Counter Balance — Challenging the European Investment Bank

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Counter Balance briefing on the Wise Persons' Panel report evaluating the external lending mandate of the European Investment Bank

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EIB External Mandate

Counter Balance admires the extensive analysis that the Wise Persons' Panel has undertaken of EIB lending activities outside the European Union, and particularly its willingness to begin to address the developmental impacts of that lending. There are many proposals put forward by the panel that can help European development finance begin to aid genuine development—as well as several that would in our view have the opposite effect. We welcome the panel's conclusion on the need that "*the EIB should increase its development focus*," and appreciate key reforms the WPP proposes to EIB lending procedures, including:

- "pay particular attention to the promotion of democracy and the rule of law;"
- "more focus on quality and tangible delivery of EU objectives and less on the volume of financing;"
- "reinforce due diligence on social aspects (including respect for human rights) in its project cycle work;"
- "strengthened…staff expertise in sustainable development, human rights, social/gender issues, use of 'pro-development' project indicators;"
- "clear compliance with EU/agreed international standards on environment and social aspects:"
- "more extensive and systematic access to project information, and greater involvement of project beneficiaries and local civil society;"

In our view, these are essential preconditions for the EIB to fulfil its development mandate, and we urge the bank to implement the WPP's recommendations in this regard with urgency. Without them, the EIB is potentially in violation of its legal obligations, which have been recently clarified in both the European Court of Justice and the Treaty of Lisbon.

Indeed, EIB's development *obligations*, could have taken a more central place in the WPP's report: it defines "the role of the EIB outside the EU [as being] to support EU external policies (including enlargement, neighbourhood and development co-operation policies)." Counter Balance is confident this definition does not fully reflect the development role placed on EIB by the ECJ judgement of November 2008, which found the EIB's former mandate invalid, dissolved it, and requires from any new mandate that:

"*EIB financing operations should foster the sustainable economic and social development of [developing] countries, and more particularly the most disadvantaged among them; their smooth and gradual integration into the world economy; the campaign against poverty; the general objective of developing and consolidating democracy and the rule of law; the general objective of respecting human rights and fundamental freedoms; as well as compliance with objectives approved by the EU in the context of the UN and other competent international organisations.*"

The WPP report acknowledges this new remit, but only on p.14, long after it claims the EIB "does not have a pure development mandate" and "is primarily focused on investment/ project financing." This is correct especially for EIB's money disbursal within the EU but is different outside of EU. It also calls the new mandate "an explicit request for EIB operations to support EU development co-operation policies." However, this is a *legal requirement*, especially under the amended Lisbon Treaty, (Art.21(2)(d) to (g)), which states that the EIB's mandate outside the EU "*shall have as its primary objective the reduction and, in the long term, the eradication of poverty*." In other words, poverty reduction, not corporate interests, must be the focus of all EIB-backed projects which are likely to affect developing countries. In addition, it is important to assess EIB's external mandate against the various commitments of the EU for aid effectiveness, to measure whether the EIB has a clear proactive lending strategy with regard to development effectiveness and what criteria EIB uses when assessing the applicability of a project. [1]

It is in this context that other WPP conclusions regarding the external mandate have to be seen. We would concur with the panel's recommendation of "a streamlined EIB mandate with high-level EU objectives for all reasons, for the purpose of establishing coherence with EIB external activities," *as long as those activities serve development*. That means the establishment of no-go sectors like fossil fuels, which are anti-developmental, polluting and exploitative; investment in cross-sectoral, long-chain projects that take time and money to bear fruit; and it means holding companies to account using mechanisms like benefits for local communities covenanted into project contracts.

The sectors the WPP suggests focusing on do not give us confidence that this is what they intend. One is energy security: the EIB is involved in a massive push for EU energy importation, authored by the European Commission that involves oil and gas pipelines, solar projects and even a 6,000km long electricity cable from the Congo River that has colossal implications for geo-politics, regional stability, energy consumption and climate change. These are issues that need to be debated democratically and at length, not given vast sums of public money in obscurity.

Another is climate change. There is a deeply worrying trend among policy makers and project financiers not to see climate change as an unarguable rebuttal of our high-consumption Western lifestyles, but instead as a possible source of profit. Carbon trading and offsetting and mitigation and adaptation technofixes like Caron Capture and Sequestration are potential goldmines for corporations; they also actively disguise the only real solution to climate change, which is to *reduce consumption*. For that reason, Counter Balance's own shadow report, *Corporate Welfare and Development Deceptions*, paralleling the WPP investigation, says, "the EIB should stay out of adaptation funding. Regarding mitigation actions, the EIB should prioritise support within the EU, which remains a major emitter compared with neighbouring countries."

In any case, for the EIB to begin to fulfil its development obligations, it will have to undertaken major institutional reform, the subject of the next section.

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[1] The European Union has signed international agreements aiming at increasing the effectiveness of aid it delivers. These are The Paris Declaration on Aid Effectiveness (2005) endorsed by the European Council, The European Consensus on Development (2005), and Accra Agenda for Action (2008).
The Accra Agenda for Action adds 48 new or strengthened commitments to the 12 indicators of the Paris Declaration, especially to improve the mutual accountability between donors and partner countries, the predictability of aid disbursements, and the transparency of development assistance in general. Donors and recipients agree to "change the nature of conditionality", to agree on a limited set of mutually agreed conditions based on national development strategies.
Donors commit to use developing countries public financial management and procurement systems to the maximum extent possible when disbursing aid. For the first time, civil society organisations are acknowledged as "independent development actors" in their own right whose efforts complement those of governments and the private sector.

Functioning of the EIB

The WPP report makes a couple of macro-assumptions with which we fundamentally disagree: that 'development' funds in poor countries are essentially benign, and that the EIB is institutionally capable of delivering EU funds in a way that generates real development. While there is no space to properly address the first assumption here, the reality is that investment by rich countries into poor countries is not inherently a good thing: it can lead to problems as varied as Western corporate takeover of local economies, corruption, social destabilisation, environmental destruction and even violent conflict. We refer the panel to the recent Bretton Woods Project report *Bottom Lines, Better Lives*, which concludes that:

- "MDBs tended to adopt an 'investment' climate approach" favouring foreign direct investment (FDI) over sustainable national private sector development;" (We likewise reference the Christian Aid report *Getting Back on the Rails*, which notes that FDI can stifle or undercut development)
- "MDBs failed to demonstrate sufficient 'additionality' for their financing—meaning that they run the risk of merely replicating the activities of private finance;"
- "Project selection is biased against poorer companies and smaller companies;"
- "The rapid growth of arms-length financial sector investments through financial intermediaries such as private banks is a particular concern [due to] the failure of MDBs to clearly define the development objectives of their investments."

The EIB model has been accused of every single one of these failings. EIB has tended to support Western corporations at the expense of local companies or needs. In Zambia, for example, three quarters of EIB investments from 2005-08 went to the mining sector, which is not even listed among the five priority sectors in the Country Strategy Plan, and those investments have precipitated terrible contracts like the one for the Mopani copper mine, in which the Zambian government received an embarrassing 0.6% of royalties. It has a pronounced bias against truly poor countries, which needs investment most: the WPP report shows that Asia and Latin America Low Income Countries received a paltry 1.4% of EIB extra-EU funding from 2000-09. And the growth of EIB investment in Global Loans and private equity receives almost no coverage in the WPP report at all.

Corporate Welfare and Development Deceptions notes among other failings that EIB:

- "does not select its projects according to how it can best use public money to maximise poverty reduction and environmental protection for those who need it most;"
- "does not have a clear understanding of development effectiveness or of the specific contribution it can make;"
- "guarantees and grants are mainly used to support private sector operations with little social or environmental value-added;"
- "should remove the harsh emphasis on cost recovery and instead embrace broader social and environmental goals;"

In other words, given its newly clarified development obligations, this institution should not be allowed to continue lending as it currently operates. Major and fundamental changes are required—and quickly, given that EIB plans to expand its loan volume by 30% in 2010 and 15% in 2011, on top of a 30% expansion last year.

For that reason, the panel's repeated praise for the EIB's "lean business model" is a source of major concern. It hardly sits well with some of the panel's own conclusions, for example that:

(i) [EIB's] translation of EU policies into EIB lending strategies and the economic and sector analysis of country needs are very limited;

(ii) the EIB efforts to monitor project implementation, ensure local presence and follow up on environmental and social aspects appear still insufficient;

(iii) the EIB ability to satisfy the mandate requirements on development aspects is only indirect.

EIB's current appraisal, evaluation and monitoring procedures are not adequate for assessing the development impact of the Bank's operations. Some of the indicators for that, also mentioned in the WPP report, is the fact that EIB lends "more than €40 mill per staff member, compared with about €3-7mill for a typical MDB". The EIB is able to operate a 'lean business model' but despite its improved intentions, it is not set up to do development work. Alone among MDBs it lacks mandatory project criteria; it selects projects overwhelmingly on economic rate of return criteria; once a project enters the funding pipeline, it is more or less guaranteed support; its monitoring of projects after funding is almost non existent; it lacks not only staff expertise in evaluating social and environmental pros and cons, but a fundamental development orientation.

This latter point is the hardest to resolve: it is to change an institutional culture. The EIB got its development role essentially by default—because the EU wanted to make further investments overseas, largely to serve its own interests, and could not find a more appropriate vehicle to do so. But it is becoming clearer all the time that the EIB is not like other MDBs: it has *a legal and political obligation to serve development and in the process to be accountable to the citizens and elected bodies of the EU* (something that the World Bank, for example, simply does not have to do).

Bringing in new staff will not be enough to make the EIB serve development. And until it can, as it is legally required to do, the fundamental question should be whether the bank is entitled to carry out development projects at all, not whether to further expand its remit. In that context, WPP suggestions such as the EIB taking on concessional financing, blending grants and loans or increasing own-lending risk are beside the point: *in its current form, the EIB is not qualified to promote genuine development, and until those institutional deficiencies are corrected, new approaches will founder.*

The WPP proposal that EIB increase own-risk exposure on its balance sheet, freeing up the Community Guarantee to cover low income countries (LICs) and riskier operations is one example. While the proposal could be beneficial to LICs if they were to receive EU funds for local renewable energy projects or small-scale sustainable industry, it will be worse if it simply opens up poor countries for yet more oil pipelines or copper mines. Thus unless major reforms are carried out such that EU development money serves real development, innovative ideas like the extension of the community guarantee are likely to cause more problems than progress.

We also disagree significantly with the panel's recommendation that EIB start handing out more technical assistance (TA) funds. The growth of TA has been a notable feature of other MDB portfolios in recent years, especially those that deal with the private sector: the IFC, for example, has expanded its TA sevenfold in the last seven years to a portfolio of nearly $1 billion. Among NGOs, TA is notorious as a form of intellectual arm-twisting, a way of pre-ordaining the development path a poor country will take. As *Bottom Lines, Better Lives* puts it, "A number of studies have found that providing technical assistance as a 'free good' severely weakens the ownership by recipients of the advice received… As Sakiko Fukuda-Parr, professor of International Affairs at the New School in New York and author of numerous reports on TA, has commented, "technical assistance has been notorious in failing to build capacity, because as an instrument it is precisely taking away ownership from developing countries. At the core of the problem is that the power relationship embedded in TA contradicts ownership."

Most of all, we underline something the panel mentions but does not sufficiently examine: EIB's colossal use of financial intermediaries (FIs) and increasing investment in private equity. From 2007 to now, what the EIB formerly called Global Loans and now calls Credit Lines, the lending of funds to FIs which are then supposed to onlend them to SMEs etc, totalled more than €42 billion, the second largest item on the EIB portfolio. There are enormous concerns about the

almost total lack of development criteria or monitoring of lending impacts enforced on FIs by the EIB, as well as what the FIs are doing with the money. For instance, evidence in the UK suggests not much of the €4billion promised to UK SMEs has reached them. As a UK small business analyst puts it, "*whilst EIB finance may be available to nearly 3,000 small businesses, the funds are only accessible via traditional banks, which continue to set vigorous criteria and credit scoring to businesses seeking financial support and will not necessarily lend to smaller firms*."[2]

If that is the case in Europe, how much more likely is it that Global Loans outside the EU are just another subsidy for the big players? Certainly EIB has failed to make any kind of convincing case that these funds serve development. Yet financing through intermediaries is set to rise 50% in the next two years. In our view, *support for FIs should be restricted to local institutions not operating in offshore financial centres and which have a substantial local ownership and are equipped to implement a pro-development approach supporting specific local SMEs in each country.* The EIB should adopt a public registry of financial intermediaries which comply with these criteria.

Added to that is the EIB's increasing if as yet poorly documented willingness to invest in private equity funds, often based in secrecy jurisdictions with well-known problems of capital flight and tax avoidance. These are very often even less accountable and committed to development than conventional project finance, and we have yet to see a convincing rationale for EIB involvement.

Having said all that, there are several recommendations we admire within the WPP report as regards the functioning of the EIB. Counter Balance particularly draws attention to:

- "Leverage with borrowers and stakeholders should be used to obtain timely and relevant information on the progress of projects. Disbursements should be closely linked to achievement of project implementation milestones." This latter idea is excellent, and can be taken further: we draw the panel's attention to our proposal, first expressed in our report *Conrad's Nightmare* on the proposed Grand Inga dam in DRC, of covenanting specific project benefits into project contracts, with the option of recalling loans if those tangible developmental goals are not met.
- "Monitoring of global loans or loans for SMEs should be improved, to ensure the financial intermediaries properly implement the EIB requirements, to ensure accountability, transparency and environmental sustainability in the use of funds." Those 'EIB requirements' will have to be heavily strengthened.
- "Indicators and benchmarks to better track the value added and impact of EIB operations should be clearly defined for all regions and sectors, building on the existing Economic and Social Impact Assessment Framework (ESIAF) and including the new development co-operation objectives, and properly monitored throughout the project cycle until ex-post evaluation. In particular, this includes assessment and tracking of the 'consistency with and support to EU policy objectives' (which should now be taken to include development objectives), as well as with specific mandate requirements."

Institutional Reform and Optional Mandate

Counter Balance is reluctant at this stage to weigh too heavily into the proposed alternatives to EIB, other than to emphasise that the changes the panel proposes make it quite clear how deficient the EIB currently is, and significantly undermines the WPP's praise for the job the bank is doing.

We would be interested in the results of the proposed feasibility study, which should identify the current loopholes of the EIB, focusing on governance capacities, performance in carrying out its development activities, and gaps/failures, as well as the establishment proposed

[2] EIB funding initiative not revolutionary, Feb 19 2010, http://www.freshbusinessthinking.com/news.php?CID=&NID=3598&PGID=1

independent Working Group. However, it is important that a process is established and this discussion involves all stakeholders and civil society with sufficient timeframe allocated.
We also welcome some of the criteria the WPP seeks to apply to a European development institution, notably to:

- "*reinforce links and ownership process with beneficiaries*;"
- "*be fully accountable as a public institution, and focus on tangible benefits and positive impacts for the final project beneficiaries; strengthen the consultation process with local civil society;*"
- "*improve access to development expertise.*"

It is questionable, however, how much any of these things will be achieved by a new mega-bank wholly owned and run by European interests. If what we seek is country-led, pro-poor, sustainable development that is sensitive to the needs of local communities, we find it profoundly unlikely that such goals will be served by a bigger, more unwieldy, top-down mega-bureaucracy. How many good examples of big Western bureaucracies serving real local needs half a world away can you find?

The point is, however, that the criteria the WPP suggests must be the *pre-requisite* for development lending, especially under the new Treaty of Lisbon. There are minimum conditions that the EIB or any European development arm must meet. Without them, *development* lending cannot and should not go ahead, regardless of the financial or strategic benefits. It is incumbent on EU institutions, member states and civil society to codify and enforce those conditions.

Essentially, the development question has been posed the wrong way, as exemplified by the issue of what to do with the optional mandate of €2 billion. The point is not to find somewhere profitable to put that money. The point is that the EU must first and foremost "do no harm", and as part of that it must ensure that development money serves real development. If it doesn't, it should not be used, regardless of EU, corporate or member state self-interest. That means, as we have already mentioned, a list of no-go areas: so no money for fossil fuels or extractive industries, for instance. It means a fundamental revamp of the EIB to promote long-term, cross-sectoral projects that need time and investment. If the EIB is not capable of that, as we believe it currently is not, then *the Bank should not be entrusted with the optional mandate.*

<u>Other issues:</u>

• EIB operations should comply with national development strategies, and project agreements should comply with principles of responsible finance included in EURODAD's Responsible Financing Charter[3] including human rights impact assessment;

• Beneficiaries and all stakeholders (in host countries and the EU) should be involved in ex-ante project assessment, including option assessments;

• The EIB should update its transparency policy to introduce a strong presumption of disclosure, with limited exceptions. This should also apply to board documents, and should use the approach in the World Bank's December 2009 revised policy; adequate tax due diligence should be put in place, including prohibition of support for entities based in secrecy and non-cooperative jurisdictions, and the requirement of reasonable national taxation compliance for corporations to increase income for national budgets and mobilise domestic resources for development;

• The EIB should adopt a public registry of financial intermediaries which comply with criteria proving their capacity to perform pro-development interventions in recipient countries;

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[3] http://www.eurodad.org/uploadedFiles/Whats_New/Reports/Responsible_Financing_Charter_report.pdf

• The EIB should implement preferential treatment for recipient country suppliers for projects that it finances, to improve its support for job creation in recipient countries;

• The EU should ensure that its Complaint Office has sufficient staff and financial resources to properly respond to submissions from European citizens and affected communities from non-EU countries alleging harm from the actions of EIB staff.

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