CEE bankwatch network

Counter Balance — Challenging the European Investment Bank

22 March 2011

Position Paper:
The EC's plans for the EIB to increase operations and the EBRD to commence operations in North Africa

Background

As a result of the recent revolts in North Africa, on 8 March 2011 the European Commission issued a *Communication on a Partnership for Democracy and Shared Prosperity with the Southern Mediterranean.* The partnership, is, according to the Communication, to be built on the following elements:

- *democratic transformation and institution-building, with a particular focus on fundamental freedoms, constitutional reforms, reform of the judiciary and the fight against corruption*
- *a stronger partnership with the people, with specific emphasis on support to civil society and on enhanced opportunities for exchanges and people-to-people contacts with a particular focus on the young*
- *sustainable and inclusive growth and economic development especially support to Small and Medium Enterprises (SMEs), vocational and educational training, improving health and education systems and development of the poorer regions.*

The most concrete part of the proposals are the following:

"In addition to accelerating the implementation and approval of projects currently in the pipeline, the EIB could provide around EUR 6 billion to the Mediterranean region in the coming three years ***if the Council approves the additional lending envelope*** *of EUR 1 billion which was recently proposed by the European Parliament.* ***The Commission supports this increase in the lending mandate and calls on the Council to reach an agreement rapidly on the increase.***

The Council is also invited to adopt the Commission proposal of May 2008 on EIB reflows*. This would allow the EIB and other financial intermediaries to re-invest funds under FEMIP reflowing from previous financing operations in favour of the private sector. In the immediate future this arrangement would generate approximately EUR 120 million now and up to EUR 200 million by 2013.*

The EBRD, not currently active in the Southern Mediterranean, could extend operations if the Bank's statutes were amended. If agreed by all shareholders this could allow an annual EBRD business activity of an initial EUR 1 billion to be reached with the Bank's existing resources. ***The Commission supports the extension of EBRD operations and calls on EU Member States and other shareholder governments to support it urgently."***[1]

We welcome the political support and proposal for building a partnership in the Mediterranean expressed by the EC paper. Yet in order to gain credibility among the affected populations as a force for the development of democracy in the region the EU must find time to reassess its relations with the Mediterranean regimes in the last few decades. **Its activities and at least some of its financing are likely to have supported undemocratic regimes whose values were at odds with the fundamental EU principles of the inviolable and inalienable rights of the human person, freedom, democracy, equality and the rule of law, as enshrined in the Lisbon Treaty**.

In this sense premature activities by European banks in the region may constitute a problem rather than a part of the solution, by supporting new regimes whose democratic credentials are far from clear, and by supporting projects developed through undemocratic processes.

The EIB has been operating in the region since 1979 and the lack of clear and verifiable development goals of its financing raises questions about who benefited from its projects. Clearly they have not contributed to improving the regimes. The operations of the EBRD, too, in the former Soviet Union, have shown the

1 http://ec.europa.eu/commission_2010-2014/president/news/speeches-statements/pdf/20110308_en.pdf, p.8

weaknesses of trying to promote democracy using a bank. Even MSME lending, which would be expected to reach smaller companies with local benefits, the two banks have never managed to show publicly where the financing has gone and whom it finally benefitted.

The EBRD - a development bank that does not measure its contribution to improving democracy, the rule of law and the sustainability of the assisted economies[2].

Just a few years ago, serious questions were being asked about the future of the EBRD. As a public bank which had begun operations in 1991 to promote transition to market economies, multiparty democracy and pluralism in the countries of the former Eastern Bloc, its greatest measure of success would be if it put itself out of business, with all countries 'graduating' from operations. Yet while several states have come far enough in the transition to join the EU, and the Czech Republic has officially graduated from being an EBRD recipient, after 20 years many of the EBRD's countries of operation are still far from being either market economies or functional multiparty democracies. While the EBRD's shareholders on one hand pressed for the bank to move east and south in order to put additional emphasis on these countries, some also began to ask broader questions about the EBRD's long-term role.

These questions were underlined by the Life in Transition survey published by the EBRD in 2007 – before the economic crisis hit the region - which included the alarming finding from 29,000 respondents across the region that trust in society had plummeted since 1989 and that only 30 per cent of people believe that their household lives better today than in 1989.[3]

The economic crisis then brought mixed fortunes for the EBRD: on one hand it gave the bank a new lease of life in central and eastern Europe as it churned out loans to prevent the collapse of the banking sector in the region, but on the other the highly liberalised type of market economics promoted by the bank took a severe knock. The crisis revealed the weaknesses in the under-regulated financial sector, and made clear the vulnerabilities of a market economy without adequately developed regulation by the state. Direct state intervention – quite at odds with the EBRD's preference for all things private - also made a comeback, with the nationalisation of certain banks, bailouts and public financing for infrastructure projects bringing home the message that ultimately many activities and risks can never be fully transferred to the private sector, as there are many areas of economic activity which are too important to be allowed by the state to fail. Thus, many of the underpinnings of the transition concept were brought into question: if there were serious failures in the West, where was the model that the transition would actually aim to lead to?

The EBRD has therefore in the last few years started to re-examine transition, as well as what had happened in the crisis and what the implications are for its work – a process which is still ongoing. Its indicators do not yet measure its impacts on democracy and the rule of law, and only measures very few elements of the sustainability of its projects.

At the same time, the bank is in the very early stages of exploring and trying to improve the impact of its activities on poverty reduction and gender – processes which we welcome but consider insufficiently developed as yet. A recent review by the UK Department for International Development agreed that the EBRD plays a “Limited role in direct delivery of the social MDGs“[4], partly because of its mandate, and that on gender issues, there is “Insufficient evidence of impact so far”. While it considered that the bank had shown some ability to act in fragile situations, “operating in fragile contexts is not its specific strength – and because few countries in the CEE region are categorised as fragile – lesson learning and experience in fragile states remains limited”.[5]

One of the sectors mentioned in relation to possible EBRD activities in North Africa has been lending to Micro, Small and Medium Enterprises. While we in principle welcome such activities if they support socially and environmentally sustainable activities and provide financing to those who need it most at reasonable rates,

2 The principles for European development activities enshrined in the Lisbon Treaty

3 EBRD: Life in Transition, May 2007 http://www.ebrd.com/pages/research/analysis/publications/transition.shtml

4 Millenium Development Goals

5 http://www.dfid.gov.uk/About-DFID/Who-we-work-with/Multilateral-agencies/Multilateral-Aid-Review-summary---European-Bank-for-Reconstruction-and-Development-EBRD/

currently the impacts of the EBRD's financial intermediary lending for small and medium enterprises are completely opaque to the public. Moreover one of the few tangible facts to emerge about the EBRD's lending to private banks in eastern Europe came in a recent report into the bank's crisis response from its own evaluation department: "some" of the EBRD credit lines for SMEs were not disbursed by the banks, and they "did not prevent the credit crunch, particularly for small businesses". While this took place in a crisis situation, and while the bank's systemic level role is acknowledged, it nevertheless raises questions about the impacts of the EBRD's financing on MSMEs.[6]

While we welcome these examinations by the bank of how it can improve its operations, we believe that **until the bank has a much clearer and more proven idea of how to promote a transition that does not only deliver a developed private sector, but also socially just and environmentally sustainable societies, it is extremely unwise to extend the scope of the EBRD's work, and particularly to move into a completely different region of the world**.

This is particularly the case with countries of North Africa, where the EBRD has no experience, and where two pressing issues are exactly those that the EBRD has only during the last two years begun to try to look at in detail: the impact of its operations on poverty and gender issues. While we very much welcome the bank's activities and efforts to improve in this area, **it cannot be concluded that the EBRD has sufficient expertise in poverty reduction and gender issues to venture into a new region where these problems are high on the agenda.**

Furthermore the EBRD's success in achieving its mission to support the transition to market economies and democracy varies greatly in the different countries where it operates. When discussing the bank's possible role in North Africa, it would be more relevant to consider EBRD's experience and contribution in still authoritarian states in the Caucasus and Central Asia, rather than with the progress made in Central European countries that joined the European Union. The economic reforms and liberalisation supported by the EBRD in resource rich countries, such as Azerbaijan, has translated in unsustainable dependence on commodities exports, but not in improved democracy, transparency and pluralism. Therefore it is doubtful that the EBRD is the right institution to address the needs for political and economic reforms in North Africa.

The EIB

The EIB has been lending in the Mediterranean Region[7] since 1979. In three decades the bank has delivered almost EUR 23 billion in the region of which 4.3 billion were lent in Tunisia and 5.6 in Egypt.

Since October 2002, the European Investment Bank's operations in the Mediterranean partner countries have been re-organized under the Facility for Euro-Mediterranean Investment and Partnership (FEMIP). The EIB regional office in Il Cairo was the Bank's first office outside the European Union. Two more external offices were subsequently opened in Tunis and Rabat. The FEMIP's governance includes a Ministerial meeting involving Euro-Mediterranean Finance Ministers to jointly define investment priorities in the area. According to the 2006 Council mandate - currently under review - *"the EIB should continue and consolidate its activities in the Mediterranean region, enhancing its focus on private sector development. In this respect, cooperation by partner countries to facilitate private sector development and encourage structural reform, in particular financial sector reform is needed, as well as other measures to facilitate EIB activities, in particular to ensure that the EIB can issue bonds in local markets".*

In its 2009 Activity Report the EIB wrote *"By increasing its volume of business to an unprecedented level of EUR 1.6bn in 2009, FEMIP confirmed to its Mediterranean partners its ability to help them modernise their public policies in the face of the global economic crisis and consolidated its position as the leading development investor in the Mediterranean"* and "*Since its creation in October 2002, FEMIP has provided more than EUR 10bn to support the modernisation of the Mediterranean partner countries and contribute*

6 http://www.ebrd.com/pages/about/what/evaluation/crisis.shtml

7 FEMIP operates in the nine Mediterranean partner countries that are also members of the Union for the Mediterranean: Algeria, Egypt, Gaza/West Bank, Israel, Jordan, Lebanon, Morocco, Syria and Tunisia. Following Turkey's elevation to the status of candidate for EU membership, the EIB's operations in this country were assigned to the South-East Europe Department, but Turkey continues to participate in the Euro-Mediterranean dialogue.

towards creating and safeguarding jobs in the region".

The European Union and its institutions have been continuously politically and economically supporting Mubarak's and Ben Alì's governments, with the aim of securing new markets for Europe and energy production and corridors in North Africa. As in many other countries, the North African economies have been evaluated only according to the growing GDP and no attention has been given to the internal distribution of wealth which was one of the main reasons for the people's revolts. Other reasons have included the corruption of the governments and the desire of freedom.

In Egypt between 2006 and 2010 the EIB lent EUR 1.85 billion, of which EUR 1.7 billion, or 92.58 percent was for energy. EUR 1.4 billion or 81.93 percent of the energy investments were for fossil fuels.

In the same period EUR 1.8 billion went to Tunisia, with 46% in the energy sector. Out of this EUR 185 million was invested into transporting gas to Italy.

Looking at these figures it is not clear whether and how the EIB has avoided contributing to the concentration of wealth among political elites in these countries. On the contrary it has helped to increase sectoral economic concentration and partly to secure energy to Europe.

Worryingly, the EIB has also recently made moves to promote Public-Private Partnerships in the Mediterranean.[8] These complex financing schemes have resulted in a number of overpriced projects and heavy budget burdens in several European countries and the economic crisis has caused several governments including the UK, Portugal and Hungary to review their PPP programmes. With such a mixed track record even in relatively wealthy and stable states it is hardly likely that such projects can be undertaken successfully any time soon in North Africa.

In reaction to the Egyptian and Tunisian uprisings the Parliament extended the EIB guarantee in the region of EUR 1bn, and the EIB speeded up the approval of projects currently under appraisal and proposed to invest up to 6 billion in the next three years. These measures have been taken without undertaking any critical review of previous operations and without legitimate elected governments as counterparts. In the case of Egypt the current political partner is a military junta and it is still not clear what will happen in the future.

The EU wants to support the democratic transition of Egypt and Tunisia, through the same recipe that contributed to consolidating previous undemocratic regimes: to pump money in and push economic liberalisation without having undertaken an evaluation of the financial operations backed in the last 30 years.

There is no debate about measures to be taken to ensure such funds do not end up in the wrong hands again and without this, the banks' primary impact may not be civic empowerment but rather taking advantage of the instability in the region to multiply business opportunities at all costs.

Conclusions and recommendations

It is premature to make commitments for EBRD and additional EIB financing for the Mediterranean region when it is by no means clear what kind of governments will follow the recently overthrown regimes of Ben Ali and Hosni Mubarak in Tunisia and Egypt. The EBRD has a mandate to work only in countries committed to multiparty democracy and pluralism, and it can in no way be ascertained that new governments in the Mediterranean region will fit this description. The EIB has not so far produced any evidence that its loans have actually benefited local populations and not corrupted leaders and businessmen even in more stable political circumstances. This casts serious doubt over the bank's capacity to suddenly perform better in the current climate of political uncertainty.

Therefore we call for:

• **An investigation** into the EIB's financing in the region so far, to examine whether the projects brought development impacts and whether the corrupt elites and their families benefited from the loans.
• **No expansion of EBRD activities** for the foreseeable future, at least until the bank has:
- gained more experience in poverty reduction and gender action and

8 See eg. http://www.eib.org/about/press/2011/2011-017-la-femip-lance-un-ambitieux-programme-dassistance-technique-pour-favoriser-le-recours-aux-ppp-dans-les-pays-partenaires-mediterraneens.htm

- demonstrated stronger commitment and ability to achieve an environmentally sustainable and socially just transition, eg. through increased transparency and public involvement in the development of its projects, and through introduction of robust social, environmental and development indicators for measuring the success of transition.

• **No increase of capital for EIB investments in North Africa** before having undertaken a careful review of its last decade investments.

• **Enhanced conditions and monitoring by the EIB and EC** are needed in order to improve the results of the EIB's current loans. These need to include conditions related to human rights, democracy, local access to resources, and sustainability, including company screening on their past record in labour and human rights.

• **A fundamental shift of the current EIB portfolio** toward social services and the genuine grassroots economy is needed.

• Any support for financial intermediaries should be restricted only 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 the specificity of local SMEs in each country. These must be screened to ensure their integrity and independence from the former regimes.

The EIB's operations are expanding into some of the EBRD's countries of operation, and now the EBRD's mandate is proposed to expand into countries where the EIB is already operating, and **it is becoming less and less clear what is the exact division of labour between these two banks.** Increasingly in the former Eastern Bloc region, they are investing in the same projects, which may lead to a duplication of efforts. Therefore:

• **a thorough review of the EIB and EBRD's functions and overlaps should be undertaken** before any expansion of the EIB and EBRD's operations, in order to clarify the future of the institutions and how they will work together without duplication of efforts.

• **Before concentrating on large-scale financial initiatives, what could help in the region is a credible grant-based EU political initiative able to support the development of democracy** through selected initiatives aimed at supporting freedom of expression, political pluralism, civil society, social services and any action aimed at re-balancing the distribution of wealth.

• In principle **the European Neighbourhood Policy Instrument** would be the most suitable existing instrument for financing in North Africa, due to its foundations in the principles of "*the rule of law, good governance, the respect for human rights, including minority rights, promotion of good neighbourly relations, and the principles of market economy and sustainable development*." However improvements in this Instrument are needed to ensure real public participation and to allocate equal importance to social and environmental aspects as to economic aspects. It is also necessary to ensure that the European Neighbourhood Policy's "positive conditionality" is conditioned on a measurable, time-specific list of AP indicators related to the development of democratic institutions, human rights protection and environmental sustainability.

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