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EIC Memo

Strengthening the future European Financial Architecture for Development (EFAD)

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EIC calls upon European policymakers to reinforce the EFAD toolbox with a well-capitalised EU Development Financing Institution

Policy Background

In October 2019, the **High-Level Group of Wise Persons (WPG)** published a report presenting fresh options to consolidate and streamline the **European Financial Architecture for Development (EFAD)**. That report suggested that **'maintaining the status quo is not an acceptable option for the future'** and instead called for the consolidation of European development finance and climate activities outside the EU into a single well-capitalised entity, referred to as **European Climate and Sustainable Development Bank (ECSDB)**, alongside the European Commission in its role of policy driver. On 05 December 20019, the **European Council requested a feasibility study** to explore the report in greater depth. Contrary to the originally proposed options, the feasibility study explores not only the options to associate the ECSDB with either the EBRD or the EIB, it also investigates an additional 'Business-As-Usual' option, labelled **'status-quo plus' or 'open architecture'**, with few extra bits of coordination.

EIC Key Recommendation

EIC observes an urgent need for the European Union to draw level with Asian and U.S. Development Finance Institutions, Exim Banks and policy banks, aid agencies, etc. in terms of both volume and management capacity for infrastructure and climate finance in third markets, and specifically in Africa. For the EU to improve its respective competitiveness it will be necessary to (1) **pool European development finance** and technical expertise for Africa's infrastructure sector; (2) to establish a complementary **EU financing institution with a broad mandate to provide competitive finance**, including all forms of Official Finance such as development and export finance linked to the "European interest"; and (3) to **streamline the project implementation cycle for EU-financed infrastructure**. Presently, European finance is fragmented across many institutions both on EU and Member States' levels operating under various mandates. This may be an advantage for small-scale investments in the social sectors, but it is a hindrance for structuring tailor-made EU financial offers for large-scale infrastructure projects globally. A **more streamlined and versatile financing institution on EU level, capable of combining European development and export finance** and thus of matching the performance of Asian and U.S. institutions, could **work alongside European DFIs and ECAs** and aggregate existing financial capacity and technical expertise.

EIC Arguments

The WPG report and the subsequent feasibility study raise the key question whether modifications in the institutional set-up of the European Financial Architecture for Development (EFAD) are inevitable to improve the overall performance of EU development cooperation or whether its efficiency and effectiveness can be maximised under the current institutional framework. **EIC considers that the preferred option to implement the 'Team Europe' approach on the financial level would be to establish the ECSDB based on the EIB or an EIB + subsidiary.**

<u>**EIB OPTION**</u> (recommended)

EIC is in favour of this option, but stresses some capacity building and strategic redirection needs:

- Compared to the second option of the report (the EBRD), the EIB has a vast experience with financing private sector projects (PPPs) in Europe. In line with the ambition to share knowledge, the EIB could replicate its model to LDCs. To this end, EIC however stresses that the EIB must improve its cooperation with private sector clients including commercial banks, ECAs and contractors and investment funds.
- With a track record of financing infrastructure, a re-enforced EIB would bring strategic autonomy and additionality in areas such as large private and public sector infrastructure financing, including sectors relevant to partner countries' development strategies in areas such as climate change, digitalization, energy, mobility and water.
- Building on its strong capability to leverage public sector actors and finance large infrastructure projects, the EIB can further act as Lead Financier in blended projects. However, EIC stresses the need to introduce Standard Procurement Documents into the EIB's tender practices.
- With desk offices located at EEAS delegations, the EIB has a direct link to EU institutions. The same applies to its experience of implementing a 'policy first' approach of various EU mandates and programmes under the lead of DG INPTA. It is therefore in a perfect position to consolidate the EU's economic diplomacy, effectively support climate action in developing countries, increase strategic EU visibility and ensure adherence and promotion of EU standards, policies and procedures.
- The required changes of the EIB's governance and ownership structure in the transition process from investment to development bank are already anticipated by the regulation on the NDICI. As regards its business model, the EIB needs to revise its risk structure with the goal to increase its risk appetite while improving the direct cooperation with private sector clients. The willingness to do so has been already assured.
- While EIC acknowledges that a decentralised business model would better suit for smaller projects, it appreciates the EIB's current set up of concluding larger infrastructure deals through centralised management.
- EIC agrees with the feasibility report that the EU needs to further enlarge its local presence and staff as well as to set up a pipeline of bankable projects.

STATUS QUO+ (not preferable)

This approach is based on the assumption that a competitive financing world would spur innovation, improve project quality and financing conditions – an assumption that EIC strongly contests:

- EIC is of the opinion that by continuing existing blending and silo financing, Europe would further lose control over project implementation and visibility. The IFI selected for tendering most of infrastructure projects in Africa is the AfDB, which has a track record of awarding projects to Chinese state-owned contractors.
- EIC stresses that already at this point, European DFIs are unable to finance large scale infrastructure projects on their own. A major disadvantage of the European model compared to e.g. Chinese Eximbank is the prolonged disbursement periods due to lengthy coordination procedures.
- The eligibility regulations of the EFSD+ and the NDICI opens EU financing to six different types of institutions which ought to compete against each other. EIC is concerned that such competition risks undermining the objective of the NDICI to simplify the European external financing architecture.
- EIC doubts that an open architecture with varying contact points, procurement methods and tender requirements would provide an attractive system for private investors.
- EIC observes that DFIs are increasingly competing around financially viable projects, excluding public infrastructure from the agenda. Such competitive process does not only negatively affect the operations of the private sector, but risks neglecting the actual needs of partner countries.
- The OECD recently assessed the DFI's official financing practices and concluded that European DFIs are still awarding larger contracts to their corporate national counterparts. While being rooted in part in the vetted cooperation with their national private sectors and its ability to respond to specific tender requirements, some European governments prescribe their DFIs to select projects that most benefit their national economies. EIC is worried that such open architecture would further accelerate national preference practices due to the very different mandates of the DFIs.

EBRD OPTION (not recommended)

This scenario faces several challenges beyond the significant costs associated with 'buying-out' EBRD's non-European shareholders. EIC does not recommend this scenario for the following reasons:

- From an institutional point of view, morphing the EBRD into a European Policy and Development Bank would face three substantial challenges, namely (1) a review on the EBRD's guarantee structure and the involvement of the EU Member States, (2) valuating the pricing of the EIB's external assets in the event of an EIB non-EU asset transferral and (3) the review of the EBRD's mandates to operate in countries that are not its shareholders, which is critical to guarantee the EBRD's creditor status.
- The third aspect presents a paradox as at the current set-up, the EBRD would need to include the ACP countries as shareholders which opposes the precondition of increasing Europe's shareholding to 100 %.

- The EBRD has little to no presence and experience with financing projects in LDCs and fragile states. Setting-up local capacities is not only a costly but also a time-consuming endeavour. It has to be added that with the EBRD enlarging its activities to Sub-Saharan Africa, the EU will create more tension, cooperation problems and competition between the already present institutions.
- While being regarded as a "European Bank", the EBRD has little to no knowledge in implementing EU mandates. It also lacks experience with blending finance and cooperation with other European DFIs on infrastructure projects.

EIC Conclusion

EIC stresses that the current discussion is too heavily focused on the inter-institutional and political "tug-war" and that it discards two essential components: Firstly, the role of private financiers and the architecture required to address their needs and concerns and secondly the necessity of institutional reform in light of the ever-increasing international competition. Europe should not waste another decade to arrive to the same conclusion: that it is in desperate need of an institution with the dual-mandate to pursue both the role of development financier and "guardian" of EU interests abroad.

Against this background, EIC clearly prefers a European Climate and Sustainable Development Bank based on the EIB, a bank which is aware of the current naivety of open procurement and is able to increase Europe's visibility and defend its strategic autonomy. To be fully effective, the EIB (or an EIB with a development subsidiary) has to enlarge its capacity to cooperate with private sector actors such as private investors, ECAs, commercial banks and investment funds. Public finance alone is not the solution.

Both maintaining the silo-financing of the current Status Quo and enlarging the geographic coverage of the EBRD to e.g. Africa would create further tension between already active development banks. The EU Commission and the Member States should question whether fuelling a system based on a few DFIs that act with different mandates and different national interests is in Europe's interest. For geo-strategic infrastructure financing and European international contractors it is certainly not.

About EIC

European International Contractors (EIC) is a European industry federation with the mandate to promote the interests of the European construction industry in relation to its international business activities. EIC has as its members national construction associations from fifteen European countries, to which the internationally active European contractors are affiliated, as well as several associated member companies from construction-related industries and professions. The annual turnover of internationally active European contractors associated with EIC's Member Federations outside their respective home countries amounts to some €170 billion representing an international market share of around 50%.