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Role of MDBs in emerging economies: an EU perspective

Check Against Delivery
Seul le texte prononcé fait foi
Es gilt das gesprochene Wort

UN Commission on Europe (UNECE),

**Panel: enhancing the role of national and regional
development finance institutions**

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This involves bilateral economic relations with non-EU countries, particularly candidate and potential (Western Balkan) countries and neighbouring regions) as well as strategic partners (G7 and key emerging economies) and the participation by the European Commission in key multilateral and regional economic institutions and fora (IMF, World Bank, Regional banks, G7-G8, OECD).

Development finance institutions play a crucial role in in transition economies' progress towards development and reform.

Multilateral banks have been providing predictable long-term finance for investments in human and physical capital that foster development or serve global public goods, often combined with technical assistance and advice on policy reforms.

In line with major political evolutions, such as the establishment of the Commonwealth of Independent States, globalisation, and the rapid development of capital movements, multilateral banks have experienced profound evolutions since the mid 1990s.

Their low cost of capital (due to multilateral shareholding), preferred creditor status and access to subsidies (e.g. trust funds) financed by donors is no longer enough to make their loans attractive to a number of client countries. MDBs are therefore redefining operations and undergoing significant adjustments.

At the same time the countries in Central, Eastern, and South Eastern Europe are themselves integrating to different degrees and at various speeds in the economic and political framework of the European Union. MDBs, some of which are European-based are also adjusting to this new situation and closely linking to EU priorities.

These are the issues I would like to address with you today and more particularly :

1. The underlying reasons and the scope for adjustment.

2. The adaptation of European based MDBs and the specific support provided to them by the European Commission.

1. THE EVOLVING MISSION OF MDBS IN TRANSITION ECONOMIES will be my first point.

In Central and Eastern Europe a number of multilateral banks are active, some of them present at this meeting. Main players are the World Bank, EBRD, EIB and the Council of Europe Bank, together with a number of multilateral banks that cover a part of the region (such as the AsDB, Black Sea Trade and Development Bank, Nordic Investment Bank etc).

Some years ago, a report was published by Dr Allan Meltzer¹ claiming that countries with access to capital markets, or above a certain level of per capita income, should not borrow any more from multilateral banks. This concept is also reflected in the 'graduation policies' of some of the banks, such as the World Bank and Asian Development Bank, that phase out their lending to countries above a certain income threshold, or the recent decision of the EBRD to discontinue operations in some recently acceded Member States.

In Central and Eastern Europe, many countries belong to the category of middle-income countries (MICs)². The World Bank, at its annual meeting in Singapore (2006), and soon after other

¹ Dr. Allan H. Meltzer served as Chairman of the International Financial Institution Advisory Commission in the US Congress.

² Group of 79 countries eligible for IBRD loans, normally with a per capita income between \$ 1025 and \$ 6055, but some poorer countries are also included (e.g. India, Indonesia, Pakistan). Countries above that level will be gradually phased out of lending operations, if they have access to external capital markets on reasonable terms and key institutions are sufficiently developed.

Regional Development Banks, adopted a strategy for adjusting and strengthening their engagement in MICs. The strategy responded to their perception of increasing challenges facing multilateral banks to maintain and develop operations in these countries as a consequence of:

- the steady economic progress of MICs, on the one hand, and
- to the raising availability of commercial financing, on the other.

Although both trends are positive developments in themselves, they have not driven MDBs out of business in these countries.

- It is indeed true that some MICs have registered impressive economic growth over the last years³ and have become major players on the international scene, but it is no less true that **more than 70% of the world's poor live in MICs**.
 - In Central and Eastern Europe, the average GDP growth rate is estimated around 6% in 2006 on average, varying between 4% and 9%⁴, even though the 'starting levels' vary widely, with GDP per capita from below \$ 1000 in most Central Asian countries to over \$ 10.000 in some new Member states.
 - However the percentage of people living on less than \$ 2 a day varies from nearly zero to about half of the population in some CIS (Moldova, Tajikistan, Mongolia). Official unemployment rates also vary from close to zero (in some CIS) to over 30% in some of the Balkan countries (Bosnia, Macedonia, Serbia).

³ Worldwide average 5.8% over the last four years (4.3% if India and China are excluded).

⁴ Exception is Azerbaijan: projected GDP growth rate of 25% in 2006. Source: EBRD transition report 2006.

◻◦ Furthermore, a number of MICs run the risk of falling back into poverty, due to indebtedness, natural disasters, conflicts or weak governance. This cannot be fully excluded for some of the countries in Central and Eastern Europe.

- It is also true that net private capital flows to developing countries are far higher than the combined aid provided by multilateral banks and bilateral donors.
 - However, access to capital is spread very unevenly among countries. In Central and Eastern Europe, FDI amounts to around € 50bn a year⁵, but is mainly directed to new EU member states, Serbia, Croatia, Ukraine and Kazakhstan.
 - Moreover, private capital flows are often of a short-term nature.
 - Furthermore, foreign banks are mainly interested in profitable private projects, and less in public sector reforms, health, education, clean energy, environment or basic infrastructure; while at the same time fast economic growth may lead to higher energy needs and increase environmental concerns.

Therefore, many transition countries still need to borrow from the multilateral banks, which offer not only affordable and predictable long-term loans, but also policy advice and technical assistance, aiming at environmentally and socially sustainable development of these countries. Multilateral development banks can also catalyse private finance (MDB participation can function as a 'stamp of

⁵ Source: EBRD transition report 2006.

approval') and MDBs, together with the IMF, constitute a 'safety net' in times of financial crisis.

The diversity among MICs⁶ as illustrated earlier requires a customized approach to their needs which are evolving rapidly.

- This first calls for MDBs fine-tuning their range of instruments to the needs of transition economies which appear increasingly interested in products and financial advice to mitigate risks, notably those related to commodity price volatility, catastrophic risk and exchange rate risk.
- Second, at the same time, loans to sub-sovereigns and blended loans for sectors with weak or delayed financial returns are in increasing demand.
- Thirdly, non-lending services, such as policy advice, economic and sector analysis, debt management and technical assistance without loans become a major element of attractiveness.

In parallel, **more cooperation** between multilateral banks is needed, to avoid competition on interest rates or lending conditions.

- This can be put into practice primarily by combining **more co-financing between MDBs** (as each MDBs can only finance a part of the project costs), but without duplicating appraisal and monitoring procedures.
- It also calls for an **increased division of labour between MDBs**: in this respect, transition economies are expected to take the lead in designing their own development strategies

and deciding the preferred role of each donor in their country. This reflects that the focus is now on stimulating these countries to develop themselves, notably through a favourable business climate and a well-developed local financial sector.

2. HOW DO EUROPEAN MDBs FARE IN THIS GENERAL CONTEXT

The EIB's main focus, following its statutes, is on development and **cohesion** within the EU. Project financing, notably for large infrastructure (transport, energy, telecom etc) in the public sector, is the main line of business, often coordinated with the EU Cohesion Fund for regional development⁷.

However, EIB activities have profoundly evolved since the early 1990's following the enlargement agenda and since 2000 the Lisbon agenda of structural reforms for Growth and Jobs.

This has resulted in a geographic and sectoral diversification of its operations, an added emphasis on regional and local levels for the former and on environment and research & development for the latter.

At the same time, private sector development was beefed up through an extension of global loans for SMEs and through the creation of the European Investment Fund, specializing in guarantees and risk capital activities for SME development.

The EIB is to remain a major player in the Western Balkans (including Turkey): in addition to € 5bn in new loans for new

⁶ MICs vary from upper-middle income countries such as Argentina, and lower-middle-income (e.g. North Africa) to poor countries with some market access (e.g. India) and small (vulnerable) islands.

member states, the EIB provided € 3bn to operations in (pre) accession countries in 2006. As for Eastern Europe and South Caucasus, EIB operations are expected to rise sizeably from 2007, due to the new EIB external loan mandate⁸.

As regards the EBRD, this bank was well equipped from the outset with a clear mandate to promote transition and development of the private sector, a wide and innovative range of financial instruments (including equity, syndicated loans and mezzanine / convertible loans) technical assistance and policy dialogue.

The mandate of the EBRD has always led it to assess projects in terms of **transition** impact, for which it developed a specific methodology and index. It also adapted its operations to the specific challenges of the countries and their evolution. For instance, in many new EU-Member states, the accent has been put on non-sovereign lending, especially in the municipal sector, energy efficiency and development of more sophisticated financial instruments.

3. WHAT IS THE SUPPORT PROVIDED TO THEM BY THE EUROPEAN COMMISSION?

In parallel, the Commission took active and innovative measures to assist European MDBs in the adaptation of their activities in transition countries.

⁷ Recent EIB initiatives funded by cohesion / structural funds are JASPERS (assistance to prepare major cohesion / SF projects, together with EBRD), JEREMIE (access to finance for SMEs) and JESSICA (innovative finance for sustainable urban development, together with CEB).

⁸ Pre-accession countries can receive up to € 8.7bn in EIB-loans, covered by an EU-budget-guarantee, in 2007-2013. The pre-accession facility without EU guarantee (€ 14bn) will be extended with an

Since the early 2000's, the Commission entrusts the EIB and EBRD, together with the Council of Europe Development Bank (CEB) in cooperation with KfW, with the management of innovative facilities⁹ in new member states and candidate countries. The interest of these instruments is two-fold: first they aim at distributing global loans to a vast number of local intermediary banks. Second, in doing so, a particular accent is put on the delivery of quality services to the final customer.

Since 1998, some 160 intermediary banks have thus provided credit lines and equity worth €2.5 bn to more than 70,000 SMEs throughout Central and Eastern Europe, while benefiting from €348 million of Commission's technical assistance for training, providing guarantees and encouraging performance through transaction fees.

Given its success, the scheme was progressively extended to Municipal Finance, for which a specialized facility was set in 2002 for those financial intermediaries dealing with municipalities in Central and Eastern Europe candidate countries. This was later complemented by a Municipal Infrastructure Facility, for municipal infrastructure projects in the border zones with the EU and by an Energy efficiency facility to promote public and private investments in this field.

additional € 5.5bn until end 2010. The mandate for Eastern Neighbours has been widened to cover Southern Caucasus and amounts to € 3.7bn for 2007-2013.

⁹ SME facility: contribution from EU budget at the end of 2006 was € 348m (for TA and performance / transaction fees, portfolio guarantees, exchange risk cover); IFI credits amounted to € 2.5bn.

Municipal finance facility: EU-contribution € 79m, IFI credits € 250m.

Municipal infrastructure facility: EU-contribution € 50m, IFI credits € 250m.

Building on this experience, the Commission is now contemplating a Neighbourhood Investment Fund (NIF), aimed at leveraging loans from EIB and EBRD in neighbouring countries with an EU-action plan. Bilateral development banks from EU-member states may become eligible as well, if their government becomes a direct donor to the NIF.

In the meantime, at the end of 2006, the Commission, EBRD and EIB already signed a MoU on joint financing of infrastructure projects in Eastern Europe, Caucasus and Central Asia in order to make best use of synergies.

Besides this strengthened cooperation between European institutions, the Commission also facilitates coordination through non-financial arrangements extending to all IFIs:

- The Commission has given impulse to two MoUs with a range of multilateral banks active in new member states and (potential) candidate countries and in Eastern Europe and Central Asia¹⁰.
- The Commission and World Bank have set up a Joint office for South-East Europe, initially to facilitate coordination of international assistance for the reconstruction and development of this region.

More generally, the Commission and MDBs are involved in a regular policy dialogue with various IFIs, both on headquarter and local level (through the EU Delegations).

¹⁰ New MS / candidate countries: EC, EIB, EBRD, IBRD, IFC, NIB, CEB, BSTDB, NEFC.
Eastern neighbours / Central Asia: EC, EIB, EBRD, IBRD, NIB, BSTDB (AsDB is observer).

The main objective of these arrangements with a broader range of institutions is to foster support to EU policy objectives, notably to prepare countries for accession and to help them develop their own reforms action plans in the framework of the European Neighbourhood policy.

- For candidate countries it aims at a progressive approximation of the whole Community legislation by candidate countries in order they can meet the obligations and reap the benefits of EU membership.
- For neighbouring countries having signed agreements under the European Neighbourhood Policy the focus is on the approximation of the EU regulatory framework regarding the EU internal market which is being monitored on a regular basis through progress reports on the action plans signed with these countries.

Let me conclude by stressing that these two major EU policies certainly act as major drivers for the adaptation of development banks in the transition economies of Central and Eastern Europe.