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The Future of European Development Banking

What Role and Place for the European Investment Bank?

Benedikt Erforth

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Bonn, March 2020 Benedikt Erforth

Keywords: development finance, private sector financing, EU budget, European Investment Bank, Africa, migration, climate change

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Abbreviations

ACP	African, Caribbean and Pacific Group of States
AFD	Agence Française de Développement
BMZ	Bundesministerium für wirtschaftliche Zusammenarbeit und Entwicklung/German Ministry for Economic Cooperation and Development
bn	billion
CSIS	Center for Strategic and International Studies
CSO	civil society organisations
DB	development bank
DFI	development finance institution
EBRD	European Bank for Reconstruction and Development
EC	European Commission
ECOFIN	Economic and Financial Affairs Council
EDFI	Association of bilateral European Development Finance Institutions
EFA	European Free Alliance Group (in European Parliament)
EFSD	European Fund for Sustainable Development
EFSI	European Fund for Sustainable Investment
EIB	European Investment Bank
EIP	External Investment Plan
EU	European Union
EUR	euro
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IFI	International financial institution
KfW	Kreditanstalt für Wiederaufbau
LDC	least-developed country
LIC	low-income country
LMIC	lower middle-income country
MDB	multilateral development bank
MFF	Multiannual Financial Framework
NDICI	Neighbourhood, Development and International Cooperation Instrument
OCT	Overseas Countries and Territories
ODI	Overseas Development Institute
OECD	Organisation for Economic Co-operation and Development
PPP	public-private partnership
SDG	Sustainable Development Goal
SME	small and medium-sized entreprise
TFEU	Treaty on the Functioning of the European Union

UMIC	upper middle-income country
UNCDF	United Nations Capital Development Fund
USD	United States dollar
WPG	High-level Group of Wise Persons

Executive summary

The European Investment Bank (EIB) is not only the bank of the European Union (EU), it is also the world's largest multilateral lender. Hitherto rarely at the centre of public attention, the ongoing negotiations on the next EU budget round – the Multiannual Financial Framework (MFF) 2021-2027 – have placed the EIB in the midst of the political struggles over form and function of the European development finance architecture.

As part of the deliberations on the MFF 2021-2027, the European Commission (EC) is proposing to reform its external financial architecture. With the Neighbourhood, Development and International Cooperation Instrument (NDICI) (EC [European Commission], 2018a), the Commission is seeking to overhaul a multi-layered and fragmented external financial architecture and to integrate the eleven existing instruments into one. At the origin of the EC's proposal lies the desire to develop a flexible, consistent, and simplified system (EC, 2018b). Geopolitical interests and considerations about aid effectiveness and impact are the main drivers behind this reform proposal. The debate centres on the allocation of funds and more importantly on the question of "how to do" development finance in the future. The substantive debate on development effectiveness and impact thereby also morphs into an institutional question, with different stakeholders advancing distinct preferences.

Against this backdrop, this Discussion Paper takes stock of the European development finance landscape and the EIB's role as part of that landscape. It looks at the interactions between various different European development stakeholders and assesses the proposed reform and its potential impact on European development policy. With the EIB at the heart of the European financial architecture, this paper seeks to answer three sets of questions:

- What is the EIB's role in the European development landscape and how does it respond to its operational environment?
- What is the EIB's institutional relationship with other EU actors and what are the main challenges and points of divergence?
- What are the competing visions for the future of European development finance and what role will the EIB be able to play in the different scenarios that are currently being discussed?

To respond to the task of assessing the European development finance architecture, the paper first describes the changing environment within which development finance institutes and development banks act. Here, the growing importance of the private sector as the most notable change to the operational environment stands out.

Building on these first observations, the second part examines the external operations of European development finance institutions, with a special focus on the EIB's lending practices in Africa. As a priority region for European development finance where changes to the current system will be most visible and are likely to cause the greatest impact, the continent constitutes a crucial case study for the future direction of European development finance.

The paper's third part turns to the drivers behind the proposed reform. In so doing it offers insights into the institutional "black box" of European development finance. This section

argues that, after revisiting the various different scenarios for the creation of a European Climate and Sustainable Development Bank, the EIB is expected to take the uncontested lead on climate financing, yet would face considerable challenges if it sought to become the EU's premier development bank.

Taken together, the three parts portray a situation, in which European stakeholders agree on the substance and priorities of financing for development, yet disagree on institutional grounds. Core goals, including an increased impact and better visibility of European development finance, need to be better defined.

For the purpose of an improved system that works for both the EU and its partners, the current debate needs to go beyond the institutional rivalries and instead focus more on how the institutional set-up can be adjusted to respond to the most pressing development challenges in partner countries.

Proposals for reform should be more closely aligned with questions of content rather than chiefly serving institutional interests. In particular, the deliberations should not focus primarily on the quantity of investments, while taking into account that the opportunities for investment are already limited in some partner countries. Thus another criterion should be: Which scenario is best placed to mobilise private-sector actors, and which arrangement is best suited to creating a favourable investment climate together with the EU's partners? As far as the partners are concerned, swift implementation and efficiency considerations will play an especially important role alongside social rights and climate change mitigation. Inconsistencies in content must also be avoided in order to preserve the EU's credibility. Going beyond this, a strong EU body would be required to coordinate matters with the national development finance institutions (DFIs) and development banks in order to harness their expertise for innovative project proposals. A well-coordinated, evidence-based EU strategy would enhance the visibility and effectiveness of Europe's development finance architecture. An impact assessment and accompanying research by a group of think tanks, as endorsed by the ECOFIN Council (Economic and Financial Affairs Council), could make a fundamental contribution in this regard. In addition, the comparative advantages of EU development policy should also be highlighted in the international debate through a consistent narrative that showcases the benefits of European development finance. This would allow Europe, with its socioeconomic model, to position itself more clearly in the international cooperation arena.

1 Introduction

Climate change, migration, poverty conflicts and demographic challenges in the EU's southern neighbourhood are steady preoccupations of decision-makers in Brussels and beyond (EC, 2018b). These developments coincide with a continuous stagnation in official development aid over the past years, showing the limits of what public allocations can achieve in an unstable world. Together – and in light of the annual investment gap for development of USD 2.5 trillion – these factors have induced a fundamental shift in the way development cooperation is framed today. The adoption of the Addis Ababa Action Agenda in 2015 institutionalised the popular narrative of private sector solutions for sustainable development. The signatories agreed that private sector investments are to compensate for the lack of public funds necessary to achieve the Sustainable Development Goals (SDGs). To incentivise private sector investments, national, international, and supranational actors alike rely on an increasingly complex web of financial instruments that are aimed at mitigating private risks and creating an environment conducive to sustainable investments, innovation, and entrepreneurship.

In the wake of these changes, national and international development finance institutions (DFIs) and development banks have gained new prominence.[1] They are increasingly seen as foreign policy instruments and useful tools to not only help address development challenges but also defend geostrategic interests in the world. The EU counts fifteen national DFIs and four bilateral development banks (see Annex table 1) but most prominently is home to its very own investment bank. The European Investment Bank (EIB), also known as the bank of the EU, is the world's largest multilateral lender – ranking before the World Bank Group (IBRD (International Bank for Reconstruction and Development) and IDA (International Development Association) and managing ten times as many assets as the London-based European Bank for Reconstruction and Development (EBRD). The bulk of the bank's operations concentrate on Europe itself. Yet, even the comparatively small share of extra-European operations makes the EIB rank among the key actors of European development finance.

Considering the bank's total balance sheet of EUR 556 billion,[2] surprisingly little has been written about the activities of the EIB, a publicly owned international financial institution (Robinson, 2009) which is central not only to fostering cohesion between different regions and sectors in the EU but also to implementing the EU's climate mitigation and part of the EU's development cooperation policies. As the "EU bank", the EIB is not only at the centre of the European development finance architecture but also shapes the outlook and output of the European development finance system.

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1 The Centre for Strategic and International Studies (CSIS) and the Overseas Development Institute (ODI) define development finance institutions as "government-backed institutions that invest in private-sector projects in low- and middle-income countries" (Savoy, Carter, & Lemma, 2016, p. v). Development banks, on the other hand, "are specifically designed to achieve development outcomes through the use of a blend of loans, guarantees, grants, and technical assistance. In particular, they remain a large source of public-sector finance for low- and middle-income countries" (Savoy et al., 2016, p. 5). However, as development banks and aid agencies increasingly concentrate on private sector development, this distinction does not always hold.

2 The figure refers to the situation on 31 December 2018 as reported by the EIB.

Against the backdrop of the rising salience of migration and climate change in public discourse, the EIB has become increasingly political by framing itself as a "climate bank" and by expanding its operations on the African continent. The EIB was the first bank to launch Green Bonds and most recently responded to a call by Commission President Ursula von der Leyen to "turn parts of the European Investment Bank into Europe's climate bank" (von der Leyen, 2019, p. 6). National DFIs and bilateral development banks contest the EIB's prerogative as the bank of the EU, rather seeing themselves as co-equals within a diversified, multi-stakeholder system. Similar to the Commission's Directorate-General for International Cooperation and Development (DG DEVCO), they fear a disproportionate centralisation and monopolisation on the part of the EIB, which in the case of the former, boils down to concerns about the access to EU resources. Other development players maintain the bank lacks the necessary experience and exposure to be implementing developmental goals. Civil society organisations (CSOs) and advocacy groups including Bankwatch, Concord, Counter Balance, and Oxfam have voiced criticism toward the bank and its investment strategies. They condemn the insufficient transparency of the bank's operations, the lack of proper human rights impact assessments in its external operations, as well as a continuous commitment to fossil fuel investments[3] (Roggenbuck, Antonowicz-Cyglicka, & Sol, 2018).

The small academic community that scrutinises the bank's structure and operations follows an eclectic approach when analysing the Luxembourg-based institution (Clifton, Díaz-Fuentes, & Gómez Peña, 2018; Griffith-Jones, Steinherr, & De Lima, 2006; Honohan, 1995; Langan, 2014; Licari, 1969; Liebe & Howarth, 2019; Mertens & Thiemann, 2019; Robinson, 2009). Clifton, Díaz-Fuentes and Gómez Peña (2018, p. 734), for instance, "analyze […] EIB lending to its Member States from the start of operations in 1958 up to the fourth enlargement in 1995" and assess to what extent EIB lending reflects the bank's original objectives of "development, integration and investment". Liebe and Howarth (2019) focus on public-private partnerships and underline the EIB's policy-making role, classifying it as a policy entrepreneur. Mertens and Thiemann (2019, p. 23), on the other hand, argue that the EIB has become an instrument to "increase the investment firepower of the European Union". Notwithstanding this diversity, only a small number of studies have looked at the bank's external operations (Griffith-Jones, Tyson & Calice, 2011; Uyvari, 2017) – mostly in conjunction with other international finance institutions – and no detailed attempts have been made to understand the EIB's role as part of the European external financial architecture.

The negotiations of the next EU budget offer a unique opportunity and compelling rationale to advance our understanding of the EIB as part of the European development finance architecture. In conjunction with the EIB's policy drive and ambition to become the EU's Climate and Sustainable Development Bank, an investigation of the world's largest multilateral lender will also shed light on the European landscape of public finance institutions. The analysis is informed by three sets of questions:

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3 On 14 November 2019, the EIB's board of directors agreed to phase out all fossil fuel lending by the end of 2021, meeting a central demand voiced by environmental groups and others; see also https://www.devex.com/news/eib-to-end-fossil-fuel-lending-by-2022-95974.

- What is the EIB's role in the European development landscape and how does it respond to its operational environment?
- What is the EIB's institutional relationship with other EU actors and what are the main challenges and points of divergence?
- What are the competing visions for the future of European development finance and what role will the EIB be able to play in the different scenarios that are currently being discussed?

To respond to the task of assessing the European development finance landscape, the paper first describes the changing environment within which DFIs act, citing the growing importance of the private sector as the most notable shift at the structural level. Building on these observations, the second part examines the EIB's lending practices in Africa. As a priority region for European development finance where changes to the current system will be most visible and are likely to have the greatest impact, the continent constitutes a crucial case study for the future direction of European development cooperation. The paper's third part turns to the drivers behind the current EU reform proposals. In so doing, it offers insights into the institutional "black box" of EU development finance. Revisiting the different scenarios for the creation of a European Climate and Sustainable Development Bank, I argue that, while the EIB can be expected to take the uncontested lead on climate financing, it is unlikely to emerge as the EU's premier development bank.

Although all actors agree that the EU's external financial architecture should be simpler, more visible and more efficient (EC, 2018a), EU development financing is plagued by conflicting interests and often sees institutional concerns prioritised over substantive matters. Institutional interests and substantive issues need to be better aligned if development financing is to be made more efficient and more sustainable. In particular, a reformed external financial architecture has to do more to reconcile European sustainability and development goals with the needs of partners. The definition of "partner" should not be limited to the state but must also include sub-sovereign entities and private actors. Given the importance of private capital for development finance, a reformed financial architecture should understand the interests and rationales of the private sector and help align them with the common good.

This paper draws on public documents, investment and aid statistics, and semi-structured interviews with stakeholders at the European Commission, the European Parliament, the EIB, the MFF NDICI Council Working Group, the EBRD, the AFD (Agence Française de Développement), the KfW (Kreditanstalt für Wiederaufbau), EDFI (Association of bilateral European Development Finance Institutions), civil society organisations, and other finance professionals (for a full list of interviews, see Annex table 2).

2 Private sector investments for development

The debate on the future of European development banking is embedded in the broader context of financing for development, which increasingly focuses on the role of private sector investments, public-private partnerships, and the intermediary and market-making role of DFIs (Jeune, 2019). According to figures published by the ODI (Overseas Development Institute) and CSIS (Center for Strategic and International Studies), "total annual commitments by all DFIs have grown from USD 10 billion [in 2002] to around USD

70 billion in 2014 – an increase of 600 per cent" (Savoy et al., 2016, p. v). Within the EU, this global trend towards more private sector support was further enhanced by the implementation of the Investment Plan for Europe and the attached European Fund for Strategic Investment (EFSI) both of which considered development banks as central to a policy whose ultimate goal it is to create economic stability and growth by mobilising private investments at a large scale in and outside of the Union (Mertens & Thiemann, 2019, p. 24). The principles of EFSI were applied to the External Investment Plan (EIP) and its backbone, the European Fund for Sustainable Investment (EFSD), both being established in 2017. Ramping up its development finance power constitutes for the EU a means to contribute to the Sustainable Development Goals (SDGs) and to project and defend economic and geopolitical interests globally. This last point has gained additional traction in light of the creation of the New Development Bank in 2014 and the Asian Infrastructure Bank in 2015, both of which are based in China – in Shanghai and Beijing respectively – and are seen by European policymakers as tools in the service of China's global expansion (WPG [Wise Persons Group], 2019, p. 10).

2.1 The rise of blended finance and other donor-private sector partnerships

Facing an "estimated shortfall of USD 2.5 trillion per year in development investment" (European Investment Bank, 2019a, p. 6), public donors have been increasingly eyeing towards private actors to provide the necessary investments to boost economies and develop specific sectors. In line with the Addis Ababa Action Agenda and its aspiration to "unlock the transformative potential of people and the private sector" (Addis Ababa Action Agenda, 2015, §5), private sector engagement re-emerged as the new panacea – if not for all ills, at least for achieving the SDGs. The World Bank Group and the EIB are among those having spearheaded the narrative of the private sector approach to development and agree in unison that financing for development must be aligned with the liberal market logic.

The concept of "blended finance" was derived from this discourse. Blended finance refers to the use of official development assistance (ODA) to leverage public and private investments and, as such, is central to the EU's international cooperation policy.[4] Blended finance can take different shapes and comes alternatively in form of guarantees, limiting investors' risk exposure, interest rate subsidies or as technical assistance in support of specific projects.

By shifting investors' perceptions of "risks versus potential returns, blending is viewed as a means of tapping into new resources" (Lundsgaarde, 2017, p. 5). Next to its promise to leverage additional investments with a limited amount of public funds, blending is also cherished for improving the quality of financed projects by allowing for a knowledge exchange between development actors and investors. In addition, blending may further the coordination between large DFIs (both national and multilateral) and EU institutions (Lundsgaarde, 2017). Greater coherence among European DFIs in turn is hoped to increase

4 "Blended finance is the strategic use of development finance for the mobilisation of additional finance towards sustainable development in developing countries" (OECD [Organisation for Economic Co-operation and Development], n.d.). In the context of the EU, blending is defined as a mechanism that combines "EU grants with loans or equity from public and private financiers"; see also https://ec.europa.eu/europeaid/policies/innovative-financial-instruments-blending_en. For a detailed discussion on blended finance, see Lundsgaarde (2017) and Bilal and Krätke (2013).

the visibility of European action. In particular, in light of China and other external actors' rising – and rivalling – activism and its growing investments in Africa, the EU is inclined to view a coherent development finance system as part of a broader toolbox to support sustainable development in Africa and defend European stewardship in the international system.[5]

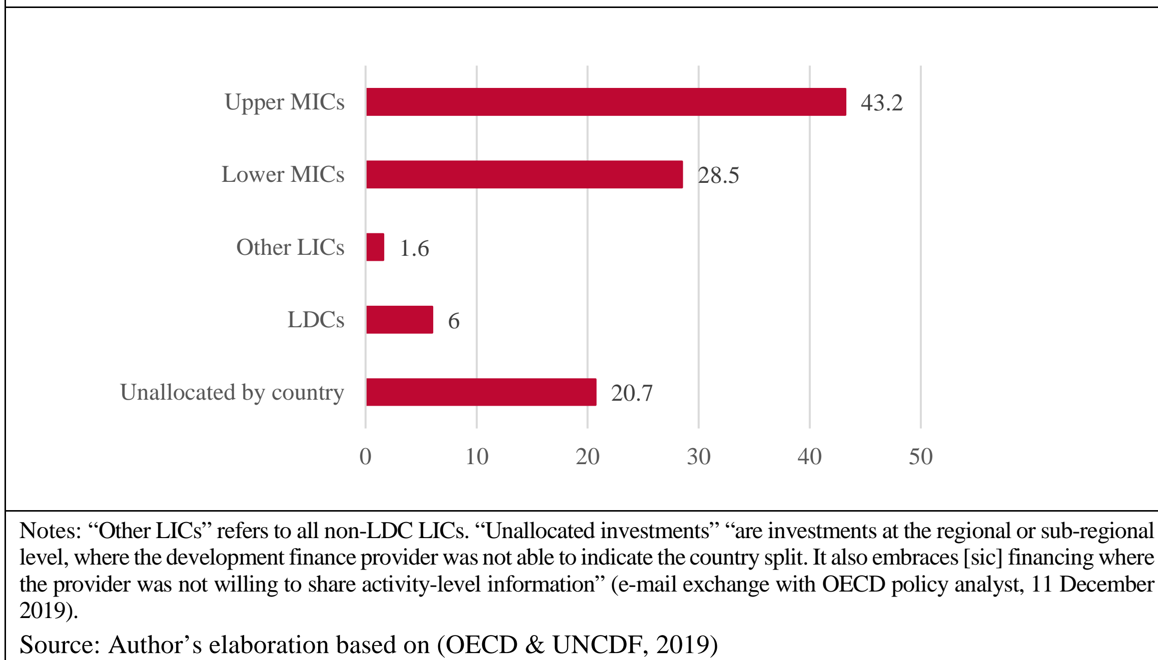
As such, the topic of blending raises two sets of questions: i) What impact/leveraging effects do blending mechanisms have? And ii) What is/ought to be the role of the state and public institutions in the area of development finance? Critics maintain that existing blending operations do not come near to reaching the promised leveraging effect, and point to trade-offs between blending and other "development-oriented interventions that could have been funded with the same resources" (Lundsgaarde, 2017, p. 11). This point is critical, not only from an aid effectiveness perspective, but also when considering the EU's geopolitical aspirations that have gained new prominence since Ursula von der Leyen assumed office at the head of the EU Commission.

There is also increasing research suggesting that prospects for the amount of investment leveraged by ODA have been overstated. A recent ODI report finds that "for every USD 1 of MDB [multilateral development bank] and DFI resources invested, private finance mobilised amounts to just USD 0.37 in LICs [low-income countries], USD 1.06 in lower middle-income countries (LMICs) and USD 0.65 in upper middle-income countries (UMICs)" (Attridge & Engen, 2019, p. 11). On average, each dollar of public finance mobilises USD 0.75 of private resources. The ODI report (2019, p. 11) concludes that the donor community's expectations in blended finance are highly unrealistic and that "billions to billions" is a more plausible scenario than the promised "billions to trillions" effect. The ODI's conclusion that blending particularly fails LICs finds support in a joint OECD-UNCDF study, which states that between 2012 and 2017 least-developed countries (LDCs)[6] only received 6 per cent or USD 9.3 billion of private finance mobilised through blending (OECD [Organisation for Economic Co-operation and Development] & UNCDF [United Nations Capital Development Fund], 2019, p. 10). These figures, although aggregated at the global level, stand in stark contrast to the EU's own projections regarding the potential leverage effect of the European Fund for Sustainable Development (EFSD). For example, the EFSD Guarantee alone (see next section), which currently stands at EUR 1.54 billion, is expected to mobilise "EUR 17.5 billion in investment, much of it from private sources" (EC, 2019, p. 2). This projection assumes a leverage factor of 11, and thus by far exceeds the factor of 0.75 that the ODI report found to be applicable for blending operations. Eventually, any of above numerical values remain approximations and should be interpreted with caution.

5 For a nuanced discussion of Chinese foreign aid, see Cheng (2019).

6 "Least-developed countries (LDCs)" are "low-income countries confronting severe structural impediments to sustainable development"; see https://www.un.org/development/desa/dpad/least-developed-country-category.html.

Figure 1: Private finance for development in per cent of total flows (USD 153.9 billion), 2012-2017



Notes: "Other LICs" refers to all non-LDC LICs. "Unallocated investments" "are investments at the regional or sub-regional level, where the development finance provider was not able to indicate the country split. It also embraces [sic] financing where the provider was not willing to share activity-level information" (e-mail exchange with OECD policy analyst, 11 December 2019).

Source: Author's elaboration based on (OECD & UNCDF, 2019)

The discussions on potential impact are complemented by the more fundamental question of the role of the state: How much responsibility for the provision of public goods can be outsourced to profit-seeking private sector entities? This line of questioning is particularly popular among civil society organisations, which doubt that the needs of people living in poverty and the "corporate bottom line" can be squared (Cohen, 2019). For instance, Oxfam expresses concerns over a large share of ODA becoming "dedicated to de-risking assets, creating a specific type of enabling environment for the private sector that may not fit to the local context" (Jeune, 2019, p. 5) and even eroding aid and development effectiveness principles and social and environmental standards (Jeune, 2019, p. 7). Related to this is the risk that finance, when following market trends, enters and exits countries and sectors without regard to the long-term effects and country needs. Lastly, pundits cite market distortions and the crowding out of private finance as possible negative effects of blended finance (Blomeyer, Paulo, & Perreau, 2017, p. 40).[7]

Notwithstanding these concerns, the EU continues to embrace blending as one of the principal means to tackle the SDG financing gap and to address the root causes of migration (EC, 2018a; European Parliament, 2016). While admitting that blending is not applicable to all sectors and environments and stressing that the concept of *additionality*[8] needs to be

7 Opinions differ on this point. As some investment professionals argue, rather than being the cause of any market distortion, DFIs play an important stabilising role through their continuous and long-term investments (Interview 2, CEO, Ethos Investments, South Africa, 18 September 2019).

8 "Financial additionality refers to situations where finance is mobilized and an investment is made that would not have materialized otherwise, while development additionality refers to the outcome and impact of the investment that goes beyond what would have been achieved in the absence of additional finance (e.g. poverty reduction, job creation, greater gender and income equality, environmental protection etc.)" (Jeune, 2019, p. 21; OECD, 2018). DFI guidelines define "additionality" as the blending of concessional and non-concessional finance (Winckler Andersen et al., 2019, pp. 15-16). The EU defines "additionality" as the blending of loans and grant money.

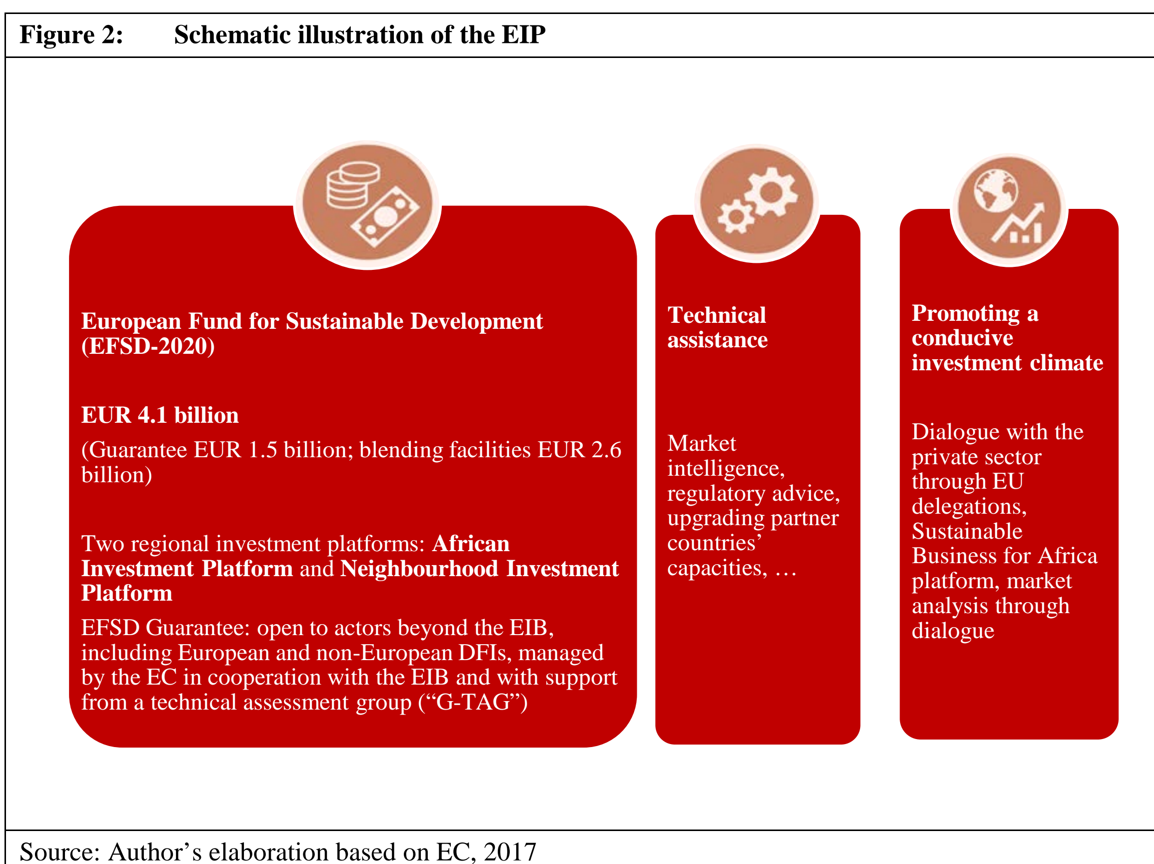
monitored more carefully, officials within DG DEVCO defend the concept of blending as the most suited instrument with which to develop a climate-neutral economy, create small and medium-sized enterprises (SMEs), and foster public-private partnerships (PPPs) – all of which are deemed essential to combating poverty.[9]

2.2 The EU's continuous commitment to the private sector

The launch of the External Investment Plan (EIP) in 2017, modelled in accordance with the Investment Plan for Europe (also known as the Juncker Plan), showcases the EU's strong commitment to blending by integrating the various different blending platforms that exist. The EIP's centrepiece and budgetary backbone is the EFSD. The EFSD innovated the idea of blending by establishing a guarantee mechanism enabling "counterpart organisations to mobilise investments in riskier areas, in particular in fragile and low-income settings" (Lundsgaarde, 2017, p. 1). This mechanism is currently being revised and is expected to remerge on a larger scale as part of the next external budget.

Resting on three pillars – the financial pillar (EFSD), the technical assistance pillar, and the investment climate pillar – the EIP seeks to promote private sector development in Africa and the European neighbourhood (see Figure 2). The EFSD pillar has received the greatest attention so far, with the other two pillars fulfilling auxiliary roles.

Figure 2: Schematic illustration of the EIP



Source: Author's elaboration based on EC, 2017

9 Interview 3, Senior Official, DG DEVCO, 2 August 2019.

The design of the EIP mirrors the importance that the EU attributes to combining various funding sources in order to "respond to the increasingly complex challenges in the world" (EC, 2018b, p. 1). The EIP and its EFSD component are designed to function in support of the EU's overall external policies, which recognise that "public and private investment are vital drivers of sustainable development, that private investment can complement public expenditure, and that businesses can be partners in sustainable development" (EC, 2018b, p. 3). Next to the achievement of the SDGs and the implementation of the Paris Agreement on Climate Change, the EU's financial commitments beyond its borders have increasingly focussed on addressing the root causes of (irregular) migration (EC, 2017). This policy assumes that, through public sector guarantees, the EU will incite the private sector to service entrepreneurs that have been denied access to financial services and thus create a resilient business environment that fosters job creation and eventually reduces the economic push factors of migration (EC, 2019, p. 6). In support of these policies, the EFSD is endowed with a capital base of EUR 4.1 billion for the period 2017 to 2020, which is expected to leverage EUR 44 billion in investments (Angenendt, Biehler, Kipp, & Meier, 2019, p. 19). Here again, the EU is rather optimistic not only as regards the expected outcomes of this policy but also as regards the leverage ratio that underlies this projection.

The establishment of the EFSD has also induced an increased competition among public DFIs. The EFSD regulation identifies six categories of counterpart organisations that are eligible to apply for EU guarantees, reducing the EIB's monopoly position in this field (Lundsgaarde, 2017, p. 15). The competition between DFIs for European guarantees is likely to increase under the next MFF. Lastly, the Commission's – and in particular DG DEVCO's – quest to consolidate its role as the manager and coordinator of EU external investments, has been trialled with the EFSD regulation (Lundsgaarde, 2017, p. 16) and informs both the current reform proposal and the ongoing negotiations.

Most importantly, the EIP and the EFSD serve as blueprints for the design of similar instruments to be integrated into the Commission's proposal for the future Neighbourhood, Development and International Cooperation Instrument (NDICI). As a consequence, EU guarantees to mobilise private investments will continue to play an important role over the next budgetary cycle. Rather than subsidising interest rates of existing loans, the EU plans to shift its focus on de-risking instruments in order to attract both public and private investors.

The NDICI proposal not only embraces private sector involvement but seeks to scale-up the volume of blending operations and other forms of PPPs. The new instrument is supposed to benefit from a new External Action Guarantee[10] of up to EUR 60 billion and an expanded EFSD, which goes by the moniker EFSD+ (EC, 2018b) and is expected to mobilise an estimated EUR 500 billion in investments for the period 2021-2027.

The impact of these additional resources remains uncertain. Even if the EU succeeds in mobilising EUR 500 billion in investments, it is not guaranteed that these funds will be put to good use. Practitioners working for investment management firms and DFIs maintain that the availability of resources would not be the most pressing problem. Instead, the availability of *good projects* is seen as the principal constraint in practice (Savoy et al.,

10 The Guarantee Fund for External Action "backs loans and loan guarantees granted to non-EU countries or granted for the purpose of financing projects in non EU countries" (European Parliament 2018, p. 2). Its financial management is entrusted to the EIB, allowing the bank to operate in high-risk environments whilst sheltering the EIB's strong credit rating from additional risk.

2016, p. 15). The development finance community is confronted with the paradoxical situation where a tremendous annual financing gap and a limited number of bankable projects coexist. If bankable projects are scarce, an increased competition between DFIs, as envisioned by the Commission, can yield negative effects in partner countries.

The absence of functioning business environments in which banking operations can be conducted and returns stand in proportion to risks is the principal impediment for investments in many developing countries.[11] It thus requires more than public guarantees to stimulate private investments. Technical assistance and the promotion of a conducive investment climate, currently relegated to the second and third pillars of the EIP, deserve additional attention.[12] As one finance professional put it: "You cannot tell capital where to go."[13] However, it *is* possible to prepare the ground for capital to follow. In other words, the emphasis that is currently being put on the leveraging of capital would have to shift in favour of a policy that addresses structural conditions first.[14]

The European institutions that are most actively involved in co-framing and implementing the EU's blending strategies are the "EIB and the EBRD at the EU level, and the Agence Française de Développement (AFD) and the [Kreditanstalt für Wiederaufbau] KfW at the national level", with the EIB taking a particularly prominent role in this area (Bilal & Große-Puppendahl, 2016, p. 11) (see Table 1).

Table 1: Comparison of key figures for the EIB, AFD, KfW and EBRD (data correct as of 2018)

	EIB	**AFD**	**KfW**	**EBRD**
AAA rating	Yes	No	Yes	Yes
Funds pledged in 2018	EUR 64.19bn	EUR 11.4bn	EUR 75.5bn	EUR 9.5bn
Of which: **- outside the EU** **- in Africa**	EUR 8.1bn EUR 3.3bn	EUR 11.4bn EUR 5.3bn	EUR 10.6bn[a] EUR 5.21bn	EUR 6.7 bn EUR 1.4bn
Employees[b]	2,900	2,650	6,376	2,600
Branch offices	50 (27 outside the EU)	66 (outside the EU)	63 (outside the EU)	53 (39 outside the EU)

Notes:
bn: billion
[a] Total funds pledged by KfW Development Bank and DEG for 2018.
[b] All employees of the banking group, not just those primarily working in the development sector.
Source: Author's compilation, data from the individual institutions

Thereby the different development institutions interact with each other, both as partners and competitors. For instance, they partner through joint initiatives such as the mutual reliance initiative, which facilitates cooperation between the EIB, the AFD, and the KfW, whilst

11 Interview 2, CEO, Ethos Investments, South Africa, 18 September 2019. Interview 4, Senior Programme Manager, EDFI, 11 September 2019.

12 Interview 5, Mandate Officer, EIB, 6 September 2019.

13 Conference remarks by Josien Sluijs, Director, NpM, Platform for Inclusive Finance at the conference The Role of the Private Sector in Economic Integration of Refugees, organised by the Confederation of Danish Industry, the EIB, and the World Bank in Paris, 11-12 June 2019.

14 Interview 4, Senior Programme Manager, EDFI, 11 September 2019.

simultaneously advancing rather different visions as to how an effective European financial system should be structured.

The next section analyses existing efficiency and coordination problems in relation to the EIB's lending practices in Africa.

3 Cooperation with Africa: a priority for European development finance

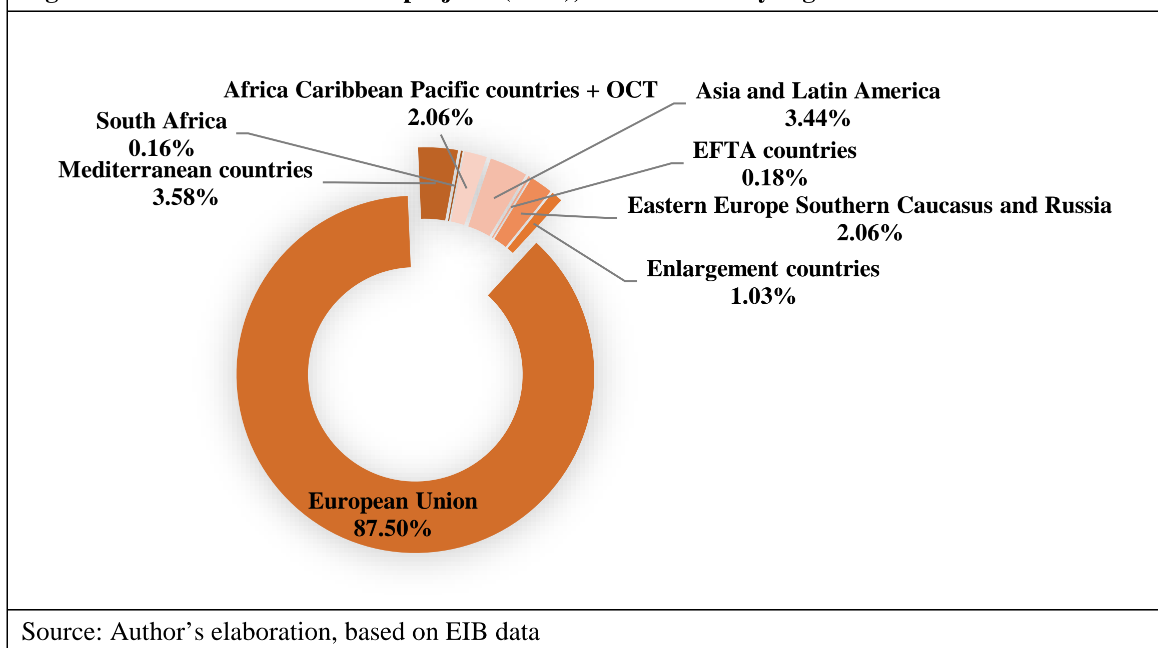
The story of the EIB is also a story of growth. What had begun with a workforce of 66 people and annual lending of the equivalent of EUR 34 million in 1959 has turned into an institution with nearly 3,000 staff that approved loans amounting to over EUR 62 billion in 2018. With this growth came an increased expertise, improved efficiency, and the aspiration to steer policies rather than just implementing them. Present in Africa since 1963, the EIB has invested the record sum of EUR 3.3 billion in support of the continent's private sector and infrastructure, including clean energy, transport and water investment in 2018. Out of these EUR 3.3 billion, projects totalling EUR 1.55 billion were signed with countries in Sub-Saharan Africa (EIB [European Investment Bank], 2019a). These achievements have reinforced the bank's conception of itself as the EU's development bank.

3.1 The evolving footprint of the EIB

The current debate on the EIB's role among EU development financers can only be understood against its historical backdrop. Despite being present in Africa since the 1960s, the bank's operations outside Europe are unbeknownst to most. This is mainly due to the fact that the EIB's external mandate – in relative terms – remained marginal over the last two decades or so, accounting for roughly 10 per cent of the EIB's overall activities. In 2019, 87.5 per cent of all EIB operations occurred within the EU (see Figure 3).[15]

15 The EIB's expansion over the past years has been mainly driven by internal developments, structural changes (notably the 2008-2010 economic crisis and the additional need for capital in the aftermath of that crisis, the creation of the European Fund for Sustainable Investment) and new regulatory settings (Interview 6, Senior Policy Advisor, EIB, 9 July 2019). Articles 308 and 309 of the TFEU, which form the legal basis of the EIB, do not evoke external operations at all. The attached Protocol (No. 5) on the Statute of the European Investment Bank mentions, but does not prioritise, external lending practices. The bank's external operations are laid out in Article 209 TFEU, which refers to the bank as the implementing institution of EU development cooperation, and Article 16 of Protocol No. 5, which specifies the decisional procedure required for the bank to lend outside the territories of the Member States.

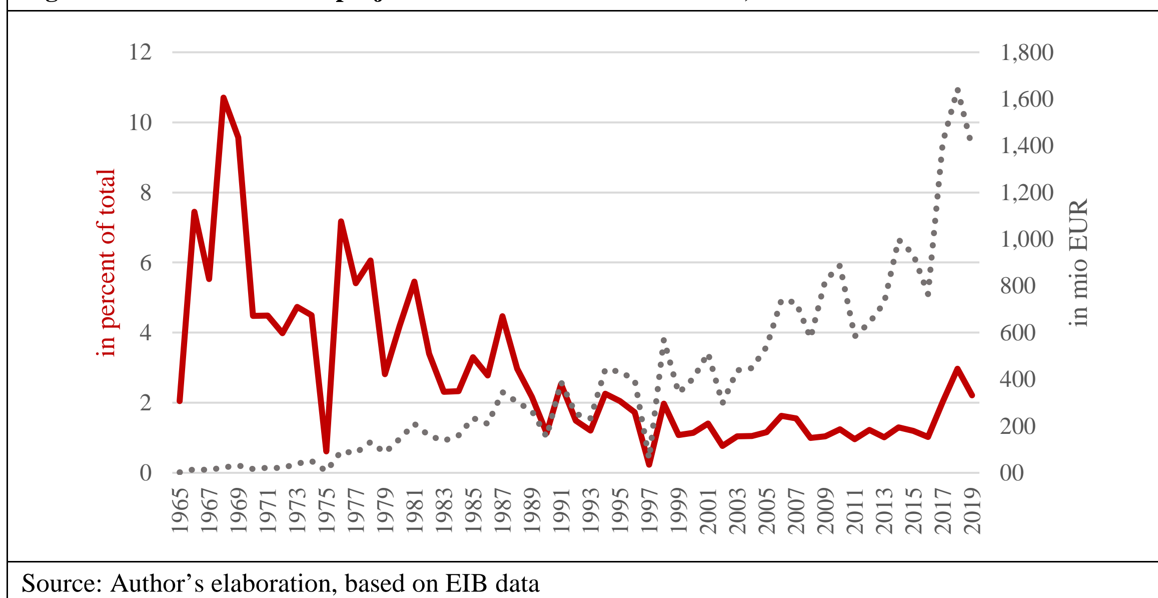
Figure 3: Total EIB-financed projects (2019), broken down by region



Source: Author's elaboration, based on EIB data

This image of the EIB being mainly a bank for Europe was further reinforced by the fact that the bank's lending activities in the ACP (African, Caribbean and Pacific Group of States) and the EU's Overseas Countries and Territories (OCTs) as a share of the total EIB operations declined substantially between 1968 and 2018 (see Figure 4). As its portfolio grew, the bank increasingly concentrated on the core of its mandate, which tasks the EIB to contributing "to the balanced and steady development of the internal market in the interest of the Union" (TFEU (Treaty on the Functioning of the European Union), n. d., Article 308).

Figure 4: EIB-financed projects in ACP and OCT countries, 1964 to 2019

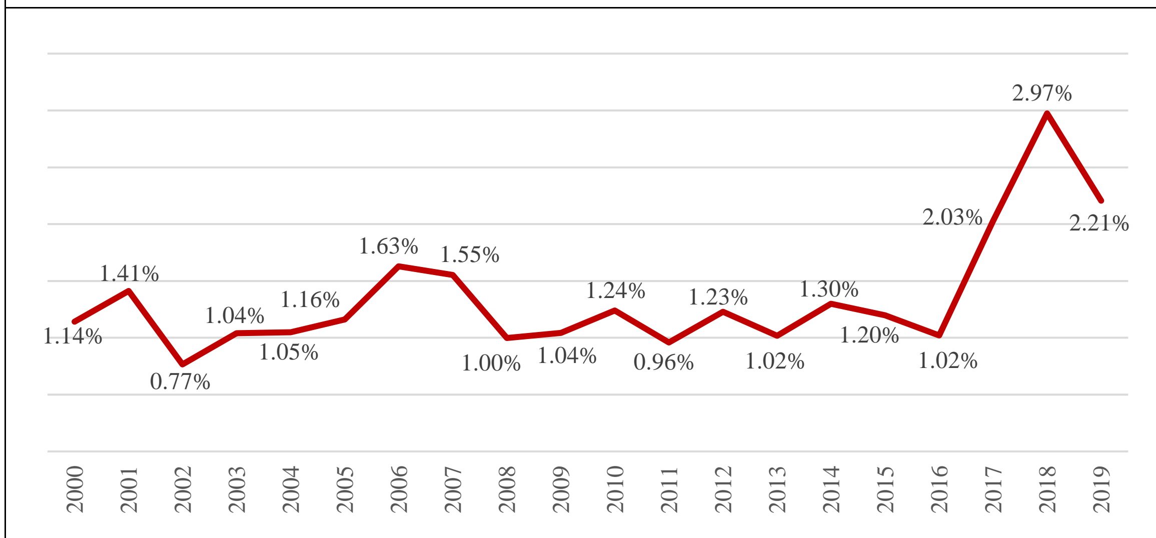


Source: Author's elaboration, based on EIB data

This political and financial marginalisation of the ACP and OCT regions in the EIB's portfolio has been reversed only recently. Between 2002 and 2016, the ACP and OCT regions accounted for approximately 1 per cent of the EIB's total operations. This figure has tripled since 2016, reaching 2.97 per cent in 2018. Over the same period, the ACP and

OCT's share of the external lending operations increased from 10 per cent to 22 per cent. This steep increase in lending to the ACP region is also the result of the EU's desire "to address some of the socio-economic root causes of migration" in African countries of origin (EC, 2019, p. 6), a policy the EIB helps to implement by its changing investment strategy.

Figure 5: Share of EIB-financed projects in the ACP and OCT regions over the course of the Cotonou mandate, 2000-2019



Source: Author's elaboration, based on data provided by the EIB

Facing an increase in numbers of migrants and asylum seekers to Europe, the EU Member States requested that the bank step up its operations in the MENA region and in Sub-Saharan Africa. The bank responded to this call by adopting a three-fold strategy: First, the EIB set aside a special envelope under the ACP Investment Facility that would allow it to engage in high-risk and pre-bankable operations in Sub-Saharan Africa. Operations backed by this revolving fund are expected to have a greater developmental impact than conventional lending operations. They are divided into assistance to financial intermediaries, the provision of money to venture capital funds, infrastructure programmes, or direct loans through, for example, micro-finance funds. Second, the bank launched the economic resilience initiative for the MENA region. The economic resilience initiative is looking to build stronger infrastructure and to simultaneously support private sector development with a particular focus on the financial sector, making it more resilient to economic shocks.[16] Lastly, the bank has begun to match its activities more closely with the policies pursued by the Commission and the EEAS, leading to an ever closer alignment between EIB activities and the EU's policy preferences.[17] Over the course of the next seven years, the EIB plans to double its investments on the African continent hoping to mobilise EUR100 billion in investments (EIB, 2019b, p. 5).

In its 2018 report on banking in Africa, the EIB emphasises the continent's difficult economic environment, against the backdrop of which it deems an increased role of public banks necessary. Sub-Saharan Africa is slowly recovering from "the most severe growth slowdown in two decades" (EIB, 2018, p. 1) and the region's growth – despite being positive

16 Interview 7, Senior Banker, EIB, 26 July 2019.

17 Interview 7, Senior Banker, EIB, 26 July 2019.

– is insufficient to reduce poverty. Non-performing loans are on the rise and public debt risks crowding out private credit, which in turn will further reduce investments and therefore hinder growth (EIB, 2018). The EIB is not alone in ramping up its operations in Africa. Rather, its actions are reflective of a general trend among DFIs, most of which allow for Sub-Saharan Africa to take centre stage in their global strategies (Savoy et al., 2016).

3.2 Private sector development in Africa

The private sector narrative dominates the EIB's activities in Africa. Since 2006, around two-thirds of the EIB's lending to the ACP region, "has been geared towards private sector operations" (European Parliament, 2016). Griffith-Jones, Tyson and Calice (2011, p. 5), describe financial support to SMEs within and outside the European Union as "one of the key core objectives of the EIB group". As EIB Vice-President Ambroise Fayolle states, "Our overarching priorities for the ACP regions are to develop the private sector and to create conditions that will improve vital infrastructure, address climate action and promote regional integration" (EIB, 2019a, p. 7). The strategy that Fayolle outlines combines the bank's traditional focus on large-scale infrastructure development with private sector development in order to address a global structural problem and a regional priority. This constitutes a first fundamental transformation in the lending practices of the "EU bank", which used to concentrate on large-scale infrastructure projects. The bank's reorientation in its external operations mimics a shift that previously had occurred in the EIB's intra-European lending in the 1990s. In his discussion on the state of the EIB in the mid-1990s, Honohan (1995) identified both the shift away from sovereign to sub-sovereign lending and the attempt by the EIB to increase its participation in the area of risk finance.

One could argue that a change in mind-set is occurring within the bank, aligning the EIB and the Commission's DG DEVCO. Anne af Ursin, Chair of the ACP Investment Facility Committee, has observed first signs of such a changing mentality. According to af Ursin, the bank is steadily moving toward a developmental logic:

> I just think that over the past five years, the perspectives have been quite different. Now we have the Impact Financing Envelope, which is a new development. There seems to be a lot more intermediated lending, and SMEs have become a real area for emphasis. (EIB, 2019a, p. 31)

While the bank's investment strategy has shifted, its risk culture has essentially remained unaltered. When investing in the ACP region, the risk involved is mostly shouldered not by the bank itself but by the ACP Investment Facility, which guarantees first losses. In total, EUR 814 million of the EUR 1,572 million signed with the region in 2018 came from the Investment Facility and another EUR 110 million from the Impact Financing Envelope,[18] thus reducing the EIB's risk exposure to a third of the total lending (EIB, 2019a, p. 14).

This built-in security net chimes in with the EIB's preference for financial prudence, which makes the bank reject the idea that the readiness to accept high risk can be used as a proxy for developmental impact. A certain degree of risk aversion and the aspiration to maintain a

18 The Impact Financing Envelope is a separate window of the Investment Facility tailored to undertake high-risk private sector operations with a potentially greater impact.

portfolio of healthy loans are framed by the EIB as an indicator of sustainable finance that in the long run will produce better results with regards to job creation and poverty reduction.[19]

While the EIB prioritises financial sustainability, DG DEVCO puts its own emphasis on developmental sustainability. This is where DG DEVCO's development mentality and the EIB's banking mentality clash.[20] However, the increasing commitment by the European Commission (EC) and the Member States to private sector solutions and a business approach to development can help close this gap. In 2014, the Commission adopted a Communication on "A Stronger Role of the Private Sector in Achieving Inclusive and Sustainable Growth in Developing Countries", paving the way for a narrative that sees private stakeholders as an engine for a sustainable and inclusive green economy and their ability to create decent jobs as the "best way out of poverty" (EC, 2014, p. 2). Today, private sector engagement clearly lies at the heart of the EU's development agenda.

The active role of the EIB in championing private sector solutions becomes crucial to our understanding of the drivers of European development finance. This is especially true since the EFSD Guarantee was not established following any private sector demands but emerged from within the European development finance system (Lundsgaarde, 2017, p. 18). By consequence, the impact that specific institutions like the EIB have on the form and format of the EFSD is more prominent than would be the case if the EFSD were a market-driven project. Today, the idea of attracting private sector investors through blending mechanisms is firmly rooted within the EU institutional landscape. This institutional embeddedness influences the way blending is understood and framed at the risk of producing a partial argument. For instance, the EIP's strategic board comprises representatives of the governments of the EU, the European Commission, the EU High Representative, and the European Investment Bank. Neither partner countries nor private sector actors are included in the decision-making or implementation of an agenda, which describes SMEs and local needs as the key drivers of economic growth (Griffith-Jones et al., 2011, p. 8).

The EIB has not only become more active in Africa but is also one of the main drivers behind the increasingly popular private sector narrative. In combination, these two developments suggest that the EIB is interested in taking on a central role within a reformed development landscape. Various public declarations by EIB president Werner Hoyer point in this direction. However, when looking at the institutional dynamics and the ongoing debates between the EIB, the EBRD and others, it is clear that a series of challenges stand in the way of an EIB subsidiary becoming the new European development bank. In order to substantiate this claim and to assess the challenges and opportunities for the future European development finance architecture, the following section engages with the institutional dimension of European development finance outlining the possibilities for cooperation as well as the prevailing divisions between the various different development finance stakeholders. The section assesses in more detail the different options for the creation of a European Climate and Sustainable Development bank.

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19 Interview 8, Senior Advisor, German Federal Ministry for Economic Cooperation and Development, 17 July 2019; Interview 6, Senior Policy Advisor, EIB, 9 July 2019; Interview 7, Senior Banker, EIB, 26 July 2019.

20 Interview 6, Senior Policy Advisor, EIB, 9 July 2019.

4 The institutional landscape: the EIB and the others

As part of the ongoing budget negotiations for the period 2021 to 2027, the Commission has called for better coordination in the short term and a reconfiguration of the European development finance architecture in the medium term, with the aim of deploying the existing resources in a more effective way and of establishing a flexible, consistent, and simplified system (EC, 2018a, 2018b). Geopolitical interests join considerations about aid effectiveness and impact as drivers of the proposed reform. Against this backdrop, the European Commission (EC) proposed a regulation for a Neighbourhood, Development and International Cooperation Instrument (NDICI) in June 2018 (EC, 2018a).

Various plans regarding the new institutional set-up have been evoked, ranging from a fusion of the EIB with the EBRD to the creation of a new development subsidiary that would be "in charge of development activities outside of the EU" (Council of the European Union, 2019a, p. 4). Given the technical nature of the negotiations and the divergence of opinions, the Council, on proposition of France and Germany, has called upon a high-level group of Wise Persons (WPG) for advice. The group published its report in October 2019. Building on the "Camdessus Report" that was issued in 2010 (WPG, 2010), the WPG assessed the role of individual stakeholders and the system as a whole. Next to a series of short-term recommendations, their report evokes three options for a European Climate and Sustainable Development Bank (for a summary of the proposed short-term and long-term recommendations, see Annex table 3). The report argues that for European development finance to be fit for the purpose "there should be one single institution in the medium term as the European actor outside of the EU for climate and development financing" (WPG, 2019, p. 29). Besides a new mixed ownership bank with the EIB and the EC as majority shareholders and the EBRD, European Development Finance Institutes (EDFIs), countries of operation, and other International Finance Institutes (IFIs) as minority shareholders (Scenario 1) (WPG, 2019), the report also ponders on extending the EBRD's mandate (Scenario 2) or creating an EIB subsidiary (Scenario 3) (see Figure 7).

Changes to the existing set-up would also determine the EIB's external lending mandates and, by extension, provoke a reconfiguration of the entire European development finance architecture. Any institutional reform, by consequence, would affect matters of content. Therefore, institutional and content-related interests need to be aligned if development financing is to be made more efficient and more sustainable. In particular, a reformed architecture for the EU's external financing has to do more to reconcile European sustainability and development goals with the needs of partners (Kaplan & Erforth, 2019).

The restructuration of the European development finance architecture brings to light the highly political dimension of the work of development finance institutions and development banks. As any other institution, they too are interested in their own survival and in defending, respectively, obtaining power and resources.

The current debate – when looked at from a principal-agent perspective – also reveals that the EU Commission is well aware of the knowledge gap and the danger of agency "slack" by the EIB. Institutions acquire sector and country expertise that grants them autonomy in their operations but also invests them with knowledge, which in turn influences the policy-making process. Principal-agent theory demonstrates how this knowledge can be employed to the detriment of the principal's capacities to control the process. Doubtlessly, any policy

that goes through the hands of an agent will, to some extent, be informed by this agent's preferences (Kiewiet & McCubbins, 1991, p. 5). Autonomy and discretion are often considered to be the price to be paid in a trade-off that promises to increase political efficiency (Kassim & Menon, 2003, p. 125).

Despite being public institutions, development finance institutions and development banks are generally not supposed to engage in policy-making (Savoy et al., 2016, p. 23). In reality, the distinction between apolitical implementing agency and policy-making body cannot always be made. For instance, EIB president Hoyer describes the EIB as a political instrument serving a political purpose (Toplensky & Barker, 2019). Hereby "political purpose" not only refers to a normative agenda defined by Brussels but also includes the EIB's own interests and understanding of how to conduct development finance.

The EIB faces multiple principals and a series of partners and competitors with diverging interests. The interest divergence between principals plays in the EIB's favour. Disagreements among Member States increase the bank's leeway. Moreover, close and direct relations with the Council and the Member States' finance ministers allow the EIB to object to unwanted proposals that may emerge from the Commission or Parliament.[21] At the same time, disagreements between the principals and among different DFIs also undermine the efficiency and visibility of the European development finance system as a whole.

4.1 Policy-maker and policy-taker: the European Commission and the EIB

As the bank of the EU governed by Article 308 of the TFEU, the EIB is primarily accountable to the Member States. Not only are they the bank's shareholders, they also are responsible for the upholding or amending of the Statute of the Bank (Art. 308 TFEU). According to the corresponding treaties, the EIB is to contribute to the implementation of "the measures necessary for the implementation of development cooperation policy" (Art. 209.1 and Art. 209.3, TFEU). Conceptualised as a policy-taker, the EIB has established itself as a quasi-policy-maker in its areas of expertise. The bank's quest for more leeway regarding the political dimension of its operations has irritated the Commission, where DG DEVCO is in "charge of development policy in a wider framework of international cooperation", responsible for "formulating the European Union development cooperation policy, leading the MFF exercise in the field of external action, and implementing the EU's external financing" (EC, 2018c, p. 3) .

The conflict between the EIB and the Commission has been smouldering for some time making the issues a central point in the design of the EFSD in 2017.[22]

> The main area of controversy in terms of inter-institutional relations was the division of responsibilities between the EIB and the European Commission, with both entities

21 Interview 1, Senior Programme Officer, national development bank, 7 August 2019.

22 In its reply to an earlier European Court of Auditors report, the Commission stated in 2014: "The Commission administers the facilities while the development finance institutions are responsible for the daily management of the projects. They implement the budget tasks that have been entrusted to them, in compliance with the rules of the indirect management mode laid down in the Financial Regulation" (European Court of Auditors, 2014, p. 36).

> seeking to have overarching control of the fund. In establishing the fund, this question was resolved in favour of the Commission, which will benefit from additional staffing capacity to support a stronger role in managing innovative financing and private-sector development. (Lundsgaarde, 2017, p. 19)

Yet, the establishment of the fund did not ease the strained relations between the guardian of the treaties and the bank of the EU. Instead, the Commission's NDICI proposal in 2018 brought to the fore the persisting question of the distribution and allocation of responsibilities between the two institutions. Stressing its prerogative to steer policies, the Commission is seeking to regain control over the European development finance system. By changing the system and redefining the scope of autonomy and discretion of its agent (the EIB) ex-ante*,* the Commission exerts what McCubbins, Noll and Wingast (1987) call the most efficient form of control. This approach is driven by the belief that coherence will strengthen the European development finance system. However, it should be noted that an overly restrictive act of delegation infringes upon the agent's efficiency, in which case the very act of delegation can become superfluous.

In its NDICI proposal of June 2018, the Commission initially did not reserve any exclusive mandates for the EIB, which the bank uses for its operations outside the EU (EC, 2018a). The Commission moved away from the present format, in which the EIB manages the External Lending Mandate and the ACP Investment Facility for the EU, and confronted the bank with a situation that could put into peril its entire external operations. According to Commission officials, the idea was not to bereave the EIB of its mandates; rather the Commission refrained from identifying specific operational windows in order to review the existing instruments and the EIB's performance during the course of the negotiations on the NDICI proposal.[23]

In April 2019, the EC and the EIB reached an agreement that proposed exclusive mandates totalling EUR 30 billion to the EIB (see Figure 6) (Council of the European Union, 2019a). Both the procedure and the resulting agreement demonstrate the Commission's desire to establish its position as the policy lead of the new external instrument and to exercise stricter control over the EIB's operations. The result is a political choice, mainly informed by institutional preferences. As such, the proposed framework risks undermining the general objective of NDICI – creating a simplified external financial architecture. In the scenario that resulted from the compromise between the EIB and the Commission, the EIB would have both access to exclusive mandates and be part of the EFSD+ open architecture, where it would have to compete with national DFIs and potentially multilateral counterparts for financial support. While this compromise seems to have appeased the two institutions, it has led to cool reactions from other DFIs. They deem the framework not only unnecessarily complicated but also contest the fact that the EIB can engage in commercial sub-sovereign operations both on its own terms – unbeknownst to others – and as a competitor within the EFSD+ open architecture.[24] For the EIB itself, the open architecture remains a suboptimal solution,[25] as the bank still finds itself in increasing competition with national DFIs. These national actors not only benefit from exclusive mandates of their respective governments but some of them even outperform the EIB in terms of both regional expertise and lean

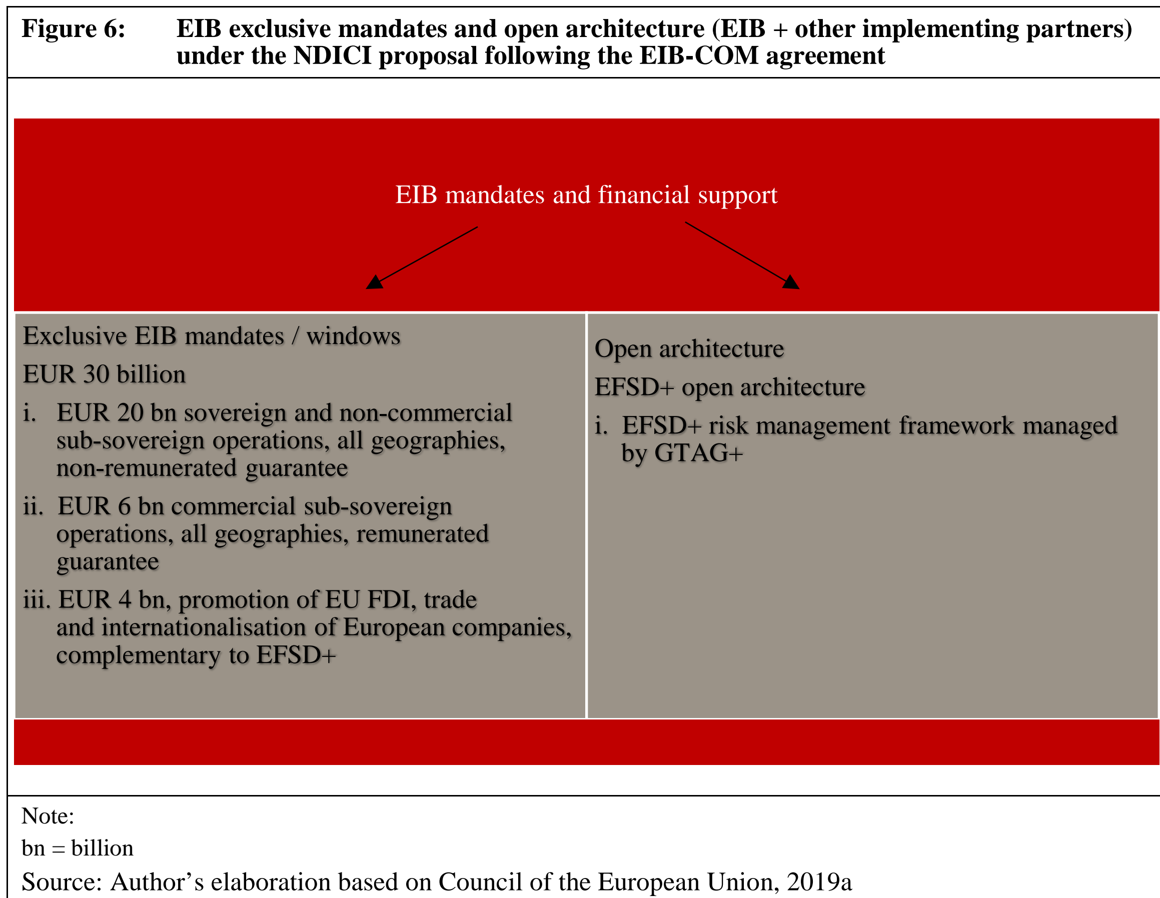
23 Interview 3, Senior Official, DG DEVCO, 2 August 2019.

24 Interview 1, Senior Programme Officer, national development bank, 7 August 2019.

25 Interview 3, Senior Official, DG DEVCO, 2 August 2019.

bureaucratic structures, making them more attractive partners to investment funds and financial intermediaries working with SMEs and mid-Caps.

Figure 6: EIB exclusive mandates and open architecture (EIB + other implementing partners) under the NDICI proposal following the EIB-COM agreement



Note:
bn = billion
Source: Author's elaboration based on Council of the European Union, 2019a

Overall, the Commission has initiated a reconfiguration of the development finance landscape, which distributes both funds and responsibilities among the existing stakeholders more equally. By inciting increased levels of competition, the Commission is hoping for more innovation in the sector and, most importantly, for an opportunity to reinforce its own ability to steer policy regarding development finance. The Wise Persons Group implicitly backs the idea of an open architecture by proposing a mixed ownership entity and a platform for cooperation as a suitable option for the next EU budget (WPG, 2019). National DFIs are said to retain a prominent role in the system and coordination between them is to be reinforced. However, the Council remains divided on this point, with smaller Member States interested in preserving the EIB's mandate and larger Member States – due to their national capacities in the area of development finance – advocating for an open architecture.[26]

4.2 Cooperation and competition: DFIs in an open architecture

In line with the Commission's request for more competition among the existing development finance institutions, national DFIs have an interest in discrediting the idea of the EIB being the central puzzle piece in the European Development Finance architecture. KfW and AFD do so repeatedly by referring to their superior external lending volumes (in

26 Interview 9, Senior Official, EEAS, 30 August 2019.

2018, AFD EUR 11.4bn; KfW EUR 10.6 bn; EIB EUR 8.1bn), their embeddedness in the development sector, their relatively higher appetite for risk, and their longstanding regional presence and local expertise, which allows for tailored projects, small and targeted investments, and better engagement with partner countries and other stakeholders.[27] The EIB can partly compensate for the lack of regional offices by relying on the work of EU delegations (Bilal, 2019, p. vi), yet so far the coordination between these institutions has been insufficient, effectively making national DFIs the more prominent face of European development finance.

In an attempt to improve the efficiency of its external investments and avoid duplication, the Commission is not only seeking to control the EIB better but is also proposing to streamline the whole external financial architecture, which includes national DFIs, development banks, and EU institutions. The fragmentation of the system in place makes coordination between the various different actors on specific projects and general policies difficult. Against this backdrop, the European Commission has elevated the need for better coordination between national and multilateral DFIs along with other development institutions to an absolute priority. National and European DFIs must adopt a "more collaborative approach, coherent with the EU external action objectives", in order to benefit from EU budget guarantees (EC, 2018b). The European Commission asserts that "a stronger policy steer" is necessary "to maximise the effects of its external action" (EC, 2018b, p. 5). In other words, the European Commission is not only seeking to control the EIB's mandate but also to steer the course of entire European development finance landscape. Accordingly, the External Action Guarantee is to be managed by the European Commission and not by the EIB (Angenendt et al., 2019, p. 19), limiting other actors to the execution and oversight of the banking operations.

The Association of bilateral European Development Finance Institutions (EDFI) stresses the already existent high degree of cooperation between their members and their ability to leverage in synchrony more capital than their multilateral counterparts. Three initiatives institutionalise the cooperation between EDFIs: The European Financing Partners initiative; the Interact Climate Change Facility; and the EU-EDFI Sector Development Facility. Beyond that, the German KfW and the French AFD, through the mutual reliance initiative and staff exchanges, foster the harmonisation of standards, procedures, and pricing (Kaplan & Erforth, 2019).

Closer cooperation between EDFIs, however, may negatively affect relations with the EIB. Not only do EDFIs compete with the EIB over who represents Europe in the field of development finance[28]; the proximity to each other and the deep knowledge of one another's processes, pricing policies, and organisational structures automatically sets their cooperation apart from any other form of cooperation. As a result, the EIB is at times framed as the outsider with reference to which national DFIs define their role, function, and added value in the system. Similar rifts are visible when looking at the relations between EIB, KfW, and AFD, despite declarations to the contrary. As co-financing partners, the three institutions work together – in particular when financing major projects such as the solar power station at Ouarzazate in Morocco –, inform each other on strategic decisions, and coordinate their projects under EFSD guarantees and blending facilities. At the same time,

27 Interview 4, Senior Programme Manager, EDFI, 11 September 2019.

28 Interview 10, Senior Policy Officer, national development bank, 16 August 2019.

staff in all three institutions agree that the EIB differs from the AFD and the KfW in its understanding of European development finance.

Despite their agreement on substantive issues – such as the role of blending instruments or sustainable finance – the financing institutions collide on the topic of exclusive EU mandates and budget guarantees. While national DFIs favour an open architecture, the EIB defends its existent prerogative which grants the bank an exclusive access to the EU budget through specific mandates on the grounds that it cannot avail itself of any national guarantees and funds.[29] Since the EIB is dependent on several different so-called EU mandates that guarantee its operations and provide the necessary resources, any competition stemming from an open architecture is perceived as an attack on its operational capacities. National DFIs describe the proposed open architecture as a tool that adds value to the system as a whole. The EDFI network stresses the greater potential for innovation in an open architecture in which the different institutions need to compete for a limited number of projects and resources, eventually producing better and more impactful financial products.[30] Competition among DFIs might lead to more innovation and as such improve the system in place. Yet, it might also undermine the EU's visibility in the world as different institutions would invest both resources and time in promoting their distinguishing features rather than investing in European branding. Clearly the current debate is centred more on institutional preferences than on developmental needs. In order to establish a powerful, effective, and sustainable financing architecture, the debate needs to leave behind the institutional quarrels and embrace a more goal-oriented perspective.

4.3 Towards a European development bank

In the name of efficiency and visibility, European policy-makers and finance institutions have pondered the idea of creating a well-capitalised powerful European development bank for some time (Wolff, 2017). In 2010, the Wise Persons' group, which scrutinised the European financial architecture at the time, listed the creation of such a bank as one of its core recommendations (WPG, 2010). Despite its potential to improve the EU's visibility in the world, to function as an inclusive financial institution, and to further the impact of European development finance, a self-standing development bank is still wanting. Instead, the large development banks have developed their *own* European models and narratives. Today, they all lay claims on the title of financial provider in the service of European climate and development goals. The reluctance to engage in a cost-intensive transformation of the development finance system is reflected in a communication of September 2018, in which the Commission opposes measures "that would require fundamental institutional and structural changes such as the creation of new bodies or entities or mobilising additional capital participation from the EU budget" (EC, 2018b, p. 2).

Today, various different options regarding the creation of a European development bank are under consideration. The most talked about options include "the creation of a standalone development lender, making the EBRD the EU's external bank and the EIB its internal

29 Interview 8, Senior Advisor, German Federal Ministry for Economic Cooperation and Development, 17 July 2019; Interview 6, Senior Policy Advisor, EIB, 9 July 2019.

30 Interview 4, Senior Programme Manager, EDFI, 11 September 2019.

lender, adjusting the mix of responsibilities between national and multinational banks' or creating an EIB subsidiary" (Barker, 2019).[31]

If history is any guide, there is a good chance that the current discussions on the future of the European financial architecture for development will result in a compromise favouring gradual adaptation over radical change. The WPG report – which constitutes the framework for the Council negotiations – lays out three options (and dismisses a fourth one) (see Table 2) as to what a reformed European financial architecture for development could look like. Each of the endorsed options would require significant institutional changes. In order to better evaluate the pros and cons of each of the proposed options, feasibility studies are being commissioned and results are expected by the end of 2020.

The outcome of this assessment, of course, depends largely on the objectives that one wishes to be prioritised. At various stages of the negotiation process, the European Commission put forward the importance of an increased competition between development financers in order to foster innovation, increased private sector involvement to improve aid effectiveness, and increased coordination in order to boost the EU's visibility in the world. Each of these goals can be addressed to varying degrees by the various scenarios under discussion (see Table 2). However, none of the solutions is able to achieve the various different goals equally.

Table 2: Scenarios for creating a European Climate and Sustainable Development Bank

Scenario 1	Scenario 2	Scenario 3	(Scenario 4)
Creating a European Climate and Sustainable Development Bank based on the EBRD	Creating a new mixed-ownership European Climate and Sustainable Development Bank	Creating a European Climate and Sustainable Development Bank as a subsidiary of the EIB	Maintaining the existing structure but coordinating matters between national and multilateral development banks more efficiently
Option supported by EBRD management. WPG report considers this the best option for crowding in the private sector, yet EU interests are difficult to safeguard.	*WPG report describes this as a tailor-made solution. This option involves the largest setting-up costs. The option was largely dismissed by the Council conclusions on 5 December 2019 (Council of the European Union, 2019b).*	*Option supported by EIB management and some smaller Member States. The WPG report describes it as the quickest and technically simplest option, yet the one involving the highest risk of ineffectiveness and uncertainty as to the development impact.*	*Not endorsed by the WPG report, yet politically most likely option.*

Source: Author's elaboration based on WPG 2019

A European development bank could either emerge as a standalone lender (Scenario 2) or as an arm of one of the existing institutions (Scenarios 1 and 3). The appeal of an institution that goes by the name of the European Climate and Sustainable Development Bank lies in the promise that such an institution would improve the coordination between the existing DFIs and make European development finance more visible throughout the world. Thanks to a broad portfolio and a large capital basis, a central development bank would be able to manage large-scale infrastructure projects, offering an alternative to the Chinese model (Wolff, 2017). As a newly created EU body that has not yet been affected by any

31 For an assessment of the different options, see Kaplan and Erforth, 2019.

institutional path dependencies, the bank could take greater account of partners' concerns and thus boost the positive image of EU development finance. National DFIs – through co-financing measures – would be able to contribute their sector and regional expertise allowing for smaller and riskier projects to be financed under one European umbrella. In order to create impact, a European Climate and Sustainable Development Bank would also need to develop local and sector expertise, which requires a global presence that only the largest national DFIs have. The creation of a new institution would be extremely costly in the short run.

The Wise Persons' group initially seconded the creation of a new self-standing mixed-ownership bank.[32] After months of deliberation, the idea can still be found among the list of possible scenarios in the final report, yet no longer as the preferred option (WPG, 2019). By giving precedence to options that build on the existing structure and institutions, the Council of Ministers implicitly put an end to the idea of creating a new bank, before even commissioning the requested feasibility studies (Council of the European Union, 2019b).

Another option (Scenario 3), which was already contained in the 2010 "Camdessus Report" and discussed repeatedly by the EIB since, would be to set up a subsidiary of the EIB. The bank's direct access to other European institutions and actors as well as the efficient structures of the investment bank could be put to good use in service of this development subsidiary. Although it would have a global mandate, such an entity would focus mainly on Africa. However, this would require the EIB to become more willing to take on risk, particularly in poor and fragile states. From the Wise Persons Group's perspective, therefore, this would require a major shift in the bank's corporate culture and a clear separation from the EIB's core activities.

Both the Commission and national DFIs already opposed this option in the lead up to the publication of the WPG report as they feared the creation of a juggernaut dominating the European development landscape. Some Member States governments are more sympathetic to the idea of a development bank as part of the EIB group. In particular, small Member States without large development finance institutes of their own yet a well-established presence on the EIB board tend to favour this option. The EIB could further rely on its longstanding experience in financing large-scale infrastructure projects in Africa and its pioneering role as a climate bank. Due to the EIB's co-financing requirements, pan-European cooperation could be fostered by opening more projects to other national DFIs and IFIs.[33]

In yet another scenario (Scenario 1), the EBRD would be designated as the EU's development arm. This would imply making the EBRD the EU's external lender and limiting the EIB to its intra-European operations. The EBRD could put its private sector expertise to good use. However, its expertise would need to be expanded to new sectors and new regions – notably the African continent. The capacities would have to be built from scratch for Sub-Saharan Africa. This would pose a challenge, as the bank has so far only limited experience in fragile and low-income countries. To meet this requirement, it would

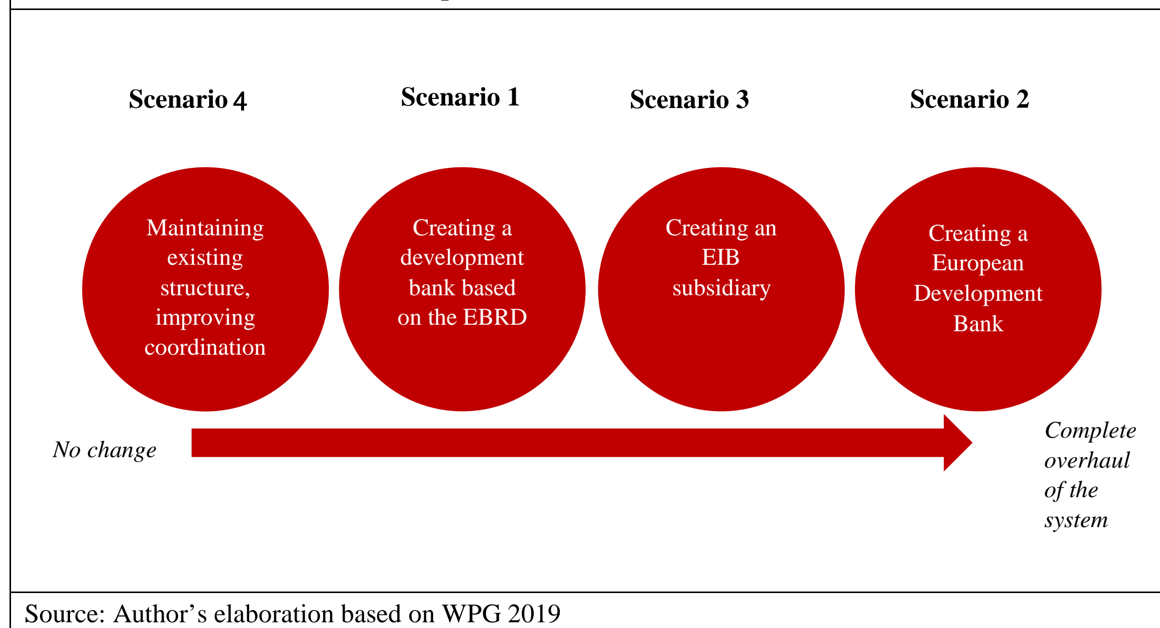
32 Internal working documents and personal conversations with actors following the dossier support this claim.

33 Interview 8, Senior Advisor, German Federal Ministry for Economic Cooperation and Development, 17 July 2019.

require a significant capital increase on the part of the EU shareholders in order to maintain the voting majority on the EBRD's board, necessary if the bank is to implement EU policies (WPG, 2019). Opposition against this option comes not only from the EIB but also from non-European EBRD shareholders. Some of the larger EBRD shareholders have become increasingly indifferent to the institution – making them opposed to any kind of fundamental changes; others fear a European takeover of this multilateral bank. The scaling-up of the London-based EBRD would also involve a host of institutional questions concerning costs, staffing, and the bank's future location in light of Brexit.

In addition to the scenarios put forward by the Wise Persons Group, there remains the option of retaining the existing structures but improving coordination and demarcating the boundaries between their regional or sectoral mandates more clearly. The interaction but also the competition between the EIB, the EBRD and the national DFIs allows the Commission to harness the comparative advantages of the individual actors. This complementarity should be borne in mind when deciding whether to maintain the status quo or opt for a restructure. National actors would be able to contribute their expertise and networks while an EU Development Bank would identify potential synergy effects between the national executing agencies. Staff exchange schemes between national and European DFIs could boost informal dialogue and coordination, with national development banks promoting the acceptance of development cooperation in the Member States.

Figure 7: Scenarios for the future of the European development finance architecture and the creation of a European Climate and Sustainable Development Bank as proposed by the Wise Persons Group (2019)



Source: Author's elaboration based on WPG 2019

The debate is still in full swing and it is too early to see any final outcome. Yet, already at the time of writing, too many stakeholders are opposed to the idea of an EIB subsidiary for it to be a likely option. Turning a multilateral institution like the EBRD into an essentially European bank carries too many institutional hurdles and does not address the objective of furthering the EU's visibility abroad. The setting up of a new mixed-ownership bank was pushed to the sidelines during the Council Meeting of 5 December 2019 (Council of the European Union, 2019b). Given the prevailing reluctance in the Council of Ministers, small adjustments to the existing system and improved coordination between national and

multilateral development financing institutions seems to be the most likely outcome that one can expect at present.

Regardless of which option will prevail, it is imperative not to lose sight of the objectives that a reform of the European financial architecture is supposed to achieve: visibility and aid effectiveness are two different issues, which are not necessarily obtained by the same means. Decision-makers should be aware of potential trade-offs. Moreover, the debate, as it currently stands, remains extremely inward-looking. Partner perspectives and the challenges and needs of private actors should inform the final reform.

5 Conclusions

This Discussion Paper has taken stock of the European development finance landscape and assessed the EIB's role as part of this landscape. Against the backdrop of the ongoing negotiations on a reformed European financial architecture for development, the paper has sought to contribute to a better understanding of the different options for reform available together with their likelihood to succeed. At the heart of this discussion is the EIB, whose position in the system served as the guiding thread of this analysis.

The growing importance of private sector investments and the rising number of DFIs constitute the operational environment within which decisions are to be made. The EU is home to a multitude of different actors and instruments all geared to strengthening the private sector in partner countries and contributing to the creation of jobs. It is no surprise that such a set-up is characterised by a high degree of fragmentation. Coordination efforts are under way and have already materialised in various formats such as the mutual reliance initiative between the AFD, the KfW and the EIB (Kaplan & Erforth, 2019). Yet, most actors continue to experience a lack of coordination between national DFIs, multilateral lenders, and EU institutions as an impediment to the effectiveness and visibility of European development finance.

The existing fragmentation is not primarily due to disagreements on the substance of development finance. National DFIs, the EIB, and the EU institutions all champion private sector involvement, advocating blending mechanisms as a way forward and subscribing to the strengthening of ESG criteria. The differences between the various actors are institutionally rooted. By consequence, bureaucratic interests and institutional survival dominate large parts of the current debate on a reformed European development landscape. The various different stakeholders are at times more interested in highlighting their own comparative advantages over their partners and competitors than in improving the system as a whole. Moreover, while development logic and investment logic co-exist in the current system, they are not always in sync. Building bridges between the different communities is key to improving the effectiveness of the system as a whole.

To remedy this situation, the EU is endeavouring to bring together all the relevant tools and institutions and combine the existing financing resources (EC, 2018b). This policy is driven not only by the desire to improve the impact of its development investments in partner countries but also by geopolitical interests, notably the desire to counter-balance China's increasing presence in Africa. These two objectives – increased effectiveness of European

investments and augmented EU visibility on the world stage – do not necessarily go hand in hand. In the worst case, they even undermine each other.

The attempt to create an inclusive system that brings together European expertise at the largest scale stands in the way of a centralised European development bank. A decentralised multi-stakeholder option can be expected as the most likely outcome of the current reform negotiations. Such as system, if well-coordinated, can improve the effectiveness and financial and developmental sustainability of EU investments in third countries. Yet, it remains questionable whether it will also strengthen European visibility abroad.

Transforming the EIB into a well-capitalised European Climate and Sustainable Development Bank would cater to the desire for a better European visibility. Yet, as the paper's last section demonstrated, at present, many stakeholders are reluctant to endorse an EIB subsidiary to become the new European Climate and Sustainable Development Bank. Some fear a monopolisation on the part of the world's largest multilateral lender. Others – including the European Commission, national DFIs, and civil society organisations – consider the EIB "too much of an investment bank" for it to be the sole European institution in an area where developmental logics prevail.[34] A more likely option is the transformation of the EIB into a European Climate Bank that contributes to sustainable development in Europe, Africa and beyond. Not only does this goal correspond with the bank's own policy narrative, it also enjoys the support of the Commission and big Member States including Germany (Riedel, 2020).

It is true that, to be successful, a reform needs to address these institutional issues and contribute to a better alignment between the various actors; but the proposed reform cannot stop there. A more impactful engagement with the African continent – to which all stakeholders have pledged themselves – requires the debate to go beyond the institutional logics that prevail between Brussels and Luxembourg. Enabling the private sector in Africa will remain integral to the economic development of the continent. A closer engagement with the partner countries' needs and specific requirements is of equal importance.

In the ongoing MFF negotiations, therefore, the EU Council and Parliament should carefully consider to what extent reforms open the door to increasing efficiency and paying greater attention to partner countries' concerns. Proposals for reform should be more closely aligned with questions of content – including development effectiveness, social and environmental standards, and job creation – rather than chiefly serving institutional interests. In particular, the deliberations should not focus primarily on the quantity of investments while taking into account that in some partner countries the opportunities for investment are already limited. Thus another criterion should be: Which scenario is best placed to mobilise private sector actors, and which arrangement is best suited to creating a favourable investment climate together with the partner governments? Competitive and financially viable green infrastructure projects will also have to be developed at local level if the climate targets are to be met. As far as the partners are concerned, swift implementation and efficiency considerations will play an especially important role alongside social rights and climate change mitigation. In particular, any conflicting aims that could arise – for instance, when resettling communities during major infrastructure projects – must be prevented by applying transparent, uniform standards. Going beyond

34 Interview 11, Senior Policy Officer, Bankwatch, 25 July 2019.

this, a strong EU body would be required to coordinate matters with the national DFIs and development banks in order to harness their expertise for innovative project proposals. A well-coordinated, evidence-based EU strategy would enhance the visibility and effectiveness of Europe's development finance architecture. "Effectiveness" has multiple dimensions in this context: as well as targets for reducing poverty and combating the causes of forced displacement, greater prominence should also be given to human rights and environmental concerns. The impact assessment and accompanying research by a group of think tanks that the Wise Persons Group is proposing could make a fundamental contribution in this regard (WPG, 2019, p. 27). In addition, the comparative advantages of EU development policy should also be highlighted in the international debate through a consistent narrative that showcases the benefits of European development finance. This would allow Europe, with its socioeconomic model, to position itself more clearly in the international cooperation arena.

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Annex 1: Overview of European development finance institutions

	Acronym	Full name	Founded	Total portfolio (in million euros)	Number of staff
Development finance institution (DFIs)[a]					
	BIO	Belgian Investment Company for Developing Countries	2001	757	64
	CDC	CDC Group PLC (United Kingdom)	1948	7,909	334
	COFIDES	Compañia Española de Financiación del Desarollo (Spain)	1988	1,053	81
	DEG	Deutsche Investitions- und Entwicklungsgesellschaft mbH	1962	8,147	561
	Finnfund	Finnish Fund for Industrial Cooperation Ltd	1980	838	79
	FMO	Netherlands Development Finance Company	1970	9,551	512
	IFU	The Danish Investment Fund for Developing Countries	1967	779	89
	Norfund	Norwegian Investment Fund for Developing Countries	1997	2,486	72
	OeEB	The Development Bank of Austria	2008	1,193	55
	Proparco	Société de Promotion et de Participation pour la Coopération Economique (France)	1977	6,285	310
	SBI-BMI	Belgian Corporation for International Investment	1971	38	4
	SIFEM	Swiss Investment Fund for Emerging Markets	2005	683	25
	SIMEST	Società Italiana per le Imprese all'Estero	1991	1,084	153
	SOFID	Sociedade para o Financiamento do Desenvolvimento (Portugal)	2007	7	11
	Swedfund	Swedfund International AB	1979	455	41

Development banks (DBs)[b]					
	AECID	Agencia Española de Cooperación International para el Desarollo	1988	987	800
	AFD	Agence française de développement	1998	42,870	2650
	CDP	Cassa Depositi e Prestiti (Italy)	1850	438,400	30,000
	KfW	Kreditanstalt für Wiederaufbau (Germany)	1948	483,500	6376
Multilateral development bank (MDBs)					
	EBRD	European Bank for Reconstruction and Development	1991	43,267	2,600
	EIB	European Investment Bank	1958	451,121[c]	2,900

Notes:

[a] Data was retrieved from the Association of bilateral European Development Finance Institutions (EDFI). “Total portfolio” refers to private sector projects in low- and middle-income countries.

[b] Data retrieved from CDP, KfW, EBRD and EIB. Total portfolio refers to projects within and outside the EU. Data for CDP and AFD refers to the total balance sheet in 2018. For the AFD, figures refer to projects outside the EU. For AECID, figure refers to the committed portfolio (63 operations approved by the Council of Ministers) of the Fondo de Promoción de Desarrollo, managed by AECID.

[c] Figure indicates all disbursed loans as of 31 December 2018.

Source: Author

Annex 2: List of interviews

Interview 1	Senior Programme Officer, national development bank, 7 August 2019
Interview 2	CEO, Ethos Investments, South Africa, 18 September 2019
Interview 3	Senior Official, DG DEVCO, 2 August 2019
Interview 4	Senior Programme Manager, EDFI, 11 September 2019
Interview 5	Mandate Officer, EIB, 6 September 2019
Interview 6	Senior Policy Advisor, EIB, 9 July 2019
Interview 7	Senior Banker, EIB, 26 July 2019
Interview 8	Senior Advisor, German Federal Ministry for Economic Cooperation and Development (BMZ), 17 July 2019
Interview 9	Senior Official, EEAS, 30 August 2019
Interview 10	Senior Policy Officer, national development bank, 16 August 2019
Interview 11	Senior Policy Officer, Bankwatch, 25 July 2019
Interview 12	Parliamentary Assistant, Greens/EFA, 11 June 2019
Interview 13	Policy Officer, French Ministry of Foreign Affairs, 15 July 2019
Interview 14	Policy Officer, national development bank, 26 July 2019
Interview 15	Policy Officer 1,2, and 3, EBRD, 14 September 2019

Annex 3: List of proposed short-term and long-term measures (Wise Persons Group 2019)

Immediate measures	Long-term measures/institutional changes
Create a strong policy centre in the EU: • Reinforce ownership of development policy by the European Council and the Council of Ministers • Create a narrative for the EU global development strategy • Strengthen the role of the European Commission at the centre of the EU development finance architecture • Strengthen the European Commission's development financing know-how • Improve coordination among EU board members in the various multilateral development institutions • Create a European knowledge hub for development (e.g. the European Think Tanks Group) • Encourage the European Commission to invest in the development of country platforms	Create the European Climate and Sustainable Development Bank building on the EBRD and the external financing activities of the EIB
Use NDICI as a catalyst for improvement: • Strengthen cooperation between EDFIs, national development agencies, the European Commission, EBRD, and EIB • Ensure a flexible annual programming for the NDICI implementation • Support a provision in the NDICI regulation, which provides the possibility of contributing to the capital of a development bank • Resources should reflect the EU's priorities in relation to Africa, climate and biodiversity • Set common standards and supporting private-sector development • Increase the use of joint programming • Support the notion of "open architecture" • Support the "policy first" approach in deploying EU guarantees • Develop a scheme incentivising implementing partners to provide access to financing to other implementing partners	Create a new mixed-ownership European Climate and sustainable Development Bank
	Create the European Climate and Sustainable Development Bank based on an EIB subsidiary

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