions and utility for ACP investment.

The next section outlines the EIB's role in the provision of EU aid to ACP countries, followed by a brief historical overview of the EIB's performance under the Lomé conventions. The EIB's mandate under Cotonou and the instruments available for ACP investment is outlined, while the final sections proposes enhancements to the EIB's role as a catalyst for ACP investment.

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This paper was prepared as a background document for a larger study on a model ACP Investment Treaty commissioned by the Secretariat. The author wishes to thank, without implication, Dr Roman Grynberg, Prof Andreas Antoniou and Dr Indrajit Coomaraswamy for very helpful input.

## The EIB and EU development aid

### A 'policy-driven public bank'?

Founded in 1958 by the Treaty of Rome, the EIB is the official financing institution of the EU, owned by its member states. The institution views itself as a 'policy-driven public bank' (EIB, 2003), and its lending guidelines are set accordingly. Its mandate states that it should serve to function as a European financial institution towards the promotion of a 'balanced and steady development of the Common market in the interest of the Community'. The EIB's principal task is to fund investment within the European Union, but it also operates in more than 120 countries in the framework of external co-operation and development policies of the EU. As such the EIB can be considered as the EU's 'development bank', performing similar functions to other IFIs such as the World Bank Group. It is the largest institution of its kind in the world (measured by volume of annual financing activity), with lending activities in developing countries stretching back nearly 40 years. By end-2001, the EIB has provided over €7 billion to the ACP and Overseas Countries and Territories (OCT) regions (EIB, 2002).

Despite its size and central role in EU external financing, the EIB's mandate in developing countries is unclear. This is due in part to its autonomous legal status, accorded by article 266 of the EC Treaty. The EIB has often argued that it serves a dual purpose (EIB, 2003); that of a bank and an EU institution. Yet within EU documentation, it is not named as an institution with a legislative or enforcement task. However, it is legally bound to act within the limits of the EC Treaty. Recently, NGOs have seized upon this ambiguity to address perceived shortfalls in corporate governance and social/economic standards in the EIB's operations. This chapter will address these issues briefly in later sections.<sup>2</sup>

From a development perspective, what is most relevant is that while the Bank's legal personality and financial autonomy are specified in the EC Treaty, policymaking autonomy is not. While the EIB is endowed with its own decision-making bodies, its freedom to manoeuvre is limited by EC decision-making. These policies often take the form of external mandates to lend from the EIB's own

resources with a Community or member states guarantee, or from grant resources provided by the EC or member states (known as risk capital operations). Thus the EIB is called upon by the EC to further its development policy objectives in partner countries. However, this somewhat derivative approach to the EIB's development financing has raised concerns with several observers. A recent DFID report (DFID, 2000) noted that:

*'The Bank manages its external lending operations according to certain broad principles. Foremost among these is the principle that external lending conforms to the EU's overall development strategy. However, there is no agreed statement setting out how the Bank's proposed activities will contribute to the EU's international development aims and external regulations. There is a need for a clear set of objectives together with associated performance indicators. Without these it is difficult to judge the effectiveness of the Bank's operations and whether it makes good use of the grant resources it receives from the EU... The Bank defines the concept of value-added in very broad terms, without differentiating effectively between internal and external lending. Lending under the mandates is intended to support the EU's development objectives, and associated budget resources (including backing for member state guarantees) are classed as development assistance. So the objectives and impact of external lending need to be defined in developmental terms. This requires assessment of the economic, financial, environmental and social impact of projects.'*

The DFID report noted that that the EIB's lack of specific mandates for development, low staff-to-disbursements ratio compared to other IFIs, heavily centralised structure and little presence on the ground in developing countries meant that 'insufficient consideration is given to whether the intervention is developmentally sound'. The DFID report goes on to say that the EIB is 'fundamentally a project-based institution': it does not prepare its own country or sector strategies, instead often relying on those prepared by the EC and its country delegations.

This situation may arise for several reasons. The first is that the EIB operates within an often convoluted and overlapping institutional architecture for

EU aid delivery. The EIB intervenes in tandem with a number of EU bodies, such as DG Development, DG Trade, PROINVEST, and CDE whose mandates also extend to developing countries and especially the ACP region. This renders any direct comparison between the EIB and other multilateral lenders difficult, since institutional instruments, capacity and mandates vary considerably across the board. Given recent developments such as the creation of a single implementing office for aid, EuropeAid, and the deconcentration of authority to developing-country delegations, any evaluation of the aggregate impact of EIB interventions – especially individual project loans – is increasingly complex. Moreover, within this institutional framework, the EIB's lending is a relatively small share – as seen in Table 1, EDF allocations dwarf those of the EIB.

The second possible reason is that the EIB's lending to ACP countries is in turn a small share of its own portfolio. As mentioned earlier, EIB priorities reflect those of the EU, of which relations with developing countries (especially far-off ACP regions) rank, by revealed preference, a distant fourth on the list. The EIB's lending to the ACP region is a small fraction of its total portfolio. Of the €42.3 billion in loans signed in 2003:

- €34.2 billion went to the EU-15;
- €4.6 billion went to the CEE accession states;
- €2.1 billion went to the Mediterranean Partner Countries;

- €372 million went to Balkan states;
- €348 million went to Asia and Latin America; and
- €723 million (1.7% of total lending) went to the ACP and OCT states, of which €260 million went to South Africa (EIB, 2003).

The third and more likely reason lies in the commercial nature of the EIB's operations. The EIB's operations within the EU, as seen above, are the lion's share of total lending. The higher grade client base and the EIB's relationship with EU banks implies that its operations within the EU are akin to that of an investment bank. This more commercial portfolio (compared to other IFIs) exerts a powerful influence on the EIB's internal guidelines shaping transparency, lending criteria, portfolio balance, and institutional structure. The EIB guidelines and institutional structure have created a unique 'lean and mean' business model that allows for relatively decentralised and streamlined operations with a minimal amount of staff.

However, the EIB's remit includes the financial co-operation protocols of the ACP-EU mandate. This gives it an external role more in common with the multilateral development banks, who have a very different structure. Reviews of the EIB's lending operations in ACP countries have raised legitimate and pressing concerns regarding the suitability of the EIB's lending toolkit for the economic prospects of its clients in the ACP region.

**Table 1. EU aid to ACP countries (ECU/€ million)**

	Lomé I	Lomé II	Lomé III	Lomé IV		Cotonou
	1975–80	1980–85	1985–90	1990–95	1995–2000	2000–07
<b>EDF</b>	3,072	4,724	7,400	10,800	12,967	13,500
Grants	2,150	2,999	4,860	7,995	9,592	–
Special loans	446	525	600	–	–	–
Risk capital	99	284	600	825	1,000	–
Stabex	377	634	925	1,500	1,800	–
Sysmin	–	282	415	480	575	–
<b>EIB</b>	390	685	1,100	1,200	1,658	1,700
<b>Total*</b>	<b>3,462</b>	<b>5,409</b>	<b>8,500</b>	<b>12,000</b>	<b>14,625</b>	<b>15,200</b>

Source: Wolf and Spoden (2000)

\*Excluding OCT (200 ECU million, of which 165 million is through EDF and 35 million through EIB).

Despite the EIB's low institutional weight in EU-ACP financing and the small ACP share of its total lending, there are several pressing reasons to reform the EIB-ACP investment nexus. First, investments that are 'small' from the EIB's perspective can certainly have large impacts in small economies that dominate the ACP membership. Second, one of the EIB's strengths is its ability to use its lending to lever in additional finance, and facilitate access to the international market for countries and enterprises that would not otherwise be able to gain access to loans. This implies that in ACP countries the actual development impact of the EIB's interventions may be several orders of magnitude larger than the nominal disbursement of individual loans.

Third, as noted in the introduction to this paper, the EIB through the language of the Cotonou Agreement is poised to play a larger role in ACP-EU negotiations. Although EIB allocations will most likely remain subordinate to those of the EDF, the larger development role accorded to the private sector in Cotonou instruments implies a greater EIB role and by extension greater consideration for its potential impact. Lastly, the recent emphasis on enhancing aid effectiveness at other IFIs includes greater co-ordination and coherence among donors to reduce the burden on aid recipients and allow for clearer evaluation of development targets. The fact that the EIB operates within overlapping institutional frameworks implies that greater formal co-ordination and accountability for outcomes is required, not less. While EIB lending based on an external mandate may not be a problem *per se*, a lack of clear, publicly available documents linking specific EIB activities and broader EU development targets is a cause for concern.

### **Evaluating EIB operations under Lomé**

Under the successive Lomé Conventions, projects or programmes were financed by grant or risk capital from the EDF or by loans from the EIB.<sup>3</sup> Risk capital for investment financing was used to assist the implementation of directly productive investment, both public and private, in order to contribute to the economic and industrial development of the

ACP states (Article 263 of the Lomé IV Convention). The main guideline for the EIB's interventions in the area of risk capital operations is to be found in Article 236 of the Lomé IV Convention, stipulating that the EIB should finance in the first instance productive projects and programmes in industry, agro-industry, tourism, mining, energy and in transport and telecommunications linked to these sectors.

Article 233.2 of the Lomé IV Convention (Article 197.2 and 3 of the Lomé III Convention) gives criteria to be considered in deciding upon the method of financing for aid projects or programmes:

1. the level of development, the geographical situation, and the economic and financial circumstances of the ACP states;
2. the nature of the project or programme, its economic and financial return, as well as its social and cultural impact; and
3. in the case of loans, the factors guaranteeing their servicing.

A series of special reports by the Court of Auditors (1998), conducted on the basis of a tripartite agreement between the EIB, the EC and the Court of Auditors, reviewed the EIB's role under Lomé. These reports were among the first to publicly criticise the EIB's lending in ACP countries and highlight the consequences of the disconnect between the EIB's 'commercial' operations and its development role. These studies' findings were partially echoed in a review by the EIB's own Operations Evaluation Department of risk capital operations undertaken between 1989 and 1998.<sup>4</sup>

### ***Lack of consideration of development context***

Both reviews found that while EIB documentation contained a high level of technical assessment at the *project* level, assessment at the *country* level regarding the development context for the intervention was absent. Both reports emphasised the need for stricter criteria and guidelines for the use of risk capital funds to be developed, in order to obtain an additional value for development purposes.

When some projects were selected, in some countries, especially those which have modernised their economic policies less than others, insufficient attention was paid to the country's development priorities and therefore the potential development impact of the EIB's risk capital resources. In particular, the proportions of total lending allocated to infrastructure projects (usually as a co-financier), private-sector enterprises and global loans through financial intermediaries were not always consistent with development priorities (EIB OED, 2000).

Both the lack of consideration of economic risks and of development considerations were tied to criticism in both reports of the lack of capacity within the EIB itself. The OED report noted that this lack of capacity caused unnecessary delays and that bottlenecks have occurred in project selection, particularly when the bank's technical, economic or legal staff – all of whom have much wider responsibilities than the ACP countries – have failed to respond promptly to requests from loan officers for advice on the suitability of projects for selection (EIB OED, 2000). The OED report ended with a blunt assessment of the EIB's capacity constraints:

*The EIB has an inadequate institutional memory and also makes insufficient use of knowledge management to ensure that the staff working on the ACP countries learn from each other's experience. Project documentation is erratic and incomplete, duplication of material is commonplace, and the introduction of electronic communication has not been matched by appropriate filing or recording systems. Partly due to work overload, there are few formal or informal opportunities for loan officers in particular to learn from the successes and failures of other loan officers in different divisions.*

### **Crowding out of local sources of finance**

On a related point the reports criticised the EIB's lack of consideration as to whether the proposed intervention could potentially crowd out local sources of financing, and whether a bilateral intervention needed to be made from risk capital resources. The ECA report noted that this was partly due to the criteria defined in the Lomé IV

Convention and by the bank being broad so that any judgement as to whether the financing of a project is appropriate is subjective. However, it provided a few examples of operations financed from risk capital resources where the rationale for an EIB intervention was debatable and/or unclear. The following examples are from ECA (1998):

- The modernisation of joint-venture fishing fleets in Mozambique and in Madagascar, which in fact were profitable and generating hard currency for repayment of the loans so that other sources of financing could have been found.
- The proceeds of the two global loans given to financial intermediaries in the Dominican Republic on-lent entirely to established SMEs which had already proven to be successful in their operations, thus the loan would have been given to the final beneficiary even without the EIB global loan being available.
- The use of risk capital funds in the form of global loans and a loan with participating rights in New Caledonia, where other sources of funding could easily have been mobilised.

### **Unclear pass-through of interest rate subsidies**

A major criticism of EIB interventions has been the lack of clarity surrounding its interest rate policies, notably the Bank's high reliance on on-lent funds (via local intermediaries, such as so-called 'global loans'). It is clear that the Bank's strong balance sheet and favourable credit rating allows financial intermediaries to access funds on borrowing conditions that are highly favourable *vis-à-vis* their own domestic market. What is less clear is how much of that borrowing premium ends up with the final investors as interest rates are usually set at market level.

It should be noted that this practice yields several benefits, noted in the ECA report: it avoids distortion of competition; it mitigates the risk of irregularities occurring in the selection of beneficiaries (risk of corruption); and encourages loan beneficiaries to be self supporting in the longer

term. For the final beneficiary, however, the only advantage of this risk capital financing is that it provides easier access to medium- or long-term financing rather than mitigating the prohibitively high interest rates that are endemic in many ACP states. While longer maturity loans are of clear benefit to investors, it is not apparent whether the EIB is best positioned to provide such domestic-rate financing as it is often available on the local market and there is a risk, alluded to above, of a crowding-out effect.

For Lomé III, the Convention provides that the interest rate shall be determined by reference to the characteristics of each project and shall not be higher than 8%. Under Lomé IV's mandate for EIB risk capital operations, Article 234(1)(c) states that, in the case of loans to ACP states or intermediaries, 'the interest rate shall, in any case, be less than 3%' (though the actual loan price can be higher if the loan remuneration includes a variable interest rate component linked to a performance indicator). Despite these provisions, both the ECA and OED reports found several cases where the interest rates established by the EIB were higher than the rate mandated under the various Conventions.

Furthermore, the EIB's high reliance on on-lent funds – as opposed to more directed interventions to potentially profitable projects – introduced the possibility of market distortion by providing concessional financing to intermediaries only. The ECA report rather bluntly stated that 'from a development policy point of view, the Bank's policy to set interest rates for SMEs at market level and to use more concessional interest rates for larger sized enterprises in the private and public sector is against the spirit of the Lomé Convention and can lead to an unbalanced situation in the allocation of the advantages of risk capital financing to the beneficiaries' (ECA, 1998).

The ECA report went further with two examples worth reiterating:

- An electricity producing and distributing company in the Dominican Republic which received a 6% loan under an on-lending agreement with the Government of the Dominican Republic and with the exchange rate risk to be borne by the

beneficiary. In the same country SMEs have to pay interest rates of between 22% and 32% for loans on-lent to them by an intermediary, however, with the exchange rate risks to be borne by the intermediary.

- In Mozambique a local subsidiary of a European enterprise active in fisheries borrowed at an interest rate of 4% from the government through an on-lending agreement. The exchange rate risk was limited as its operations generated hard currency. Newly established SMEs paid interest rates varying between 40 and 46% on on-lending agreements with intermediaries, as the latter had to cover the exchange rate and the inflation risks.

In sum, the use of different types of financing (direct loans, loans via an ACP state, global loans) potentially led to the unequal treatment of final beneficiaries: while some benefit from the 3% maximum interest rate mentioned in the Lomé Convention, the others have to pay market rates. Though not the only determining factor, the effects of exchange rate fluctuations play an important role in setting interest rates above the 3% level. These effects and thus the justification for higher interest rates can be calculated only after loans have been fully repaid. In addition, in the case of loans with participating rights, the total remuneration to the EIB – being at least partly dependent on the result of the beneficiary enterprises – could well exceed the 3% limit (ECA, 1998).

Both reports noted a lack of explicit consideration (i.e. through available documentation) within the EIB of the development value-added of EIB interest rate policies. The OED report criticised the EIB for its '*inadequate justification for, as well as severe inconsistency in, the use of the interest rate differential in those projects where the EIB's loans were on-lent to the ultimate beneficiaries... there has been very little supervision of, or even information about, how this differential was actually used in each case*' (EIB OED, 2000).

### **Other shortfalls**

Both the ECA and OED reports included several other EIB shortfalls in their review of the Lomé III-IV risk capital operations experience:

- **Flawed tendering:** In many cases, the EIB did not comply with EU rules that tenders should be only open to firms having their main seat in ACP or EU member states.
- **Loan undertakings:** Several cases occurred where undertakings were not met by beneficiaries – progress reports / financial statements not provided, foreign currency not provided by state, etc. – and the EIB's reaction was either inconsistent or one of resignation to the problem.
- **Delayed implementation:** Several projects suffered from delayed implementation for a variety of reasons, leading to risk funds being committed without being effectively used (so-called 'sleeping balances').
- larger responsibilities for the private sector in the implementation of projects and programmes;
- more diversified packages of financial support and private sector support instruments;
- provisions for capacity-building support to strengthen the organisation and representation of intermediate private sector bodies (ECDPM, 2001).

This new approach, deepening the provisions of Lomé IV bis (1995–2000) and complementing the 1998 integrated EC strategy for private-sector development, promises an integrated and dialogue-oriented approach to developing the private sector in ACP states.

Through Cotonou the EU has agreed to provide support at three levels:

- the *macro* sector (policies for macro stability, investment climate reform);
- the *meso* level (sound intermediate business structures and associations); and
- the *micro* level (fostering competitiveness and productivity through access to credit and technical assistance).

## Cotonou mandate and instruments

### *The Cotonou approach to the ACP private sector*

In 1996 the European Commission issued a Green Paper<sup>5</sup> outlining the EC's approach to the post-Lomé ACP–EU relationship. The Green Paper's main policy message was that the ACP–EU relationship should reflect 'the growth of trade, the unification of capital markets and the globalisation of production and distribution markets'. Any new ACP–EU agreement would have to formulate:

*'new approaches concerning the role of aid and a redefinition of the parties' respective roles: emphasis is placed on the policy environment, local capacity building, the role of civil society, and on new ways of including other agents of development, especially in the private sector'.*

The Cotonou language promises a new attitude towards the private sector and its primary role in development – as noted in the introduction, a major change from the 25 years of Lomé co-operation marked exclusively by government-to-government relations.

A recent ECDPM report outlined the major Cotonou provisions reflecting this change:

- systematic involvement of the private sector in political dialogue and in defining co-operation policies, strategies and priorities;

### *The EIB's mandate under Cotonou*

The Agreement establishes the EIB's mandate under the new Cotonou approach. According to Article 71.6(c), 'Co-operation shall provide long-term financial resources, including risk capital, to assist in promoting growth in the private sector and help to mobilise domestic and foreign capital for this purpose. To this end, co-operation shall provide, in particular, risk capital for equity or quasi-equity investments, guarantees in support of domestic and foreign private investment and loans or lines of credit.' Particular emphasis is placed on efforts to improve access of SMEs to risk-sharing instruments and to term finance.

In addition, Article 3.1(b) of Annex II of the Cotonou Agreement emphasises the development of the local financial sector to make it an effective channel for the financing and development of small business, and on domestic ACP capital markets to foster their capacity to mobilise domestic savings. The IF will also fund viable public or private infra-

structure projects as a prerequisite to encouraging investment and sustained growth (Article 3.1 of Annex II). The IF is required under Article 3.1(a) of Annex II to be a revolving fund operating on market terms, ultimately generating adequate economic rates of return in the long run.

### **EIB instruments under Cotonou**

The Cotonou Agreement provides for EU financial assistance to be provided to the ACP states by the EC (for the grant aid programme) and by the EIB (for loans and equity financing for the business sector). The first financial protocol of Cotonou – covering the 9th EDF – is for €15.2 billion over the first five-year period. While Cotonou mandates a wide range of instruments for financial co-operation to be made available by the EIB for private-sector project financing, in practice the number of instruments has been rationalised under a single €3.9 billion tranche. Part of this will be made available through a new Investment Facility (IF) provided for under the Cotonou Agreement. The IF replaces the former risk-capital funds of the member states under the stewardship of the EIB.

Under the IF, the EIB will manage €2.2 billion in EDF grant funds to disburse non-grant aid to investment projects as well as providing €1.7 billion in loans from its own resources. Separately from the EIB, the EDF will disburse €11.3 billion in grant aid for long-term development through national and regional EC programmes (see Table 2).<sup>6</sup> The EIB's mandate under Cotonou includes a separate bilateral agreement with South Africa, where the EIB will provide €825 million in loans from its own resources. The EIB instruments available under Cotonou are described below and summarised in Table 3.<sup>7</sup>

**Eligibility:** EIB funds under Cotonou are available to investors in the private sector or the 'commercially run public sector', comprising state-owned enterprises involved in market-oriented production. Generally, all sectors are eligible with the exception of a small negative list of excluded sectors (non-ethical drugs, gambling, etc.). Sectoral priorities will be adjusted for portfolio diversification and EC strategies (most notably financial sector development). Beneficiaries include, among others, local and foreign enterprises, financial intermediaries, and state-owned enterprises. The IF's contribution to a given operation will normally not represent more than 50% of the total funding required and the EIB encourages co-financing with other IFIs such as the World Bank. However, circumstances – such as small project size, a small country, or the absence of alternative resources – may justify a larger share.

**Operations:** Article I of Annex II to the Cotonou Agreement specifies that operations can be financed directly or through intermediaries. On-lent funds are subject to a number of prudential requirements and the right of the EIB to veto any project approved through an intermediary. The dividing line between direct and indirect financing varies according to the size of the economy. In medium/large ACP states, EIB directly finances projects requiring €5 million; in smaller ACP states, particularly island economies, the threshold is €2–3 million.

**Instruments and terms:** The IF uses a number of instruments on a case-by-case basis to fund ACP investments:

- **Loans:** Senior or junior/subordinated debt where maturity, assessed on a case-by-case basis and interest rates or on a 'market-related' basis. For

**Table 2: First financial protocol (€15.2 billion) of Cotonou Agreement**

European Development Fund (EDF)		
European Commission (EC)	European Investment Bank (EIB)	
Grant aid for long-term development (national and regional programmes)	Investment Facility – Loans/equity/guarantees for investment projects	EIB's own resources – loans for investment projects
€11.3 billion	€2.2 billion	€1.7 billion

Source: EIB (2000)

**Table 3: EIB financial instruments available under Cotonou**

	<b>EIB's own resources</b>	<b>Investment facility</b>
	<b>Loans for investment projects</b>	<b>Loans/ equity/ guarantees for investment projects</b>
<b>Senior debt:</b>	<p><i>Pricing:</i> EIB reference rate  <i>Security:</i> 1st class guarantee or prime-quality security (with possibility of political risk carve-out)  <i>Currency:</i> EUR, USD, GBP and ZAR  <i>Amount limit:</i> max. 50% of project cost</p>	<p><i>Pricing:</i> EIB reference rate + mark-up  <i>Security:</i> guarantee (international or local) or project security  <i>Currency:</i> EUR (possibility of other currencies, including local currency, in certain cases)</p>
<b>Junior/subordinated debt:</b>	Not applicable.	<p><i>Pricing:</i> EIB reference rate + mark-up  <i>Security:</i> project guarantee or other covenants  <i>Currency:</i> EUR (possibility of other local currencies)</p>
<b>Quasi equity: participating or conditional loans</b>	Not applicable.	<p><i>Pricing:</i> variable remuneration as a function of performance  <i>Security:</i> usually unsecured or junior status with covenants  <i>Currency:</i> EUR (possibility of other local currencies)</p>
<b>Equity participation</b>	Not applicable.	<p><i>Pricing:</i> dividends/capital gains  <i>Security:</i> none  <i>Currency:</i> local currency</p>
<b>Guarantees</b>	Not applicable.	<i>Pricing:</i> reflection of the risk borne
<b>Loans with subsidy in special cases</b>	<p><i>Pricing:</i> EIB reference rate less 3%  <i>Security:</i> 1st class guarantee or prime-quality security</p>	<p><i>Pricing:</i> EIB reference rate less 3%  <i>Security:</i> guarantee (international or local) or project security</p>

Source: EIB (2000)

each loan, the rates will be the EIB's reference rate (in turn a function of borrowing costs), plus an administrative margin, plus a mark-up to cover the perceived market or credit risk. In the case of indirect lending, intermediaries determine their own on-lending terms, which are in turn monitored by the IF.

- **Quasi-equity:** Mainly in the form of conditional or participating loans in operations requiring risk-sharing. This may include variable remuneration loans where the variable element is set to a relevant parameter such as the price of output.
- **Equity:** Taken principally through investment funds, other intermediaries or special-purpose vehicles (although direct equity investments will be considered). The EIB, however, will not normally take a controlling interest nor seek to influence management decisions (though it reserves

the right to do so on a case-by-case basis).

- **Guarantees:** Pricing of risk of expropriation, war/civil disturbance, non-transfer of currency, breach of contract, etc.

Loans from the EIB's own resources are only available in widely traded international currencies (and for projects in South Africa, in ZAR). Loans from the IF are normally disbursed and paid in EUR but can be made, on a case-by-case basis, effectively in local currency through a currency swap though at a higher interest rate reflecting domestic conditions.

**Subsidies:** The Cotonou Agreement provides that €195 million of EDF resources will be available to subsidise the interest rate of loans for projects financing by the IF and from the EIB's own resources. The interest subsidies may be capitalised and used in the form of grants paid up front.

Cotonou provides that the subsidised rate may not be lower than 50% of the unsubsidised (reference) rate. In principle it shall not be higher than 3%. Interest rate subsidies are permitted in the case of:

- public sector infrastructure projects in LDC or post-conflict countries;<sup>8</sup>
- restructuring operations in the context of privatisation;
- for exceptional projects with a strong social or environmental impact; or
- for project-related technical assistance.

**EFP:** In January 2003, the EIB signed a Framework Agreement on Financial Cooperation with the European Development Financing Institutions (EDFIs), Agence Française de Développement (AFD) and Germany's KfW Development Bank to launch the European Financing Partners (EFP), a special-purpose vehicle jointly owned by the EDFIs and the EIB on behalf of the Investment Facility. EFP is a co-finance investment matching facility to support private-sector investments in the ACP region. Its funding will be provided by the Investment Facility (€90 million) and by following EDFI members (€50 million): BIO (Belgium), CDC (United Kingdom), DEG (Germany), FINNFUND (Finland), FMO (the Netherlands) and PROPARCO (France).

### **Recent EIB investments**

The Investment Facility came into force on 1 April, 2003. To carry out its Cotonou Mandate, the EIB established a special business unit within the EIB's ACP department with additional staff, as well as opening regional representative offices in Dakar, Nairobi and Pretoria. Despite the increase in capac-

ity, EIB activity in the ACP states under the Cotonou mandate has been muted so far, with nine projects signed in 2003. As shown in Table 4, EIB lending to the ACP has totalled €2 billion from 1999–2003 (€2.75 including South Africa) evenly distributed across sectors with nearly a third of total lending concentrated in global loans.

According to the 2003 *IF Annual Report*, this is due to '[the IF's] nature as a revolving fund, its more ambitious objectives in support of the private sector and the wider range of financial instruments to be deployed, all imply that a great deal of organisational preparatory work was required within the EIB... In these circumstances, it was inevitable that operational activities themselves would only make a modest start in the nine months from 1 April 2003 to the end of the year' (EIB, 2003).

Annex I summarises recent EIB lending, both under the Cotonou/IF mandate and previous mandates. Out of 45 loans for which publicly available information is available, 22 are above €10 million, largely concentrated in heavy infrastructure and utilities (10 loans) and global loans for SME financing (six loans). The largest EIB loan in 2003/04 was a €90 million disbursement under the EIB's co-financing arrangement with EFP. IF financing was also used for equity investments in a series of regional African funds. The most striking aspect of the investments listed in Annex I is that only four loans of the 45 total are explicitly earmarked for a non-African country: global loans for Tuvalu (€1 million), the Caribbean (€8 million) and the Dominican Republic (€40 million) as well as a €11 million hotel investment in Fiji.

### **Reforming the EIB–ACP investment nexus**

Any review of the EIB–ACP investment nexus – a relationship that has now stretched back over sev-

**Table 4. EIB lending to ACP and Republic of South Africa (RSA), by sector (€ million)**

	ACP (1999–2003)	ACP (2003)	RSA (1999–2003)	RSA (2003)
Energy	478	60	107	50
Transport/telecoms	295	56	145	–
Environment	213 88	–	–	–
Industry/services	308	47	25	–
SMEs (global loans)	713	212	475	210
Total	2,009	463	752	260

eral decades – must address the fundamental disconnect between its structure and its ACP mandate.<sup>9</sup> The EIB enjoys the efficiency gains of a more hands-off, streamlined ‘commercial’ bank operating as an independent body; whose mandates are formulated externally but whose operating guidelines are formulated internally; whose funds are provided at premium rates but is not required to monitor individual loans on a less-than-large scale. This structure avoids much of the hassle experienced at many other IFIs where individual loan officers must often navigate a bureaucratic maze of safeguards, external consultations and formal cross-checks. This more commercial, decentralised and streamlined structure has provided a value-added in its operations within the EU.

However, the previous sections have outlined several criticisms which arise from the EIB implementing an extra-EU development mandate which, this chapter – and others cited within – has argued, it does not have the capacity to implement. The crucial (and potentially problematic) assumption here is that implementing such a development role requires the same structure and capacity of other IFIs. Reshaping the EIB’s guidelines in this manner, given the small share of ACP lending in its total portfolio, is arguably both unfeasible and unadvisable. The fundamental issue here is how to balance the EIB’s dual role as a commercial financing arm of the EU, but operating under a development mandate without compromising its effectiveness in either role.

The previous two sections of this paper noted that the EIB, under Lomé and Cotonou, operates under a relatively broad mandate, again in comparison to other IFIs where lending activities are formulated on more detailed country strategies, which in turn draw from policy decisions and institutional research. It is not surprising, given this leeway and the EIB’s commercial and balance sheet constraints, that it has chosen to take a relatively narrow and conservative view of its development mandate.

This chapter is not arguing that the EIB has fundamentally misinterpreted its Cotonou mandate. This paper has argued that its interpretation, while legally valid, has rendered the EIB highly risk-averse in its delivery of development aid, which often

requires higher risk lending, a substantial technical assistance component, and a trial-and-error approach to assessing investment conditions in a given country or sector. There is a clear case for reform if indeed the EIB is to fulfil its complete Cotonou mandate, which includes (in Article 1) the goal of ‘reducing and eventually eradicating poverty, consistent with the objectives of sustainable development and the gradual integration of the ACP countries into the world economy’.

### ***Strengthening development-oriented capacity***

Although the internal OED report was highly critical of the EIB’s lack of a ‘development context’ for its lending, it unsurprisingly did not call for any major structural changes to the EIB’s procedures:

*Some Member States ... have argued that the EIB should begin to operate like other large multilateral financial development institutions, getting involved in a wide range of macroeconomic, sector, governance, social, environmental and other issues, participating in more co-financed projects while producing much more documentation and justification for the development impact of its lending and the consistency of this impact with EU development policy. The evaluation team believes, on the contrary, that for the allocation of risk capital resources in the ACP countries, the EU’s development policies would be best served if the Bank enhances its development impact by concentrating on those strategies, areas and projects in which it has proved to have a comparative advantage over other donors and investors. It should continue to operate on a ‘lean and mean’ basis, with the maximum flexibility in the way it does business and the greatest speed it can achieve in processing and disbursing high quality loans (EIB OED, 2000).*

However, the OED report quoted above also refers on two separate occasions to the need to enhance the EIB’s ‘development impact’ and states that ‘The EIB should co-finance with the World Bank Group (or other multilateral donors or investors) only when its contribution is expected to have a distinct development impact or it can make a strategic

input, by transferring European technology and project experience, or it can exert leverage to ensure the sustainability of its component of the project' (EIB OED, 2000). Assuming that (a) a 'development impact' is assessed on a case-by-case basis and (b) such an assessment goes above and beyond whether a project is sustainable at prevailing domestic interest rates, it is not clear how the EIB is in a position to assess its development impact without moving to some degree towards a development financing institution. In response to criticisms from environmental groups, the EIB has added several environmental specialists to its staff to produce impact assessments for individual loans. Adding similar staff for its development lending (i.e. a dedicated development research and evaluations team), and making such documents publicly available, may be seen as a positive first step.

Difficulties may stem from the EIB's highly decentralised structure, where, unlike most other multilateral or bilateral financial institutions, major decisions on project selection are taken at the loan officer level, in consultation with the relevant technical, economic and legal staff. While such consultations are no doubt undertaken by competent and experienced loan officers, there is (at present) little possibility for external observers to ensure that adequate consultations – both within and outside the Bank – have taken place before loans are approved. A similar point can be made for monitoring, again quoting the OED report regarding the development implications of the on-lent interest rate differential:

*In all cases, the EIB has not seriously monitored or obtained reports on the actual use of the differential, mainly because the staff believed it was the responsibility of the recipient to spend the differential in the way it felt most suitable and that the impact of some of these programmes would have been difficult to monitor (EIB OED, 2000).*

Again, the question lies in the 'comparative advantage' of the EIB which is referred to in the OED report. If the EIB's 'comparative advantage' is based on market considerations at the level of an individual loan, coupled with a relatively hands-off approach from the lender and focused on a narrow range of potentially profitable sectors, there is legitimate

scope for the EIB's clients in the ACP region to ask whether this comparative advantage is wide enough to justify a large (€2 billion) and growing share of lending mandates. The implicit OED endorsement of the *status quo* rests on the assumption that a 'high-quality loan' is assessed using equal criteria by the client (ACP countries) and lender (EIB) perspectives. This chapter is suggesting otherwise.

### **Increasing transparency and accountability**

A related point concerns the EIB's transparency. This has been the focus of many NGOs – especially those concerned with environmental issues and to a lesser extent developing countries – and was a major focus of the DFID report. The availability of documentation regarding specific loans and lending strategies is often limited to publicly available information on the EIB website, such as Annual Reports and general material reiterating the EIB mandates. However, on loan-specific material, despite recent improvements there is a paucity of descriptive material.

A useful counterexample is the World Bank, which provides in the public domain a summary of the main project document, materials regarding evaluations and safeguards, information on the implementing agency, and a description of how each loan fits into the World Bank's overall development strategy in the country. The immediate concern would be one of capacity – if, as the OED report mentions often, the loan officers are currently overworked as is, such transparency may put undue strain on the EIB's capacity and decrease its effectiveness. However, two points must be made. First, such documents are undoubtedly drafted for projects; thus making them publicly available should not require significant resources. Secondly, the EIB has not made a clear case why the publication of such documents would imperil the efficiency of its lending. Third, as the EIB currently has the lowest staff per euro disbursed among the IFIs and it oversees a much larger asset portfolio (due to its relatively larger lending in high-investment grade countries), it is not clear why the EIB cannot increase its capacity without adversely affecting the strength of its balance sheet.

Perhaps a more useful example is the International Finance Corporation (IFC), which undertakes many private-sector projects that are closer in nature and scope to the EIB's interventions. The difference in disclosure is striking. For a large number of projects, the IFC's website lists the following information:

- Description of company and purpose of project
- Project sponsor and major shareholders of project company, with contact details
- Total project cost and proposed IFC investment
- Location of project and description of site
- Project development impact and IFC's Role
- An analysis of environmental and social issues, with proposed mitigation mechanisms and monitoring/compliance

While the EIB provides some of the information headings listed above in its project pipeline, the information is often quite minimal (total of less than half a page for most ACP projects currently available on the EIB website) and unavailable once the project has been approved. The EIB state that its transparency policies had to 'protect the interests of its customers, having a duty to respect the confidentiality of business-sensitive information and the privacy interests of individuals... Its information policy must also support the effectiveness of the Bank's decision-making processes and operations'.<sup>10</sup> However, it is not clear how the EIB's lack of transparency *vis-à-vis* the IFC enhances its effectiveness given that both organisations service similar sectors and initiatives.

The accountability of the EIB – i.e. its adherence to basic corporate governance rules – has also been questioned by several external observers. The degree of supervision over and input into the EIB's external lending policy by stakeholders is unclear. For example, while ACP countries were party to the negotiations creating the Cotonou mandate, the operational guidelines of the Investment Facility itself – which arguably matter as much, if not more than the mandate – were drafted within the EIB and presented to the ACP states as a 'fait accompli'.<sup>11</sup>

The formal structures through which stakeholders can present their concerns and ideas to the EIB should be made explicit and accessible.

### ***Linking development with the market***

A lending institution whose commercial nature renders it highly risk-averse may not fulfil its development objectives, which often require higher risk lending, a substantial technical assistance component and a trial-and-error approach to assessing investment conditions in a given country or sector. Grynberg and Forsyth (1998), in their review of Lomé aid, make this point in the Pacific context:

*Virtually every donor has failures. The EU is no exception but some project failure is true of any entity that does anything in a commercial context. As we shall see, many of the less than satisfactory projects in the Pacific are small and highly commercial in nature. Moreover, they are frequently 'green fields' projects that attempt to develop new industries or lines of production and are often in the most difficult areas. That such projects should not meet with complete success should come as no surprise to those working in development.*

Grynberg and Forsyth further note that many EIB loans to the Pacific under Lomé have been channelled through the government, notably state development banks. Thus the EIB loans have been used not only as an indirect source of government revenue, but also a means by which the government increases its control of the commercial sector. The end result is that the EIB, by pursuing existing channels of short- and medium-term profitability, has 'not become an instrument for private-sector development but has become an institution that has facilitated the expansion of the state sector, *often at the expense of private sector investment*' (emphasis mine) (Grynberg and Forsyth, 1998). There is a potential danger then of the EIB, by concentrating on a narrow range of market instruments and initiatives, will simply crowd out local sources of finance and further dampen the prospects of financial sector development in ACP countries.

The IF, for example, is meant to be a market-related revolving facility which, based on the first

few years of its lending history, is focusing on large, profitable projects (with concessionality on a case-by-case basis) and relying on a high share of global loans (where rates are set by intermediaries at the domestic market level). If this trend continues, there is a concern that IF funds will be primarily focused on developing niche markets which, given the history of many ACP states, notably post-preferences, may be the only sectors that yield rates of returns in endemically high-cost economies. The net result can be a situation where investment is flowing towards individually profitable projects, but the net investment portfolio of a given country is not tailored towards long-term sustainability, capacity-building and flexibility in the wider economy.

If the ACP–EIB relationship is a commercial rather than a development partnership, then the EIB runs the risk of exacerbating the sharp differences in economic growth and investment quality between ACP states rather than reducing them. This was echoed in one of the main recommendations of the DFID report which ‘encouraged the EIB to finance projects which develop the private sector in recipient countries and focus less on financing repeat business with the same clients’. This was indirectly acknowledged in the internal OED report, which noted that:

*The Investment Facility is clearly better designed for those ACP countries which have progressed further down the road of economic development, where market mechanisms have displaced state controls, where private investment in productive enterprises is strongly encouraged and supported and where a coterie of competent project promoters and managers has emerged... In other, less progressive ACP countries, the EIB will necessarily play a less important role, at least until conditions become more amenable (EIB OED, 2000).*

All these factors point to a potential re-assessment by ACP countries, most notably those with less attractive investment climates, as to whether the EIB and the IF in particular are well-suited to their development objectives. No doubt there is a strong role for state activism in reducing the cost premium due to market-distorting economic policies, however many recent papers have suggested that the

scope for such a reduction is limited in many ACP countries (see Winters and Martin, 2004). In sum, ACP states must ask whether a facility that lends to high-cost economies yet is meant to be self-sustaining (i.e. deliver market-level returns without future donor flows) can deliver the development impact that they require.

The interest rate issue is a useful case in point. Both reports noted the capacity constraints at the EIB and the result that the value-added of its investment-grade on-lent funds often remain with intermediaries rather than the final investor. While the need to develop capacity at the intermediary level is beyond dispute, such capacity-building may not result in concomitant increases in investment – which is ultimately the goal of an instrument of financial co-operation – if the investor does not receive some pass-through of the implicit subsidy. As noted earlier, EIB credit lines allow for intermediary banks to extend credit to final investors which they may not provide otherwise – an important first step. However, due to concerns over market distortions, the EIB – in line with other multilaterals – has generally avoided passing on the subsidy to the final investor (except for exceptional cases). This approach, while market-friendly, has the potential to exclude projects whose rates of return are marginally lower than the prohibitively high interest rates prevailing in most ACP countries (for further discussion see Havelock and Brewster, 2003).

A potential avenue for the EIB–ACP relationship lies in the IFC’s pilot SME lending initiatives in Mozambique (summarised in Annex II). The facility is designed to provide a high technical assistance component which includes a matching grant element, in some cases including working capital and outside services, for so-called ‘transformative’ expenditures designed to increase the capacity and/or profitability of beneficiary firms. In order to reduce distortions in the domestic money market, the matching grant and technical assistance elements are disbursed directly to the final investors rather than on-lent through an intermediary. This approach, while requiring substantial presence on the ground, a concomitant increase in resources, and substantial donor participation, has been

shaped by the IFC's experience of SME lending in developing countries:

*There have been various attempts in recent years by bilateral and multilateral lenders to address the need for credit in the SME sector. Results to date have not been encouraging. IFC through its SEF program extended loans to six companies in Mozambique, of which five are currently considered problem loans. The EIB had a similar experience with a recent US\$10 million line of credit/partial guarantee program extended through the banking system. While this program achieved utilisation of around 60%, most of the loans were not repaid. The World Bank's US\$10 million PoDE line of credit has remained largely unutilised since it was approved in 2000. The two existing private equity funds, GCI and Aureos, operate conventionally and are virtually inactive (IFC, 2004).*

The initiative is a joint IDA–IFC programme and provides some fresh thinking into how to tackle chronically prohibitive lending rates while still encouraging private-sector development.

It is worth reiterating that the EIB as an institution walks a fine line between its higher grade lending within the EU – its core business – and its relatively riskier ACP lending. As such it may be necessary for the EIB to 'ring fence' its ACP lending operations in some manner – for example, by operating the IF funds off its balance sheet – in order to allow it adequate breathing room to expand its scope, scale and initiative of its development lending while still maintaining its comparative advantage as a high-grade, efficient lender.

### **A fine balance**

In conclusion, this chapter argues that, like any institution lending to developing economies, the EIB must place its policy choices within several spectrums:

- between a 'lean and mean' business structure which focuses on a few key outputs, and a more bureaucratic structure that attempts to cover as many bases as possible;
- between providing the concessionary finance needed to kick-start investment in high-cost economies, and avoiding introducing further distortions into the domestic investment climate; and
- between protecting the confidentiality of clients and providing the information external observers require to monitor its operations.

The EIB's location within these spectrums is informed by both policy choices and constraints. This paper has argued that the EIB's 'position' in these policy arenas is often to the detriment of its effectiveness as a lender to the private sector in developing countries. This chapter has further argued that in some cases, there is a Cotonou constraint – i.e. the EIB is restricted by the letter of the Cotonou Agreement.

This chapter, however, finds that in many cases there is an EIB constraint – i.e. there is no apparent *external* reason for the perceived shortfalls in the EIB's performance in the ACP region. The paper has argued that there is scope for the EIB to increase its development effectiveness – and perhaps more importantly its legitimacy in the eyes of the development community – without compromising many of the aforementioned institutional characteristics which make it an important partner in the ACP–EU development relationship. By increasing its forward and backward linkages within the group of EU and ACP stakeholders, by incorporating new thinking in private-sector development, and by increasing its capacity to lend evenly across the entire ACP region (especially outside Africa), the EIB can more effectively execute its increasing role in the ACP countries.

## Annex 1. EIB lending in ACP regions 2003/2004

Country	Sector	Signature	Name	Amount (M €)	Description
Mozambique	Energy	22/10/2004	MOZ/RSA Natural Gas-Upstream Component	10.00	Development of two gas fields in Mozambique and construction of gas pipeline from field area to Secunda in South Africa
Gabon	Global loans	18/10/2004	Global Loan II (GABON)	10.00	Financing for SME ventures
ACP states	Services	12/10/2004	African Lion Mining Fund II	6.45	Credit line for the financing of leasing operations in local currency of a minimum duration of 36 months
Botswana	Farming	04/10/2004	Fabulous Flowers	2.00	Creation of the first 5ha phase of a 20ha greenhouse project for the production and export of roses
Uganda	Global loans	09/08/2004	DFCU Leasing	5.00	Financing for SME ventures
Mauritania	Industry	30/06/2004	MAPESCA	5.00	Construction of fish-processing plant in Nouadhibou
ACP states	Services	29/06/2004	Shorecap International Ltd (SCI)	2.50	Microfinance
Mozambique	Industry	18/06/2004	Moma Titanium	55.00	Mining, concentration and separation of heavy mineral sands
ACP states	Services	13/05/2004	EDFI European Financing Partners (EFP)	90.01	Co-financing with European Development Finance Institutions of operations in ACP countries under joint agency agreement
Kenya	Industry	07/04/2004	Magadi Soda Pure Ash Project	21.92	Expansion of soda ash production capacity and product quality enhancement
Fiji	Services	27/01/2004	Novotel Denarau Project	11.00	Construction of hotel on Denarau Island
Tuvalu	Global loans	26/01/2004	DBT GL II	1.00	Financing for SME ventures
Ethiopia	Global loans	29/12/2003	Ethiopia – Global Loan DBE II	25.00	Financing for SME ventures
Cameroon	Global loans	16/12/2003	Private Sector Development – GL	28.00	Financing for SME ventures
Zambia	Industry	11/12/2003	Kansanshi Copper Mine	34.00	Development of open-pit copper mine in Kansanshi, north-west Zambia
Burkina Faso	Global loans	08/12/2003	Global Loan Burkina Faso II	12.00	Financing for SME ventures
Guinea	Transports	28/11/2003	Port De Conakry	12.00	Rehabilitation and extension of port of Conakry
Kenya	Services	25/11/2003	Co-Op Bank Microfinance Loan	2.00	Loan to Co-operative Bank of Kenya for refinancing selected savings and credit co-operatives
Uganda	Global loans	23/10/2003	EIB Microfinance Scheme	2.00	Financing for SME ventures
Cameroon	Global loans	20/10/2003	Africa Leasing Company S.A. PG	0.35	Financing for SME ventures

Country	Sector	Signature	Name	Amount (M €)	Description
Tanzania	Water	16/10/2003	Dar Es Salaam Water Supply & Sanitation	35.00	Repair and extension of water and sanitation facilities in Dar es Salaam
Indian Ocean	Services	26/09/2003	I&P Capital Investment Fund	2.00	Financing for SME ventures
Africa	Services	09/09/2003	African Banks Holdings, LLC	30.00	Equity investment in regional fund for acquiring control of commercial banks in course of privatisation
Mauritius	Services	12/08/2003	Bel Ombre Hotel	12.20	Construction and operation of hotel complex in Bel Ombre in south of island
Madagascar	Transports	17/07/2003	Reseau Nord Des Chem Fer (Madarail)	11.00	Rehabilitation and operation of Madagascar's northern railway network
Zambia	Global loans	14/07/2003	Capital Investment Line GL II – ZAMBIA	20.00	Financing for SME ventures
Mozambique	Energy	02/07/2003	MOTRACO II	1.75	Reinforcement and upgrading of power transmission facilities linking South Africa, Swaziland and Mozambique
Chad	Global loans	30/06/2003	Tchad – Private sector Global Loan	2.00	Financing for SME ventures
West Africa	Services	30/06/2003	Aureos West Africa Fund	8.75	Participation in fund providing equity to private-sector SMEs in West Africa
Southern Africa	Services	30/06/2003	Aureos Southern Africa Venture Capital	10.50	Participation in fund providing equity to private-sector SMEs in Southern Africa
East Africa	Services	30/06/2003	Aureos East Africa Fund	6.80	Participation in fund providing equity to private-sector SMEs in Eastern Africa
Swaziland	Energy	18/06/2003	MOTRACO II	1.75	Reinforcement and upgrading of power transmission facilities linking the Republic of South Africa, Swaziland and Mozambique
Swaziland	Energy	18/06/2003	SEB III Maguga Hydropower irrigation dam	7.00	Construction of a 19MW hydropower station to be added to an existing large
Mauritania	Urban infra.	02/06/2003	EBTR Mauritanie	4.00	Purchase of equipment for construction of and roads and other infrastructure in Mauritania sub-region
Caribbean	Global loans	13/05/2003	CFSC GL III	8.00	Financing for SME ventures
Niger	Global loans	08/05/2003	NIGER – Financial Sector Global loan	5.00	Financing for SME ventures
Cape Verde	Global loans	06/05/2003	CAP-VERT Financial Sector Global loan	5.00	Financing for SME ventures
Dominican Republic	Global loans	31/03/2003	Financial Sector GL II	40.00	Financing for SME ventures
Mozambique	Energy	28/03/2003	Mozambique–South Africa Natural Gas	50.00	Gas field development and construction of gas pipeline from Mozambique (Secunda) to South Africa

<b>Country</b>	<b>Sector</b>	<b>Signature</b>	<b>Name</b>	<b>Amount (M €)</b>	<b>Description</b>
Africa	Transports	28/03/2003	ASECNA IV	33.00	Renewal and upgrading of airport and aeronautical equipment to improve air traffic safety
Swaziland	Water	28/03/2003	Lower Usuthu Smallholder Irrigation	36.00	Construction of irrigation systems from Usuthu river for smallholdings
Malawi	Industry	13/03/2003	Kangankunde Feasibility Study	0.30	Feasibility study for development and mining of strontium deposit in Kangankunde, north of Blantyre
Botswana	Water,	14/02/2003	Francistown Water Supply	12.50	Extension of water supply network for greater Francistown area
Central Africa	Services	24/01/2003	CAGF-Central Africa Growth Fund	5.30	Regional fund for financing equity participations in private companies

Source: EIB Website ([www.eib.org](http://www.eib.org))

## Annex 2. IFC Mozambique SME lending facility

The IFC has launched a new, frontier-market approach to small business investing through the creation of the Mozambique SME Initiative, which would be established on a pilot basis as an IFC-administered programme to provide an integrated package of risk capital and technical assistance (TA) to selected SMEs. The total cost of the Initiative is \$12 million including investment capital, TA and overhead, with an initial term of five years. The Initiative would be grant-funded with support from donors, and it is proposed that the IFC's contribution take the form of a grant of \$3 million in the first year. The project has been developed in consultation with IDA, who may contribute financial and human resources from their existing Enterprise Development Project (PoDE) programme. Mozambique is one of the pilot countries for the new joint IFC-IDA initiative for MSME development.

The project involves creating a \$12 million Mozambique SME Initiative to finance small and medium enterprises (SMEs) in Mozambique on a commercial basis. The Initiative would have two components:

1. An Investment Programme (the Investment Programme) of \$8 million, including \$3 million for management and overhead costs for five years, for financing SMEs by making loan, quasi-equity or equity investments on commercial terms; and
2. A Technical Assistance Programme (the TA Programme) of \$4 million to support the Investment Programme by providing direct assistance to investee companies as well as funding costs associated with outside service providers.

Both the Investment and TA Programmes would be funded from donor contributions and by an IFC grant of \$3 million in the first year.

The underlying premise of the Initiative is that the investment climate in Mozambique, while improving, remains extremely difficult for private investors. It is not at this time feasible to attract significant private capital to invest in the SME sector in the country given the relatively undeveloped

state of this sector. Even the most promising SMEs require significant technical assistance as well as financing in order to develop further. At the same time, there is a strong need to create some success stories if the sector is to develop.

The Initiative has been designed to take into account the lessons of experience from IFC's previous work in Mozambique and experience with SME lending elsewhere in Africa. Its main features are as follows:

- **Integrated investment/technical assistance** – Experience indicates that this is the key success factor for SME financing. Given the challenges of this market, the TA component is relatively high, representing 50% of the Investment Programme. The TA will be dedicated exclusively to supporting the activities of the Investment Programme in developing 'bankable' clients. The Initiative will also draw on the considerable in-country resources of the World Bank Group (in particular the Enterprise Development Project (PoDE) and Africa Project Development Facility (APDF)).
- **IFC managed** – While the IFC's preference is always to work with local partners, the integrated investment and TA nature of this Initiative requires that the IFC maintain close control over its management and operations. The proposed Initiative would be led by two experienced IFC officers and it would benefit from existing IFC infrastructure, operating out of the IFC office in Maputo. The Initiative would also be able to draw on the resources of the Regional and the relevant industry departments, in particular Agribusiness.
- **Small initiative** – The World Bank's African Enterprise Fund (AEF) and Small Enterprise Fund (SEF) experience indicates that volume orientation is directly related to high failure rate. The IFC's value added will come from the IFC's ability to select and nurture a limited number of the most promising clients. If use warrants, the Investment Programme can be increased at a later date.

- **Off-balance sheet** – Establishing a financial company in Mozambique would be an expensive and time-consuming exercise. Such a company would not benefit from IFC's immunities, and would face issues of taxation, banking license, employment of expatriates, etc. From an internal IFC standpoint, creating a subsidiary also raises major consolidation issues. Commencing with a donor-funded Initiative structure would allow us to avoid these issues during the initial phase, permitting the officers to focus their efforts exclusively on developing the business model.
- **Conversion option** – The Initiative will have an initial term of five years, during which the prior-

ity will be to develop a successful client base. If it succeeds in this goal, the Initiative can at any time be expanded, and/or converted into a stand-alone SME investment company. The Initiative Agreement will contain language providing donors with an option to convert their share of the Initiative into equity in a new venture to be created. This allows flexibility for duplication, and expansion if it works well. Given the nature of IFC's funding by grant in a Trust Fund structure, proceeds would not revert to IFC's general revenues.

Source: World Bank/IFC

## Endnotes

1. EDFs 1–3 related to the Yaoundé Conventions, EDF 4 to Lomé I, EDF 5 to Lomé II, EDF 6 to Lomé III, and EDFs 7 and 8 to Lomé IV. The 9th EDF relates to the first five years of the Cotonou Agreement.
2. See AILC (2002) for a detailed exploration of the EIB's legal status as a Community instrument.
3. This section will primarily focus on EIB activities during the last decade of Lomé co-operation, covering the fourth Lomé Convention. The information has been summarised from Court of Auditors (1998).
4. EIB OED (2000). 31 projects, considered to be representative of the types of risk capital operations by the EIB in the ACP countries, were included in the evaluation. Nine of the operations (29%) were global loans, 11 (35.5%) were individual loans to private sector industrial firms, and 11 (35.5%) were loans to revenue-earning infrastructure projects. In all, the 31 projects represented 17% of the EIB's risk capital operations in the ACP countries during the period.
5. 'Green Paper on Relations Between the European Union and the ACP Countries on the Eve of the 21st Century: Challenges and Options for a New Partnership', EC Directorate-General VIII (Development), Brussels, November 1996.
6. This amount does not include the €195 million available to OCT countries: €155 million in grant financing from the EDF and €40 million through the EIB split 50%–50% between loans from the IF and the EIB's own resources.
7. This section is summarised from a more detailed outline in EIB (2000)
8. In HIPC countries, as IMF and World Bank conditionality mandates public sector borrowing at very concessional terms only, IF financing will apply the maximum authorised subsidy to the loan.
9. This section benefited greatly by comments from Prof Andreas Antoniou of the Commonwealth Secretariat.
10. See 'EIB's Transparent Information Policy' on the EIB Website ([www.eib.org](http://www.eib.org)).
11. See 'Notes on the Operational Guidelines for the Investment Facility', ACP Secretariat.

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