Privatizing European development finance: the role of the European Investment Bank

EU development finance architecture needs to be revamped in light of the significant changes that have taken place over the last few years due to the global crisis. Civil society organizations are raising concerns about the fundamental ambiguity surrounding the status of public banks such as the European Investment Bank (EIB), which is clearly not a regional development bank even though it pretends to finance development through friendly investment operations. There is a risk that the debate on rethinking European aid and the wider role of development financing could be influenced by approaches promoting a corporate-driven agenda.

Antonio Tricarico (coordinator)
Campagna per la Riforma della Banca Mondiale (CRBM)

European development finance is at a crossroads. The impact of the financial and economic crises on public finance in most EU member states is reversing the trend seen in the last decade of increased Official Development Assistance (ODA).[1] Although European governments remain major donors, providing more than half of global ODA, it is increasingly clear that the EU as a whole will not reach its 2015 targets. At the same time, efforts to increase aid quality and effectiveness, strongly supported by European donors in international forums, are at risk.[2]

In this negative context, a new and opportunistic narrative has been emerging in official circles in Brussels and in other European capitals that a more "holistic" approach to international development cooperation and development finance is needed. It aims to widen the definition of development finance to include commercial and investment activities and prioritize private sector intervention as an engine of economic growth and possibly development at large.

At first such an approach might look like a reworking of a Washington Consensus-style "trickle down effect." However, despite the ideological bias in favour of private markets, a new vision and strategy dealing with public and private partnership and reciprocal roles is being developed. This sees development finance as not simply an instrument for pushing macroeconomic policy reform in the global South – as has happened in the last decades – but increasingly as a public lever to move private capital. In the context of economic crisis and the renewed importance assigned by the G20 to development finance and international financial institutions as key instruments of international public finance, this approach has also become instrumental in supporting European business worldwide at a time when private capital markets have dried up.

Thus European development finance risks becoming part of a long-term bail out plan benefiting European business – framed by someone as "corporate welfare" – instead of helping the poor in the global South who had no responsibility for creating the crisis but suffered the most from its impacts.

The involvement of the private sector

Financing to the private sector by multilateral development banks[3] (MDBs) has increased ten-fold since 1990, from less than USD 4 billion to more than USD 40 billion per year. Private sector finance is now a major part of the overall portfolio of many multilaterals and constitutes nearly half of global ODA.

Since the Monterrey Consensus in 2002 the premise that financing for development was increasingly to be extracted from international capital markets has been implemented by major development institutions, with an increasingly residual and auxiliary role for aid in capacity- and institution-building, promoting an enabling environment for private investment, both domestic and foreign. These ideas were reiterated at the Doha Review Conference on Financing for Development in December 2008.

Of course, development is much more than aid spending, and the private sector can be a vitally important engine for sustainable development, but private companies can also have detrimental impacts on poverty, human rights and the environment, in particular in the context of international private investments. Furthermore it should be clarified which private sector – foreign or domestic, for profit or other actors – should be primarily awarded scarce international public support for achieving development goals and under what conditions.

International civil society has recently highlighted that MDBs' approach to the private sector and development has not always sufficiently focused on promoting sustainable development or reducing poverty.[4] MDB project selection and monitoring and evaluation procedures have tended to prioritize commercial rather than social and environmental returns. The rapid growth of "arms-length" financial sector investments through intermediaries such as private banks or private equity firms is a particular cause for concern. As shown by new research several MDB-backed intermediaries operate via offshore financial centres and could contribute to capital flight from the global South to the North.[5]

New approach

This trend culminated at the EU level in the proposal for a "whole of the Union" approach[6] – drawing on the G8-sponsored idea promoted under the Italian Presidency in 2009 of a "whole of a country approach." This would mean that not just ODA but also export credits, investment guarantees and technology transfers are counted towards the EU's development contribution. Trade and investment promotion instruments would be used to leverage foreign private investment in developing countries as a key engine for development.

Such an approach draws on transformations that have already taken place within European development finance. The EU "house bank," the European Investment Bank (EIB), which since the 1980s has slowly but consistently increased its volume of operations outside the EU, has become a player in development finance comparable with European Commission (EC) aid and major European bilateral donors. The EIB can be regarded as a "European International Financial Corporation," given its mandate of most often lending directly to the private sector for project operations. At the same time, similar institutions at bilateral level – the so-called European Development Finance Institutions (EDFIs) – financially support primarily member countries' private sector operations abroad in the name of development and are also growing their business and scope of action.

European governments have already turned their attention to how to boost these mechanisms rather than rethinking the ODA infrastructure through innovative financing mechanisms for development.

1 CONCORD, "Broken EU aid promises push Millennium Development Goals out of reach, says CONCORD as OECD announces aid figures," media release, Brussels, 14 April 2010.

2 Organisation for Economic Co-operation and Development/ Development Assistance Committee (OECD/DAC), *Development Cooperation Report* (Paris, 2010).

3 International or regional inter-governmental agencies such as the World Bank or the African Development Bank.

4 Action Aid, Bretton Woods Project, Christian Aid, CRBM, European Network on Debt and Development (Eurodad) and Third World Network (TWN), *Bottom Lines, Better Lives? Multilateral Financing to the Private Sector in Developing Countries – Time for a New Approach*, March 2010. Available from: <www.brettonwoodsproject.org/doc/private/privatesector.pdf>.

5 Richard Murphy, "Investment for development: derailed to tax havens," draft report on the use of tax havens by Development Financial Institutions prepared for IBIS, NCA, CRBM, Eurodad, Forum Syd and the Tax Justice Network, April 2010.

6 Commission of the European Communities, "Supporting Developing Countries in Coping with the Crisis," Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, Brussels, 8 April 2009.

Such a strong emphasis on supporting international investment as a primary engine for development – at a time when the EU is reviewing its overall investment policy[7] – is also undermining opportunities to energize domestic resources mobilization. This would be the most sustainable long-term approach to development because of its capability to reduce the aid and foreign investment dependency of developing countries and insulate them from the impact of exogenous shocks and crises.

At the same time, the entry into force of the Lisbon Treaty at the end of 2009 has structurally established development goals, and in particular poverty reduction and eradication in the long term, as horizontal objectives of overall EU external action[8] – as well as human rights protection and promotion and the promotion of democracy. However, implementation of the new Treaty has opened a wider discussion about how development matters will be operationalized in the new external action service of the EU under the guidance of the newly established High Representative of the EU for Foreign Affairs and Security Policy, and consequently how development policies and goals – as defined in the European Consensus on Development of 2005[9] – could be subordinated to the Union's commercial, security and wider geopolitical priorities. In this context the use of some of the limited development budget at European level for the new external service has become a controversial political issue.[10]

In this new political context, the review of the external lending of the EIB, which started in 2009 and is expected to be completed early in 2011, has generated a wider debate well beyond the future of the Bank's lending in developing countries, triggering a new reflection on the need to change the European development finance architecture. This will likely become a major battleground between civil society and European institutions and governments – among other stakeholders – in the next few years and in the run-up to the EU new budget definition for the period 2013-2020. It is worth looking more carefully at the current debate and advance bold questions and proposals on how to avoid the increasing privatization of European development cooperation in its goals and practice.

The European Investment Bank: a case study

The task of the EIB is to contribute towards the integration, balanced development and economic and social cohesion of EU member states.[11] Outside the EU, it operates under various mandates. In December 2006, the European Council approved a new EIB External Lending Mandate (ELM) for 2007-2013. This provides up to EUR 27.8 billion (USD 35.3 billion) of EU guarantees – an increase of over EUR 7 billion (USD 9 billion) compared to the previous mandate – for providing loans to projects in countries outside the EU, except the Africa, Caribbean and Pacific (ACP) regions.

In terms of the ACP, the EIB operates under the Cotonou Partnership Agreement between the EU and the 79 ACP countries, assigning EUR 1.7 billion (USD 2.2 billion) from its own funds and EUR 2 billion (USD 2.5 billion) under the Investment Facility, a fund financed from the European Development Fund (composed of EU member state contributions administered by the EC) and managed by the EIB.

Civil society organizations monitoring EIB lending have raised several concerns in the last decade about the fundamental ambiguity around the status of this public bank, which is clearly not a regional development bank as it finances supposedly development-friendly investment operations without statutorily abiding by European development policies and goals. In short, EIB lending outside the EU has mainly focused on co-financing large-scale infrastructure operations, energy projects aimed at increasing energy security for the EU and private sector development interventions – including the private financial sector in the global South – so that most EIB loans have first benefited European companies and exporters before local communities' needs.

At the occasion of the approval of the new ELM in 2006 a specific provision to hold a mid-term review of mandate implementation was included for the first time[12] under pressure from a few EU member states. These countries expressed their concern about the growing mission creep in the EIB through this often inconsistent and unclear enlargement of the scope of the Bank's action outside the EU.

The review process has also included two external evaluations, the most important of which was carried out by an *ad hoc* steering committee of "wise persons" established by the Bank and the EC and chaired by Michel Camdessus, former head of the IMF. Among the recommendations in the final report,[13] several concerns were raised including that the "[EIB's] translation of EU policies into EIB lending strategies and the economic and sector analysis of country needs are very limited; the EIB efforts to monitor project implementation, ensure local presence and follow up on environmental and social aspects appear still insufficient; [and] the EIB ability to satisfy the mandate requirements on development aspects is only indirect."[14]

However, the Camdessus report in the end restates the supremacy of private sector support as the core business of the Bank. It also contradictorily calls for a significant expansion of the role of the EIB in development finance by topping up its mandate with EUR 2 billion (USD 2.5 billion) for a new climate finance mandate, increasing the Bank's investments beyond the EU guarantee (including social sectors) and the range of financial instruments offered, and undertakes concessional lending by mixing EIB money with EU grants.

Corporate welfare and development deceptions

The EIB was founded as an investment bank. It is hard to transform the institution into a development one given the difficulty of changing its culture, as the example of the IMF in the last ten years has clearly shown.[15]

Nevertheless, the EIB has been granted a significant role in the 'Whole of the Union' approach since 2009 in the context of the financial and economic crises. Since more resources were needed and EU member states were not keen to increase their ODA contributions, the EIB remained the only institution that could easily lend more through bond issuing in capital markets and increasing the community guarantee scheme for its external lending. Civil society is extremely concerned about the proposal that the EIB should fill the development role that EU member states have failed to provide in the crisis context.[16] The EIB lends at quasi-commercial rates, thus generating new foreign debt in developing countries. Moreover, as an investment bank, the EIB is not best placed to provide a holistic and meaningful response

7 Seattle to Brussels Network, "Reclaiming public interest in Europe's international investment policy," civil society statement on the future of Europe's international investment policy, Brussels, 12 May 2010.

8 Treaty on the Functioning of the European Union. Available from: <www.eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2008:115:0047:0199:EN:PDF>.

9 Available from: <www.europa.eu/legislation_summaries/development/general_development_framework/r12544_en.htm>.

10 Cidse, Eurostep, CONCORD and Aprodev, "Lawyers reveal Ashton's EEAS proposal breaches EU law," media statement, Brussels, 26 April 2010.

11 See: <www.eib.org/about/index.htm>.

12 "Council Decision of 19 December 2006," *Official Journal of the European Union*, 30 December 2006. Available from: <www.eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2006:400:0243:0271:EN:PDF>.

13 Michael Camdessus et al., "European Investment Bank's external mandate 2007-2013 Mid-Term Review: Report and recommendations of the steering committee of 'wise persons'," February 2010. Available from: <www.eib.org/attachments/documents/eib_external_mandate_2007-2013_mid-term_review.pdf>.

14 *Ibid*, 26.

15 Eurodad and Counter Balance coalition, "Joint submission of the European Network on Debt and Development and the Counter Balance coalition to the Wise Persons Panel in the context of the mid-term review of the European Investment Bank's external mandate," Brussels, 28 January 2010.

16 Alex Wilks, *Corporate welfare and development deceptions. Why the European Investment Bank is failing to deliver outside the EU* (Brussels: Counter Balance, February 2010).

for developing countries in times of crisis. This is particularly true for low-income countries, which should be given grants to meet the needs generated by the crisis and, in the worst case scenario, should only take up concessional lending but never commercial debt.[17]

Even though foreign direct investment (FDI) might contribute to endogenous development processes, this is only the case to a limited extent and under some very specific conditions, as documented in detail by the United Nations Conference on Trade and Development (UNCTAD).[18] Counter-cyclical financial interventions in the context of the crisis require a much more ambitious approach than a mere leveraging of EIB financing in the South. Current attempts to limit negative environmental and social effects on local communities are welcome, but they are a poor substitute for strengthening other more effective development assistance mechanisms within the EU aid architecture. These principles are also valid in the case of the promotion of global public goods such as finance for climate mitigation and adaptation measures. Even though climate finance should be kept clearly separate from aid, it should take into account a number of lessons learnt on how aid should be channelled and delivered in order to be more effective.

Forcing a transformation of some EIB lending into proper development finance instruments by establishing operational links with the EU aid system – European Development Fund, funding instrument for development cooperation (DCI) and EuropeAid – may be too risky if done in a rush and without the appropriate guarantees that the EIB will live up to the standards of EU aid. The intrinsically different nature of these institutions and mechanisms would jeopardize hard won and still limited progress slowly achieved within Europe as concerns the implementation of key aid effectiveness priorities (among which are recipient country ownership, alignment to recipient country strategies and transparency).

The EIB should not expand its role in other development finance areas, such as technical assistance. The EU Court of Auditors found in a report in 2007 that EU technical assistance remained highly ineffective.[19] Recent studies have shown that it is mainly a vehicle for supporting Western firms and does not mobilize effective resource deployment in the South. Technical assistance should instead be, as a minimum, demand-driven, tailored to the recipient countries' needs and have a strong capacity-building component.[20]

In the short term, rigorous do-no-harm policies have to be put in place in order to align EIB lending to cross-cutting EU development and human rights objectives that should guide overall EU external action and minimize negative development impacts on the ground. Resources generated by the EIB – which could be blended with grants – should be transferred to other existing European mechanisms or other international financial institutions (IFIs).

EU development finance architecture

This recommendation would trigger in the medium term the need to redefine the overall EU development finance architecture. This approach is in line with the key priority of the aid effectiveness agenda to reduce fragmentation and duplication among donor-led institutions.

In this regard, the steering committee of 'wise persons' went beyond the remit of its work and made some clear suggestions concerning the integration of the EIB with the renewed European development finance architecture. It identified the need to develop an EIB subsidiary in order to manage the external lending of the Bank and at the same time an "EU platform for external cooperation and development," providing a comprehensive coordination mechanism based on an optimal model for blending grants and loans and building on principles of mutual reliance between financing institutions. This should be open to the participation of the European Bank for Reconstruction and Development (EBRD), the Council of Europe Development Bank and European bilateral financing institutions – in particular EDFIs – and with appropriate beneficiary involvement. This mechanism would accelerate needs identified by the European Council at the end of 2008[21] concerning common guidelines for matching grants and loans at European level, thus leveraging additional resources for development finance.

At the same time, concerning the medium-term and next EU budget period the Camdessus Report highlights two possible solutions that – in line with short-term developments – would drastically change the European development finance architecture: the establishment of a "European Agency for External Financing," which would integrate the external financing activities of the EIB and the external investment-related financing activities managed by the Commission (thus excluding most of the EU development budget); or the creation of a European Bank for Cooperation and Development, which would be a major European instrument bringing the external activities of the EIB under a common shareholding umbrella together with the external activities of the EC and the EBRD.

So far European institutions have been debating these proposals internally, without taking public positions. However, there is a growing appetite for the EIB to be used as a key vehicle in the wider external action service of the EC, possibly with the combination of additional resources, and keeping the centrality of financial support for private sector development within the overall action. In the meantime, EDFIs have stated their interest in cooperating closely with the EIB and promoting the idea of a joint platform, with some pilot activities in the field of climate finance.

Civil society believes that the EU does not need to establish its own development bank.[22] There is no need to add yet another MDB to the existing global and regional ones when much work still has to be done to reform and improve their effectiveness. Signing memorandums of understanding between the EIB and IFIs has produced limited outcomes so far. The EU could consider transferring more resources to existing IFIs instead if appropriate reforms are put in place. In this regard, IFIs should implement strict standards of responsible finance and European governments should perform with more coordinated and effective action on their boards.

Concerning the proposal for an agency, it is highly questionable that the EU would better structure and possibly expand the private sector lending dimension of development finance, partially drawing on its development budget to make some concessional lending to the private sector, while not putting similar efforts into enhancing the actual core of development finance architecture and its development cooperation instruments.

The future of EU development finance

There is a need to rethink the EU development finance architecture in light of significant changes that have taken place due to the crisis, the possible failure of the Millennium Development Goals' agenda and new challenges posed by international cooperation and the promotion of global public goods.

From this perspective tackling an EIB transformation is central for pushing wider EU development finance in the right direction. In the short term the EIB should remain just an investment vehicle, even though its scope of action outside of the EU should be restricted (both geographically and sectorally). The EIB's external action should also be strictly aligned with overall EU development and human rights objectives. Moreover, development effectiveness

17 Eurodad and Counter Balance coalition, *op. cit.*

18 UNCTAD, "Economic development in Africa. Rethinking the role of foreign direct investment" (New York and Geneva: United Nations, 2005). Available from: <www.unctad.org/en/docs/gdsafrica20051_en.pdf>.

19 "Special Report 6/2007 of the European Court of Auditors on the effectiveness of technical assistance in the context of capacity development," *Official Journal of the European Union*, 21 December 2007. Available from: <www.eca.europa.eu/portal/pls/portal/docs/1/673583.PDF>.

20 Eurodad and Counter Balance coalition, *op. cit.*

21 Council of the European Union, "Framework on loans and grants blending mechanisms in the context of external assistance," Financial Counsellors Working Group, 11 December 2008.

22 Eurodad and Counter Balance coalition, *op. cit.*

principles go beyond aid and should also be applied to public-backed investment banking in developing countries, including those promoted by EDFIs.

Furthermore, the EIB must ensure that all its investments have clear development outcomes, in particular in sectors where it is most active such as infrastructure, energy and extractives. As a public institution it also needs to ensure that the companies and investments it supports comply with the highest financing standards with the aim of ending tax evasion and capital flight to the EU and help restore stolen assets to the countries of origin.

However, in the long run – starting with the new EU budget period 2013-2020 – more effective institutional alternatives should be found to this institution concerning its lending outside the EU. In particular, lending to Asia and Latin America should be stopped while prioritizing the increase of development support for low-income countries of these regions through existing EU mechanisms (DCI), IFIs and new regional institutions. As for the lending to Central Asia, the EIB should only financially support EBRD-decided interventions, given that the EIB is already an EBRD shareholder together with the EC and EU member states. Regarding lending to neighbouring regions (Eastern and Southern) the EIB as an investment bank should adopt a stringent development and human rights perspective and clear priorities in line with overall horizontal EU development and human rights objectives of external action.

The effectiveness of EIB's action and its relationship with the European Partnership and Neighbourhood Instrument (ENPI) in these regions should be reviewed once again before the adoption of a new external mandate in 2013. Finally, regarding ACP lending, in the context of the Investment Facility review in 2010 the EC and member states should explore all possible alternatives beyond 2013 for the management of the European Development Fund resources currently administered by the EIB, including regional IFIs, existing EU mechanisms and eventually new mechanisms to be established.[23] ■

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23 *Ibid.*