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REPORT FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT AND TO THE COUNCIL

On operations conducted under the External Lending Mandates of the EIB and future outlook

Review of regional outlook under the new EIB External Mandate 2007-2013

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COMMISSION STAFF WORKING PAPER

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1. INTRODUCTION

This Commission Staff Working Paper is an annex to the Report from the Commission to the European Parliament and the Council which is submitted in accordance with Article 2 of Council Decision 2000/24/EC adopted on 22 December 1999, as amended. The paper reviews the future outlook in the various regions of the mandate and analyses the orientations of the Bank's future activities in response to their differing needs, thus supporting the Commission's proposals for the new EIB external mandate.

2. REGIONAL OUTLOOK AND ORIENTATIONS

The new mandate will build upon the existing achievements of the Bank, broadening the geographical and sectoral focus of activity in line with the new political priorities of the EU. Foreseeable future needs and potential absorption capacities vary across the different regions. This section will analyse these regional variations and orientations of the Bank's future activities in response to these needs. Table 1 below compares the ceilings of the mandates during 2000-2006 and the ceilings proposed by the Commission for the period 2007-2013.

Table 1: Comparison of current and proposed EIB mandates

EU POLICY / MANDATE	2000-2006		2007-2013	
	€ bn	%	€ bn	%
Pre-accession				
Pre-accession countries	*10,2*	*49,5%*	*9,0*	*28,6%*
- of which pre-accession countries 2007-2013	5,2	25,2%		
Sub-total	**10,2**	**49,5%**	**9,0**	**28,6%**
Neighbourhood				
Mediterranean countries (*)	*6,5*	*31,6%*	*10,0*	*31,7%*
Eastern Europe, Southern Caucasus and Russia	*0,6*	*2,9%*	*5,0*	*15,9%*
Sub-total	**7,1**	**34,5%**	**15,0**	**47,6%**
Development Cooperation/Economic Cooperation				
Asia and Latin America				
Asia			*2,0*	*6,3%*
Latin America			*4,0*	*12,7%*
Sub-total	**2,5**	**12,0%**	**6,0**	**19,0%**
ACP - South Africa				
South Africa	*0,8*	*4,0%*	*1,5*	*4,8%*
Sub-total	**0,8**	**4,0%**	**1,5**	**4,8%**
Total regional mandates	**20,7**	**100,0%**	**31,5**	**100,0%**
Reserve mandate	**0,0**		**1,5**	
TOTAL	**20,7**		**33,0**	

(*) Following the restructuring of the mandates after the mid-term review of 2003, the ceiling for Mediterranean countries was de facto increased, since Turkey was excluded from the Mediterranean mandate and included in the South Eastern Neighbours' one.

The EUR 31.5 bn would represent in real terms a 7-year increase of around 16%[1] (or slightly more than 2% annually). As detailed in the following sections, the regional ceilings have been considered with regard to political EU priorities as well as absorption capacity perceived by the EIB.

It should be noted that, while the current mandates have a fragmented geographical coverage, the new mandate will offer global coverage, by supporting the three circles of the EU external policy (Pre-accession, Neighbourhood and Development Cooperation and Economic Cooperation). The level of the amounts devoted to the different regions will depend on the relative importance of such regions within the EU's external policy. The estimated allocation per capita implied by the proposed ceilings under the different mandates is as follows: Pre-Accession ± € 100; Neighbourhood and Partnership ± € 40; Development Cooperation and Economic Cooperation ± € 2.

2.1. Pre-Accession countries

The existing South-Eastern Neighbours mandate includes Acceding countries (Bulgaria and Romania), Candidate countries (Croatia, The former Yugoslav Republic of Macedonia and Turkey) and Potential candidate countries (Albania, Bosnia and Herzegovina, Montenegro, Serbia, including Kosovo). Romania (EUR 2.8 bn) and Turkey (EUR 3 bn) accounted for more than half of EIB lending under mandate in the region. Before the 2004 accession, 8 of the 10 new Member States were included under this mandate. Only EUR 0.6 bn was signed in new Member States under the mandate since the bulk of the operations in these countries were carried out without Community guarantee coverage under the Bank's Pre-Accession Facility, taking into account the relatively advanced stage of the pre-accession phase.

EIB lending activities in the region focused on projects in infrastructure sectors essential to stimulate economic activities and ensure the development of the Pan-European corridors crossing the region. Support to SMEs through global loans showed satisfactory results in terms of job creation and economic benefits. Following the earthquake of August 1999 in Turkey, the Bank, under the TERRA mandate, has addressed the rehabilitation or reconstruction of basic infrastructure in the region and has supported small businesses.

The EIB has co-financed 37% of its projects with the Commission and other institutions. There has been close cooperation with the EU budget, particularly through the ISPA and PHARE instruments and the European Agency for Reconstruction. Several projects have been co-financed with the World Bank in different sectors of activity, in particular energy and urban infrastructure. Cooperation with EBRD has been particularly successful, not only in terms of volume of co-financing but also in view of the mutual support in monitoring activities. In the Western Balkans, in particular, the close co-ordination between the EIB and the other IFIs, notably the World Bank and the EBRD, has been identified as a best practice.

In general the investment climate in the region is improving. It is predicted that demand for the financing of infrastructure projects in the Pre-Accession region will increase, as

[1] Figures deflated on the basis of the ENR International Construction Cost index.

will the need to support SMEs through global loans. As the countries in the region come closer to accession, investment demand will increase rapidly as outlined below. Conversely, progression towards accession will gradually reduce the need for the Community guarantee on loans as countries will become eligible for the EIB Pre-Accession facility. It should be noted however that the accession process for these countries is likely to take longer than that of the 10 new Member States and the anticipated accession of Bulgaria and Romania.

In particular the rapid growth of the Turkish economy, as well as recent demographic growth, makes it very likely that the need for infrastructure will also grow in parallel. The unbundling of the railway and the maritime sector will trigger a wave of fresh demand for upgraded infrastructure, particularly ports, ship building yards and railways, and especially after 2009, when Turkish authorities will be able to finalise the environmental and engineering studies for the prioritised projects under the TINA study. There is also a need for investment in Turkey in areas in which local banks are reluctant to lend, e.g. support for SMEs.

During recent years, the political and economic situation in the Western Balkans has been gradually stabilising. At the same time, the initially important grant support by the international community has been receding and the loans volume provided by IFIs has been increasing[2]. While the need for investment in infrastructure and SMEs is likely to remain high, investment demand in areas such as health and education is also likely to increase.

Weaknesses in the institutional framework and administrative, institutional and organisational bottlenecks have limited the absorption capacity of local markets in Pre-Accession countries. Nevertheless, these institutional and structural constraints are viewed as short to medium term problems and the EIB is seeking to support the local administrations so as to reduce their impact over time. On the other hand, increasing loan volumes in the region presents certain risks as public indebtedness in some Western Balkan countries is critical. Simply replacing grants by loans, and thus increasing borrowing substantially, would jeopardise the sustainability of public finances of these countries and therefore contradict IMF conditionality, unless proper concessionality could be achieved by combining EIB loans with EU budget funds.

As regards the future mandate, EIB financing in Pre-Accession countries should reflect the priorities established in the accession and European partnerships, the Stabilisation and Association agreements, and negotiations with the EU. The focus of EU action in the Western Balkans should continue to progressively shift from reconstruction to pre-accession support. In this context, EIB activity should also seek to encourage the institution building aspect, where relevant, in cooperation with other IFIs active in the region. While the EIB plans to progressively extend its own-risk operations in these regions, the availability of the Community guarantee is fundamental to ensure sustained activity, notably in countries which have not attained 'investment grade' status.

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2 While in 2001 grants from bilateral donors and from the EC accounted for 58% of the (non-security related) assistance to the Western Balkans of 3.6 bn €, its share is expected to decrease to 37% of expected total assistance of 3.2 bn. € in 2005. Conversely, the share of loans is expected to increase from 42% in 2000 to 63% in 2005.

In this context, the Commission proposes a ceiling of EUR 9 bn, which represents an increase of around 30% in real terms over the amounts forecast to be signed in (current) Pre-Accession countries between 2000 and 2006. The EIB indicative lending in 2007-2013 without Community guarantee would amount to around EUR 4 bn, which would bring total EIB resources dedicated to this region to EUR 13 bn in nominal terms.

2.2. Neighbourhood policy

2.2.1. Mediterranean countries

EIB activities in this region are currently carried out under the Facility for Euro-Mediterranean Investment and Partnership (FEMIP), which was endorsed in March 2002 by the European Council of Barcelona. In November 2003, the ECOFIN Council recommended to reinforce activities under FEMIP with a view to enhancing the EIB support of private sector development. Furthermore the Council decided that "*the incorporation of an EIB majority-owned subsidiary dedicated to the Mediterranean partner countries will be fully assessed in December 2006, on the basis of an evaluation of the reinforced Facility's performance, and taking into account the outcome of consultations with the Barcelona process partners*". The Commission, in close collaboration with the EIB, is currently carrying out a full evaluation of FEMIP which will be submitted to the Council in Autumn 2006.

The work of the EIB in this region is more labour intensive than in others under the mandate and the Bank has a dedicated staff in a "special business unit" charged with the management of a wide range of financial instruments, including loans, technical assistance and risk capital. Furthermore, three external offices were opened between 2003 and 2005 in Cairo, Tunis and Rabat, to help the EIB to identify new projects and to ensure coordination with local authorities, financial institutions and borrowers.

The primary objective of EIB activities in the Mediterranean region is the development of the private sector. Providing direct support to private sector has proved to be challenging. Other IFIs have faced similar challenges as evidenced by their low level of private sector activity in the region. This was mainly due to structural obstacles, such as the overall slow path of market sector reforms and the low level of Foreign Direct Investment (FDI) throughout the region, where only two countries (Tunisia and Israel) are currently rated investment grade. Public sector entities continued thus to be the main direct recipients of EIB lending, mainly for infrastructure projects enabling the development of the private sector. The Special FEMIP Envelope (SFE) was created, in order to cover riskier projects by allowing the Bank to undertake selected investments with a broader range of counterparts.

Despite these impediments, however, recent developments are more encouraging and prospects for the region have improved. At the conjunctural level, the region has benefited from favourable global economic and financial conditions, lifting growth in the region from 4.5% in 2004 to an estimated 5.5% and 5.6% for 2005 and 2006 respectively.

Without prejudice to the outcome of the FEMIP review requested by the Council, the EIB would seek to consolidate its operations in the Mediterranean region, with its focus on private sector development (including local companies and SMEs through global loans). Furthermore, support to structural reform projects should be implemented in close synergy with other donors and IFIs. In this context, the EIB should strengthen, through project-related terms and conditions, the development of sector reforms (e.g. tariff setting, improved management and framework conditions, etc.), in line with the policy objectives defined in the Country Strategy Papers and the Neighbourhood Action Plans wherever applicable. This will be supported by technical assistance operations funded by the EU or by Member States, which are increasingly forming part of the EIB project cycle in these countries.

The EIB should also consolidate its support to transport and energy networks of strategic EU interest, where possible involving private sector operators. The need for a significant increase in public sector lending is not apparent, taking into account European Neighbourhood Policy (ENP) goals related to the consolidation of public sector finances. A case in point is Egypt with a budget deficit of 5.9% where the IMF cautions against more public lending for projects which are not self-sustainable. Moreover, it should be noted that booming oil and gas prices have led the Algerian Government to reduce its borrowing and repay outstanding EIB loans ahead of schedule.

The EUR 10 bn ceiling proposed by the Commission represents a 16 % increase in real terms over the ceiling of the existing mandate. The EIB indicative lending in 2007-2013 without Community guarantee would amount to around EUR 2 bn, which would bring total EIB resources dedicated to this region to EUR 12 bn in nominal terms, which is in line with the indications given by Member States in 2003 on a reinforced FEMIP.

2.2.2. Eastern Europe, Southern Caucasus and Russia

So far, EIB activity in the Eastern Neighbours has been rather limited. However, from a political point of view, the progressive economic integration of all the countries covered by the ENP into the EU economy is one of the major objectives of the EU external policies in the coming years. Furthermore, the events at the beginning of 2006 between Russia, Moldova and Ukraine put energy security needs high on the political agenda of the Union, as evidenced by the Commission's Green Paper on "A European Strategy for Sustainable, Competitive and Secure Energy" issued in March 2006. ENP promotes integration with Europe’s energy market and helps to create the regulatory environment in which private sector investment in infrastructure can take place.

Support under the ENP includes the Southern Caucasus which should now be added to the EIB mandate. The EIB should also step up its activity in the other Eastern neighbours and Russia where it has had so far a limited mandate. The EIB will start operations in Moldova and the Southern Caucasus (and eventually Belarus) only when the Commission has confirmed the fulfilment of the necessary policy-related and macro-economic conditions.

There are currently constraints on the borrowing capacity of poorer indebted countries in the region and, while oil revenues are high, oil producers may feel less need to borrow. But there are huge infrastructure requirements across the region and major investment is needed in oil production and transport, as well as in communications links with the EU. Individual projects as they materialise are likely to be large and the EIB should be in a position to contribute to projects of EU interest in these fields and in support of the environment.

Therefore, the EIB should finance projects of significant interest to the EU in transport, energy, telecommunications and environmental infrastructure. Priority will be given to projects on extended major Trans European Network (TEN) axes, projects with cross-border implications for one or more Member States, and major projects favouring regional integration through increased connectivity. In the energy sector, strategic energy supply and energy transport projects are of particular importance.

In this context, a tripartite agreement, in the form of a MoU, between the Commission, the EIB and the EBRD, will set out cooperation patterns concerning operations in Eastern Europe, Southern Caucasus, Russia and Central Asia[3]. The modalities of cooperation envisaged in the tripartite agreement foresee intervention by the EIB and the EBRD in these regions with, in general, agreed 'joint offers' to borrowers, each of them bringing in most cases half of the financing. The final beneficiary would thus in general benefit from a blended package and pricing. A steering committee composed of high-level officials of the three institutions will oversee the application of the tripartite agreement. The EBRD would continue independently its support of projects outside the major infrastructure fields.

The close cooperation with the EBRD should help address potential absorption capacity problems in this region. In this context, the Commission also envisages providing appropriate support through the ENPI for project preparation or enhancement of the legal and regulatory framework. EIB operations are expected to increase progressively over the seven-year period.

2.3. Development Cooperation and Economic Cooperation

Under the ALA mandate, the Bank supports projects of "mutual interest", which involves notably investment in EU FDI, subsidiaries of European companies, joint ventures between EU and local firms, private enterprises holding public concessions and transfer of European technology. Some 80% of loans were made to private sector borrowers, particularly in support of European investors in the area. The pattern of activity to date has been broadly one third of lending in Asia and two thirds in Latin America, with Brazil and Argentina being the main beneficiaries (44% and 12% respectively).

EIB projects in ALA are financed within the broad framework of cooperation agreements and are complementary to the activities financed under specific Community assistance programmes. The latter focus on social sector and poverty alleviation programmes in poorer countries[4] while EIB focuses on economic cooperation in middle income countries. Two thirds of the EU budgetary support goes to Asia and one third to Latin America.

The EIB activity in South Africa is detailed in section 2.3.3 below.

[3] Central Asia belongs to the regions covered by the Development Cooperation and Economic Cooperation policy.

[4] A part of the EU budget was used for a similar mutual interest objective, notably through the Commission AL-Invest and Asia-Invest programmes.

2.3.1. Latin America

There is a high degree of complementarity between Commission budgetary actions in Latin America and EIB activity. EIB activity is greater in volume terms in middle-income countries such as Brazil and Mexico where Commission programmes are proportionately more reduced. By contrast, the Commission has strong programmes in areas such as Central America where EIB has traditionally been less active.

Under the new mandate, as well as supporting EU companies investing in the region, the EIB should also start financing investments in priority sectors central to EU policy in the region, such as environment and transport, energy and communications infrastructure projects favouring regional integration.

It is difficult to predict demand for financing over the period 2007-2013, but the indications are that EU FDI continues to be strong, and that interesting regional integration projects keep being prepared and will be proposed for financing over the coming years. Key markets for EU companies' investments are Brazil, Mexico, Argentina, Colombia and Peru. As regards regional integration projects, activity is expected to be high in Central America, e.g. the connections between Mexico and Guatemala and between Panama and Colombia , within the Andean region and its connections with Brazil, and South Cone regional projects. Concerning environmental projects, they are likely to be found in virtually all countries.

EIB activity in Latin America should be strengthened to provide meaningful support to EU action in these regions, notably taking into account the scarce budgetary resources available to the Commission. In these sectors, an enhanced coordination with the Commission, the regional IFIs and the EU bilateral institutions active in the region should be sought. The identification of a specific increased allocation as a "Latin America Facility" will largely improve the visibility of the financial support given to Latin America at a time when the EU is strongly stating its interest for this region. The proposed broadening of the scope of the mandate and the need to ensure a visible EU action are the key justifications for the increase of the ceiling up to EUR 4.0 bn, which represents some 12.7% of the total regional ceilings.

2.3.2. Asia

Surging net exports, strong investment, and accelerating consumption are expected to propel economic growth in the region in the coming years. Growth across the region is predicted at 6.6% for 2006 by the ADB, with GDP growth in China predicted to reach 9.2% this year. Such growth is expected to create a need for investment in infrastructure projects aimed at improving sub-regional integration and involving transport, power transmission and telecommunication backbones.

Furthermore, recent developments have created a need for investment in the environment sector. The Clean Development Mechanism (CDM), which was established under the 1997 Kyoto Protocol and came into effect on 16 February 2005, has created new business opportunities in greenhouse gas emission reduction projects in developing countries. Several types of CDM projects are developing and will develop further in Asia, in particular those aimed at displacing or reducing the use of fossil fuels as well as those seeking to introduce clean coal technologies, creating a high demand for investment.

The new EIB mandate will also cover countries of Central Asia, which are currently not covered under the existing mandate and which are nevertheless essential partners in the energy security strategy of the Union. This reflects the country coverage of the Development Cooperation and Economic Cooperation Instrument. EIB lending in Central Asia will be carried out in close cooperation with the EBRD, in line with the above-mentioned tripartite agreement (see section 2.2.2.) and will focus on major energy supply and energy transport projects with cross-border implications.

The proposed lending in Asia of EUR 2 bn over the period 2007-2013 represents some 6.3% of the total regional ceilings. The ceiling reflects a widened geographical scope to include Central Asia and a broadened sectoral scope to include notably environmental[5] and regional integration projects. The Bank should endeavour to also address the less prosperous countries in the Asia region and continue to support the EU presence in the region through FDI, transfer of technology and know how, and public and private partnerships, thus complementing the activities undertaken by the Commission through EU grants.

2.3.3. Republic of South Africa

EIB activities in South Africa have mainly focused on global loans channelled to the municipal sector and SMEs. Direct lending operations targeted major infrastructure projects in the energy, transport and water sector boosting economic activity in adjacent communities. The EIB has also assisted the Commission in the design and implementation of a dedicated EU-funded risk capital facility for South African SMEs.

South Africa's status as middle-income country (about 2800 USD GNI per capita in 2003) hides huge disparities in wealth, revenues and access to basic infrastructure. These can only be overcome through stronger sustainable GDP growth of at least 6% p.a. and a continuation of the Government's Black Economic Empowerment policy. This will require important investments, notably in infrastructure, and the supply of adequate financial resources to finance them.

The new mandate will focus on infrastructure of public interest (including municipal infrastructure, power and water supply) and private sector support, including SMEs. The implementation of the provisions on economic cooperation under the EU-South Africa Trade and Development Cooperation Agreement will further promote EIB activities in this region. In view of the above prospects, the Commission proposes to increase the ceiling for South Africa up to EUR 1.5 bn. Furthermore, the Commission intends to put in place a follow-up risk capital facility with the assistance of the EIB.

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[5] Since EU companies have a leading role and technological advantage in most of the environment-related disciplines, it is expected that a sizeable part of EIB financing of environmental projects in Asia will also result in support to EU companies.