The EU's Financial Architecture for External Investment: Progress, Challenges, and Options

Mikaela Gavas and Hannah Timmis

Abstract

In 2017, the EU launched an ambitious programme of investment mobilisation in Africa and the Neighbourhood: the External Investment Plan (EIP). The EIP aims to increase the scale, impact, and coherence of EU-supported external investment by introducing various innovations to the European financial architecture, including a new guarantee mechanism and a unique "three-pillar" approach to investment support. The European Commission is proposing a significant expansion of the EIP under the EU's new long-term budget, the Multiannual Financial Framework 2021–27, replacing the current plethora of investment tools and modalities with a single framework.

This paper provides a comprehensive overview of the evolution of the EU's complex external investment architecture. Based on interviews with stakeholders, it documents lessons learned during the EIP's first year of implementation and proposes a series of options for the design and operationalisation of the new investment framework. To increase the additionality, development effectiveness, and efficiency of EU-supported external investment, it recommends that the European Commission improve the current architecture by providing greater policy steer to investors; increasing competition among institutions for investment support; clarifying linkages between the three pillars; setting clear guidance, fee structures, and standardised contractual terms; and strengthening management of investment tools.

Keywords: European Union, the External Investment Plan, the European financial architecture, blended finance, guarantees, Multiannual Financial Framework, development finance institutions

Center for Global Development
2055 L Street NW
Fifth Floor
Washington DC 20036
202-416-4000
www.cgdev.org

Center for Global Development
www.cgdev.org

CGD Policy Paper 136
January 2019

The EU's Financial Architecture for External Investment: Progress, Challenges, and Options

Mikaela Gavas
Center for Global Development

Hannah Timmis
Center for Global Development

The authors are grateful to Owen Barder and Mark Plant at the Center for Global Development and San Bilal at ECDPM for their comments and suggestions. We are also very grateful to the European Commission and the development finance institutions listed in Annex 1 for kindly taking the time to share their insights and early experiences of the EIP. This paper represents the views of the authors alone, and they are responsible for any errors in fact or judgment.

The Center for Global Development is grateful for contributions from the Bill & Melinda Gates Foundation in support of this work.

Mikaela Gavas and Hannah Timmis, 2019. "The EU's Financial Architecture for External Investment: Progress, Challenges, and Options" CGD Policy Paper. Washington, DC: Center for Global Development. https://www.cgdev.org/publication/eus-financial-architecture-external-investment-progress-challenges-and-options

Center for Global Development
2055 L Street NW
Washington, DC 20036

202.416.4000
(f) 202.416.4050

www.cgdev.org

Contents

Introduction

The EU's development finance architecture has grown in complexity. Over the past decade, it has developed a diverse toolbox of financing mechanisms and modalities, including blending facilities and guarantees, which attempt to mobilise additional resources for investment in partner countries. This multiplication of financial tools and the absence of a unifying framework has led to fragmentation, duplication, and incoherence. With the onset of the negotiations on the new EU seven-year budget—the Multiannual Financial Framework (MFF) 2021-2027—the European Commission (EC) is proposing a radical reconfiguration of its development finance architecture. Its new investment framework will significantly scale up the model of the existing European External Investment Plan (EIP), while also bringing the plethora of financial tools under a single umbrella and establishing a single entry point for investors seeking EU support for operations outside the EU. The EC predicts that the new framework will mobilise half a trillion euros in additional investment over the period 2021–2027.[i]

As the EU prepares to significantly scale up its deployment of blended finance, guarantees, and other risk-sharing tools aimed at stimulating investment in developing countries, this paper offers three contributions. First, it provides a comprehensive overview of the evolution of the EU's external investment architecture. Second, it assesses how well the current framework is working and identifies key issues and challenges, focusing particularly on the EIP. Finally, it proposes a series of options for the design and operationalisation of the new investment framework.

The paper recommends three ways in which the current architecture could be improved under the 2021–27 MFF to increase the additionality, development effectiveness, and efficiency of EU-supported external investment:

- support development finance institutions to undertake investment beyond their "business as usual" by providing a greater policy steer on the EIP's objectives and by increasing competition among institutions for investment support

- improve the operationalisation of the EIP's three-pillar approach by establishing clear budgets for the nonfinancial arms, pillar 2 (technical assistance) and pillar 3 (policy dialogue), and by elaborating country-specific investment plans as part of the EU's programming of external assistance

- streamline the deployment of the EIP's guarantee mechanism by setting clear investment guidance, fee structures, and standardised contractual terms, as well as strengthening its management

While the full evaluation of the EU's investment tools is scheduled for the end of 2019, this paper is based on early lessons from the the EIP's first year of implementation. The analysis draws on documents available in the public domain, including EU regulations, EC communications and external commentary related to the EU's external investment architecture, as well as input from interviews with stakeholders. Interviewed stakeholders included representatives from the EC and the Bill and Melinda Gates Foundation, as well as DFIs currently engaged with the EIP (see Annex).

Evolution of the European Financial Architecture for External Investment

The EU has frequently reiterated its commitment to mobilising investment for developing countries in order to expand the scope and impact of its external action and to achieve the Sustainable Development Goals (SDGs). Blended finance modalities, which the EU first established in 2007, have been the earliest expression of this. Over time, however, the EU's investment tools have grown in scale, nature, and complexity.

Blending

The EU has been at the forefront of promoting blended finance, which combines budgetary grants with loans or equity from public and private investors.[ii] The objective of blending is to mobilise additional finance for investment in partner countries by increasing the risk-adjusted return of development projects. Since 2007, the EC has established eight regional blending facilities covering the entire geographic range of its development cooperation.[iii] Additionally, various thematic initiatives use blended finance, including the Agriculture Financing Initiative (AgriFI) and the Climate Finance Initiative.[iv] These facilities and initiatives are funded from the relevant financial instruments in the EU budget and the European Development Fund (EDF). According to the EC's most recent estimates, €3.4 billion worth of EU grants have financed over 380 blended projects via the facilities. These grant contributions have leveraged approximately €26.2 billion of loans by European development finance institutions (DFIs), unlocking investment with a total estimated value of €57.3 billion in partner countries.[v]

The European Investment Bank (EIB) is the largest implementer under the blending facilities, notably via its implementation of the Resilience Initiative in the Southern Neighbourhood and Western Balkans and its operations in Africa under the ACP Investment Facility.

Guarantees

For the period 2014–2020, the EU guaranteed EIB's operations against losses on its investments outside the EU to the tune of €27 billion, with an optional €3 billion subject to approval by the European Parliament and the Council during the MFF mid-term review. The guarantee aims to enable the EIB to increase its external lending in support of EU policies while mitigating its risk exposure and protecting its credit rating.[vi] The EU initially guaranteed up to €27 billion of EIB operations in pre-accession countries (€8.7 billion), the Neighbourhood (€14.4 billion), Asia and Latin America (€3.4 billion), and South Africa (€0.4 billion). Its thematic objectives were (i) local private sector development, (ii) social and economic infrastructure development, and (iii) climate change mitigation.[vii] In 2018, following the mid-term review, the EU expanded the size and scope of its guarantee to the

EIB, increasing the maximum ceiling to €32.3 billion and introducing a fourth thematic objective to address the root causes of migration. Additionally, it revised the regional allocations, lowering the amount earmarked for pre-accession countries and increasing the amounts for all other regions.[viii]

The guarantee to the EIB is underpinned by the Guarantee Fund for External Actions (GFEA), which is funded from the EU budget annually in order to maintain a target amount of 9 percent of its total outstanding loans. The EIB mandate represents around 90 percent of the portfolio covered by the fund. While the GFEA is the property of the EU, its financial management is entrusted to the EIB.[ix] During the MFF mid-term review, the EC proposed to transfer the management of the GFEA from the EIB to the EC. However, this proposal was rejected in the compromise agreement reached by the European Parliament and the Council, which instead provided for an independent external evaluation of the GFEA's management arrangements in June 2019.[x]

The External Investment Plan

The MFF's mid-term review also led to the adoption of the EIP in September 2017. The EIP's stated aims are to contribute to the SDGs and to mobilise sustainable public and private investment for development in Africa and the Neighbourhood.[xi] Underlying its creation was the recognition that traditional aid was not going to be sufficient for the next development "leap."

The EIP introduces two new aspects to European development finance. Firstly, it offers a new guarantee mechanism to actors beyond just the EIB, including European DFIs, non-European DFIs, and private investors from EU Member States and partner countries.[xii] Unlike the EU guarantee to the EIB, this new mechanism is managed by the EC with support from a technical assessment group ("G-TAG") comprising staff from the EIB and other DFIs.[xiii] Secondly, it complements financial tools with nonfinancial assistance aimed at building a project pipeline and improving the business environment in partner countries. The Plan is made up of three pillars of interventions:

1. Financial support. The Plan's financial arm, the €4.1 billion European Fund for Sustainable Development (EFSD), comprises two parts:

    - **An EFSD Guarantee** (for a total of €1.5 billion by 2020), underpinned by an EFSD Guarantee Fund of €750 million, funded from the EU budget and the EDF. The EFSD Guarantee offers various risk-sharing tools, such as risk capital; first-loss guarantees; and micro-, small-, and medium-sized enterprises (MSME) loan guarantees.[xiv]

    - **Blending Facilities** (for a total of €2.6 billion by 2020), comprising a Neighbourhood Investment Platform and an African Investment Platform. The regional investment platforms are a rebranding of the current blending facilities—the Neighbourhood Investment Facility and the African Investment Facility.[xv]

2. Technical assistance focused on advisory services and capacity building to help local authorities and companies develop bankable projects and attract investors.[xvi]

3. Policy dialogue with the public and private sector focused on improving the investment climate and business environment in Neighbourhood and African countries via regulatory, policy, and governance reforms.[xvii]

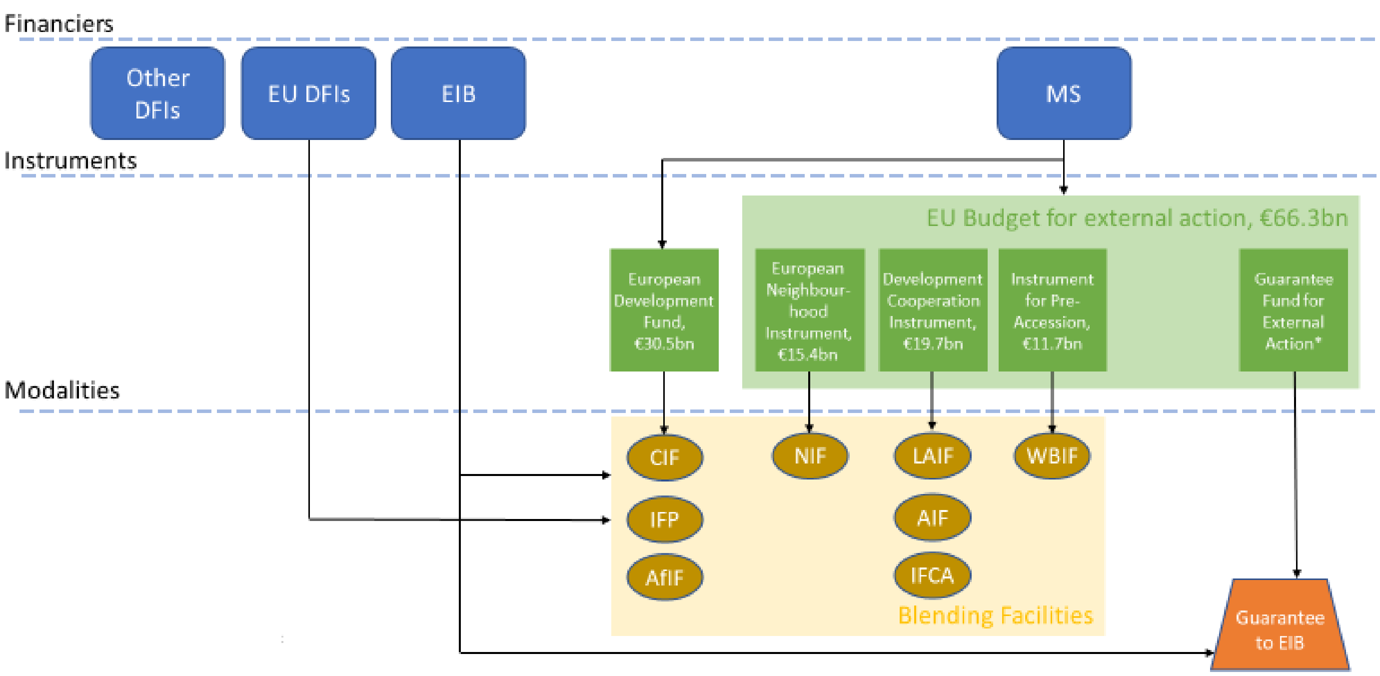
Since the Plan's launch, the EC has established five thematic investment windows: sustainable energy and connectivity, MSME financing, sustainable agriculture, sustainable cities, and digital solutions for development.[xviii] The EC has allocated €1.6 billion from the EFSD to 52 blending projects in Africa and the Neighbourhood, which it estimates has leveraged €16 billion in public and private investment.[xix] It has also approved 12 investment portfolios to benefit from guarantees worth €800 million and is planning to allocate the remaining €700 million by end-2018.[xx] However, none of the guarantee agreements between the EC and DFIs has a finalised contract, nor have the programmes begun implementation. Finally, while EU Member States and approved donors have been encouraged to contribute to the EIP, only the Bill & Melinda Gates Foundation had committed funds (€40.9 million to Pillar 1 and €10.2 million to Pillar 2) at the time of writing.[xxi]

The Proposed Investment Framework

In 2018, the EC released a series of proposals for the next MFF 2021–2027, which included a new investment framework for external action. The overall intention is to significantly scale up the EIP, while also streamlining the EU's external investment architecture. To this end, the proposed framework would adopt the same three-pillar approach but with an expanded financial arm, the EFSD+, comprising a single worldwide blending facility and a new External Action Guarantee with a ceiling of €60 billion.[xxii] The EFSD+ would fold in the regional blending facilities, the EU guarantee to the EIB and the EFSD, thus providing a one-stop-shop for all investors seeking financial support from the EU.[xxiii] It would sit within the new proposed Neighbourhood, Development and International Cooperation Instrument (NDICI) of €89.2 billion, with each operation funded from the instrument's geographic programme envelope.[xxiv] While the EC does not propose a specific budget for the EFSD+, it states that the External Action Guarantee would have a provisioning rate of 9 percent to 50 percent, suggesting that between €5.4 and €30 billion of the NDICI's total budget could, in theory, be dedicated to guarantee operations. The External Action Guarantee would also accept contributions from EU Member States, third countries, and other third parties.[xxv] It would continue to be managed by the EC with support from a risk assessment group.[xxvi]

The EU's external investment architecture has clearly evolved over time. Figure 1 shows the introduction of the regional blending facilities into the EU's development finance architecture and the beginning of the shift in the deployment of EU budgetary resources for external action away from grant finance and towards blended finance and guarantees. Figure 2 demonstrates that the number of actors eligible to access investment support has also increased over time as the EU has sought to diversify its partnerships for development cooperation. Whereas originally only the EIB benefitted from an EU budgetary guarantee, under the new framework all public and private investors, including those from third countries, would be eligible for this support (though they would need to undergo a "pillar assessment" before signing a guarantee agreement with the EC).[xxvii] Additionally, the EC would have sole responsibility for managing its guarantee mechanisms, further levelling the playing field between the EIB and other DFIs. Figure 2 also shows how the proliferation of new tools and modalities has led to a highly complex and fragmented architecture with little visibility amongst stakeholders. The introduction of the EFSD went some way in reducing this complexity by combining blending facilities and guarantees for Africa and the Neighbourhood, albeit excluding the EU guarantee to the EIB. Finally, figure 3 demonstrates how the new investment framework would go one step further and establish a single entry-point for investors seeking EU support by integrating the blending facilities, the EIB guarantee to the EIB, and the EFSD into a single framework—the EFSD+.

Figure 1. Evolution of the EU's architecture for external investment, phase 1: 2014–2016



AfIF: Africa Investment Facility
AIF: Asia Investment Facility
CIF: Caribbean Investment Facility
IFCA: Investment Facility for Central Asia
IFP: Investment Facility for the Pacific
LAIF: Latin America Investment Facility
NIF: Neighbourhood Investment Facility
WBIG: Western Balkans Investment Facility

*9% of total loans under the ELM

Figure 2. Evolution of the EU's architecture for external investment, phase 2: 2017–2020

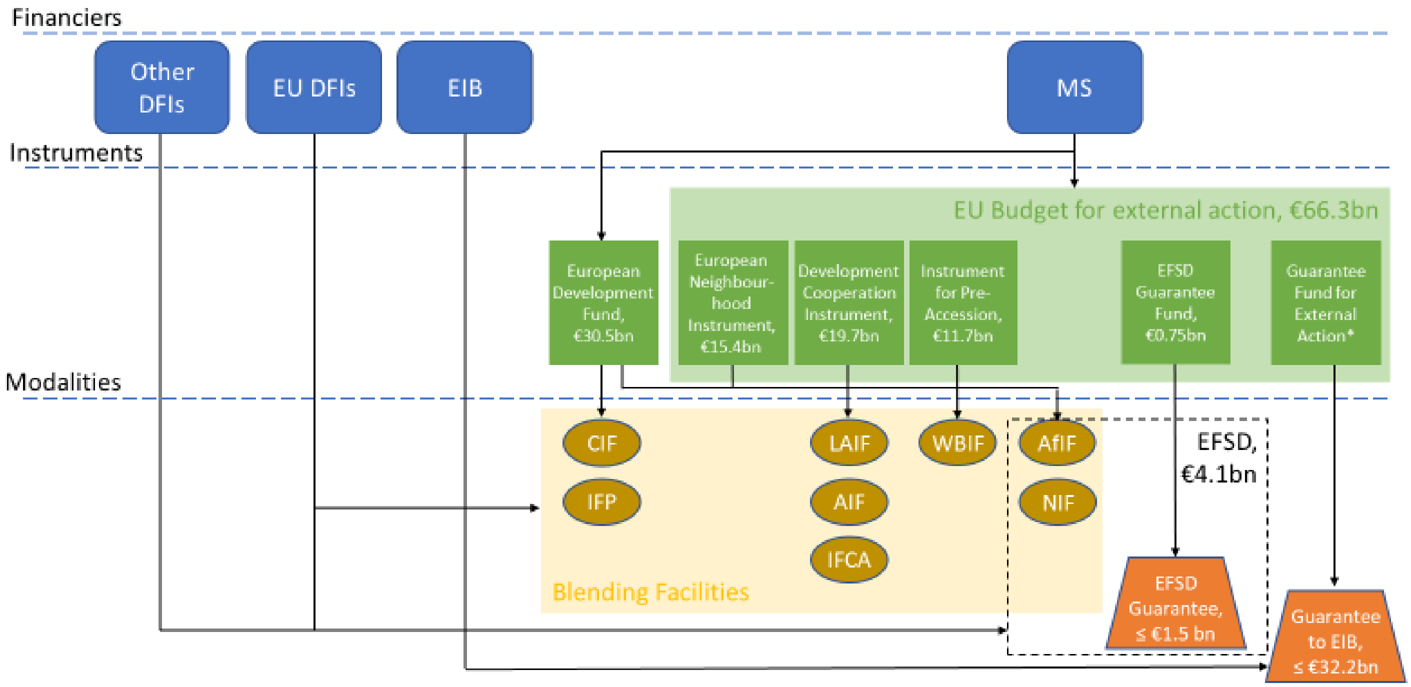
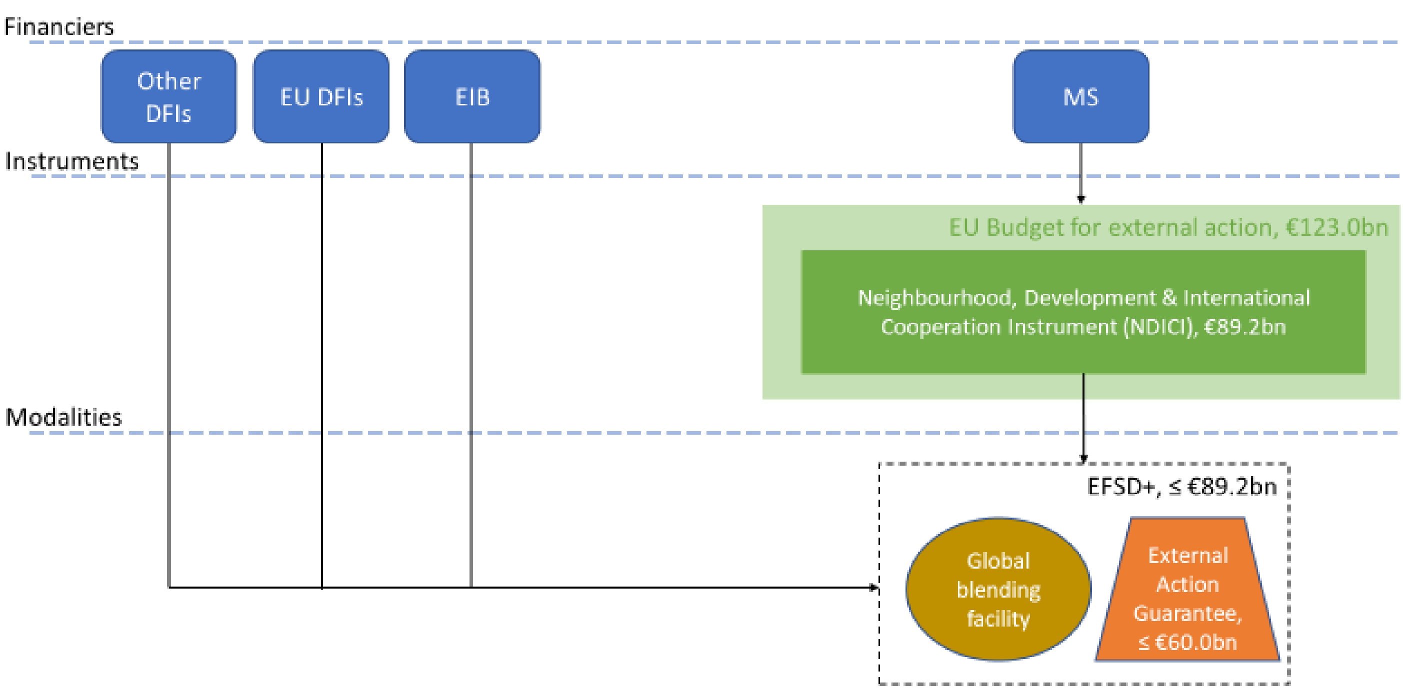


Figure 3. Evolution of the EU's architecture for external investment, phase 3: 2021–2027



Source: Authors' elaboration

Issues and Challenges with the EIP

As reform of the EU's investment architecture continues to pick up pace, this section aims to take stock of the current framework, in particular the EIP. Given the EC's proposal to significantly scale up the EIP under the MFF 2021–27, it is essential to understand how well the model is working and to identify issues and challenges. The views presented were provided by a range of stakeholders, which are listed in the annex .

The EIP is hugely aspirational. It seeks to leverage high volumes of investment; demonstrate impact; reach the poorest and most fragile countries; improve the pipeline of bankable development projects; encourage innovation; foster greater cooperation among partner governments, the private sector, civil society, and development actors towards an enabling business environment; and change the way EU institutions, donors, and DFIs work together with a view to promoting greater coherence and synergy towards achieving the SDGs.

Stakeholders were generally positive about the recent reforms to the European architecture for external investment. While most acknowledged that the EIP was in early days and a full assessment was premature, they nevertheless welcomed the Plan's ambition in terms of its objectives, scale, and thematic-geographic coverage.

Several stakeholders highlighted early successes against one or more of the EIP's strategic objectives. The risk-sharing tools under the EFSD, particularly the new guarantee, have reportedly supported some financial institutions to undertake additional investments, successfully mobilising new resources for EU external policy. For example, the EFSD Guarantee has, in some cases, enabled penetration of smaller DFIs into new markets. Most stakeholders were optimistic about the potential of the three-pillar approach to enhance the quality and impact of EU-supported investments, at least in theory. The EIP also seems to have had some early success in incentivising coordination and joint initiatives between DFIs. Because the EFSD Guarantee was over-subscribed in its first year with investment proposals equal to double the amount on offer, the EC has encouraged applicants to collaborate and partner. The resulting partnerships have reportedly created higher quality proposals, as institutions have combined their different skills and experiences in complementary formations.

In addition to these strategic achievements, stakeholders praised the EC for its market-driven and collaborative approach to identifying, designing, and implementing the EIP. There was a palpably high level of external ownership, as demonstrated by the DFIs' commitment to supporting the initiative and the EC's objectives. With a substantially larger guarantee, however, it will be challenging for the EC to maintain the level of external ownership, collaboration, and coordination it has encouraged.

Three big challenges have been identified with the current investment framework, at both the strategic and operational levels:

- clarifying the vision and ensuring the EFSD reaches under-served markets

- operationalising the three-pillar approach so that the various interventions reinforce one another
- deploying and scaling up the EFSD Guarantee

1. Clarifying the Vision and Ensuring the EFSD Reaches Under-Served Markets

The EIP has multiple, ambitious objectives and its financial arm has been designed accordingly, with maximum flexibility to respond to these various aims. The EFSD does everything for everyone. It offers diverse financial tools, covering a variety of risk and investment instruments, to public and private actors operating across multiple sectors in Africa and the Neighbourhood. However, this breadth and flexibility has led to ambiguity over the EFSD's primary purpose and a user-driven approach to allocating its resources. As a result, there is a real risk that the fund is subsidising DFIs' "business as usual."

It is particularly unclear whether the EFSD is intended to operate primarily as a high-leverage fund, mobilising the maximum quantity of investment for a given input of EU budgetary resources, or as a high-risk fund, mobilising investment for under-served markets with low risk-adjusted returns. The EFSD Regulation and subsequent EC Communications allude to both aims, stating that the fund should "maximise, where possible, the mobilisation of private sector capital" and also "be allocated to fragile and conflict-affected, landlocked and least developed countries, where the perceived risk is higher and there is a great need for private investment."[xxviii,xxix] Yet, there is an inherent trade-off between the two: programmes with lower risk-adjusted returns will require larger injections of grant finance, either via blending or guarantees, to be commercially viable. That is, a higher risk fund will achieve lower leverage and vice versa. Neither the Regulation nor the EC provide much guidance on where the EFSD sits along this spectrum or how the ambition to reach under-served markets will be achieved in practice.

The flexible framework has further resulted in a user-driven approach to allocating EFSD resources. While the EC has defined five thematic investment windows to guide the fund's operations, their scope is extremely broad and their budget is deliberately undefined. Moreover, the criteria for selecting investment proposals for EU support, as set out in the EFSD Regulation, are vague and relatively subjective. For example, they include "contributing to sustainable development, in its economic, social or environmental dimensions" and "helping to address specific root causes of migration."[xxx] Notably, a criterion to address highly suboptimal investment situations, for example in fragile and conflict-affected states, is missing. Consequently, DFIs have maximum flexibility to propose investment programmes that suit their objectives, specialisation, and risk-appetite.

For both these reasons, various stakeholders expressed concern that the EFSD may not be pushing DFIs much beyond their day-to-day operations. Investment programmes with poor risk-return ratios tend to be more difficult and time-consuming to prepare and implement, requiring larger levels of financial support and expertise to ensure commercial sustainability and development impact. Without any political steer or competitive incentive, DFIs are unlikely to undertake these more complex programmes. Rather, they may simply use the EFSD's risk-sharing tools to increase the expected return of investment that is slightly sub-optimal or, worse, already commercially viable.

2. Operationalising the Three-Pillar Approach

The three-pillar approach, combining blended finance (pillar 1) with technical assistance (pillar 2) and an increased attention to improving the business enabling environment (pillar 3) is a key innovation of the EIP. Technical assistance is intended to support pillar 1 by supporting the development of bankable projects in partner countries. Technical assistance also supports policy reform under pillar 3 by, for example, providing market intelligence and investment climate analysis and delivering capacity building for public and private sector representatives. Coordination among the three intervention pillars is therefore critical for the success of the Plan. There is, however, no formal regulation establishing pillars 2 and 3. Rather, their implementation is left to the discretion of the EC in collaboration with the European External Action Service (EEAS) and notably the EU Delegations. This has created confusion among stakeholders as to how support under pillars 2 and 3 is accessed and resourced.

To date, €5 billion in technical assistance has, according to the EC, been made available under the EIP, 80 percent of which is in support of pillar 3 and only 20 percent in support of pillar 1. Yet, stakeholders reported little visibility over the programme allocation and impact of this spend, nor justification for its concentration in pillar 3.

Meanwhile, realising pillar 3 requires coherence and complementarity of EU actions with DFIs and local actors, facilitated by the EU Delegations. However, stakeholders reported that either structured dialogue is not happening in practice, or there is little visibility of how it is taking place. Furthermore, there is a lack of consensus among the DFIs regarding their role in the policy dialogue.

3. Deploying and Scaling Up the EFSD Guarantee

The deployment of the EFSD Guarantee has been challenging for various reasons. Overall, there is a lack of clarity over its intended beneficiaries, technical provisions and eligibility, and controversy surrounds its optimal management arrangements. There are two ways in which the guarantee can be used; either to support the balance sheets of the eligible counterparts (namely, pillar-assessed European and international DFIs) or to support the balance sheets of third parties, such as banks and financial institutions in partner countries. The latter requires eligible counterparts to pass on the benefits of the guarantee to local institutions in Africa and the Neighbourhood. While both approaches should generate leverage and improve access to finance, they have different implications for the types of investors that ultimately benefit from the risk-sharing mechanism. Although the EC's general principle and original intention was that guarantee be passed on to third parties in developing countries, stakeholders reported that the majority of the proposed investment programmes are, in the first instance, using the guarantee to support the balance sheets of the European and international DFIs.

Furthermore, although the EFSD Risk Policy Framework includes the EFSD Guarantee's pricing policy and investment guidelines, they seemed to have passed under the radar of many of the stakeholders, who reportedly were unaware of their existence. No contracting templates have been attached to the EFSD Guarantee. Rather, the contract for each investment programme is designed from scratch and thus progressing from proposal to implementation has proved time- and labour-intensive. Stakeholders proposed various reasons for the guarantee's absence of technical guidance. First, the EC retains ultimate management responsibility for the mechanism but lacks the required banking expertise to operationalise it effectively. Second, political pressure to allocate the entire guarantee amount within one year has left little time for negotiating standardised contracting templates and policies with relevant stakeholders. Finally, the guarantee's very flexibility, which allows it to cover a variety of instruments and risks, further inhibits standardisation in contracting and implementation.

Management of the EFSD Guarantee has also proved controversial. On the one hand, questions have been raised about the EC's technical capacity to effectively manage the guarantee. On the other, there have been concerns that assigning this responsibility to a beneficiary of the guarantee may result in a conflict of interest. In particular, there has been a question mark over the role of the EIB, which has managed EU budgetary guarantees in the past but is also a key beneficiary of the tool. The G-TAG was established as a compromise solution. Its mandate is to assess and opine on the guarantee proposals, providing banking sector expertise to help ensure proper risk assessment. Stakeholders agreed that the G-TAG has worked well as a de-politicised forum bringing together senior credit experts from different DFIs and providing much needed advice to the EC. However, in a scaled-up investment framework, stakeholders suggested that a more robust and professionalised management structure would be needed.

With regard to eligibility, the EFSD Regulation states a preference for allocating the guarantee via European counterparts under Article 11(2): "The EFSD Guarantee shall be implemented whenever possible under the lead of a European eligible counterpart in line with the criteria set out in this Regulation." How this preferential treatment will be actioned has yet to be clarified. In fact, the EC has encouraged non-EU DFIs to apply, generating confusion as to whether the EFSD Guarantee does indeed prioritise European counterparts.

Other Issues and Challenges

Other issues and challenges to operationalising the EIP include designing appropriate results frameworks, integrating the OECD's blended finance principles and achieving complementarity with other initiatives, including those in partner countries. Ensuring effective monitoring and evaluation is essential for improving the development impact, transparency and accountability of the EIP. However, a byproduct of the stakeholder breadth has been a lack of uniform standards. It has proved particularly challenging to harmonise approaches and results measurement across the initiative's various implementation partners, projects and instruments.

A further concern is how to operationalise the OECD's blended finance principles, which currently define best practice for blending programmes. While the EC supports these principles, there is a question mark over the extent to which it should promote and enforce them within the EIP. Finally, there are numerous other non-EU initiatives seeking to promote sustainable investment in African and Neighbourhood countries, many of which also employ risk-mitigation instruments. Key examples are the IDA18 IFC-MIGA Private Sector Window, the G20 Compact with Africa, and BMZ's Marshall Plan with Africa. Additionally, many partner countries have adopted their own strategies. There is little evidence that the EIP is seeking to ensure complementarity and create synergies with these initiatives, undermining its stated ambition to promote the coherence of its development cooperation.

Options for the New Investment Framework

We put forward three ways in which the new investment framework could be improved to ensure greater clarity of objectives; improved effectiveness and impact of EU-supported investments; and more efficient deployment and management of the guarantee.

1. Providing a Greater Policy Steer and Increasing Competition among Counterparts to Push DFIs beyond "Business as Usual"

The EFSD's unclear vision and user-driven approach increase the risk that its operations are subsidising DFIs' "business as usual." To ensure its successor, the EFSD+, increases both the quantity and quality of EU-supported external investment, the EC could do two things. First, it could provide a greater policy steer as to the fund's priority objectives. This could be done within the NDICI Regulation by clarifying the extent to which EFSD+ operations should support high leverage versus high risk. For example, the EC could provide indicative financial allocations to under-served markets or include a programme selection criterion that explicitly encourages higher risk investment. It could also be done within the investment window specifications by defining more narrowly the strategic aims, programmes and activities supported by each. While these actions would inevitably reduce the flexibility of the EFSD+, they would help ensure that its operations were additional.

Second, the EC could ensure that EFSD+ resources are allocated via a genuinely competitive process. Under the current EFSD, the dominant approach to disbursing financial support has been user-led: DFIs identify and design investment programmes which are subsequently approved by the EC. While the fund's small size has generated some competition for resources among DFIs, this has been offset by its broad coverage and its requirement that eligible counterparts undergo a "pillar-assessment" before bidding. These factors have limited demand under each window, such that DFIs have had little incentive to ensure their proposals maximise additionality by increasing leverage or taking on more risk.

2. Earmarking Resources for Pillars 2 and 3, and Clarifying Pillar Access and Linkages

With regard to the three-pillar approach, to date, most of the focus has been on pillar 1. However, if the new framework is genuinely intended to be a one-stop shop, combining financial and nonfinancial support to enhance the quantity and quality of the pipeline of projects as well as the investment climate, there needs to be more clarity about how pillars 2 and 3 are resourced, accessed and linked to pillar 1. This can be done in various ways. The NDICI Regulation could set aside earmarked funds for pillar 2 to ensure the creation of a pipeline of bankable projects, and for pillar 3 to enable the EU Delegations to facilitate dialogue platforms with the DFIs and local partners. Furthermore, country-specific investment profiles setting out the main challenges to investment at national level could be drawn up to form part of the EC's in-country programming process for external assistance. However, greater attention will need to be given to the ability and capacity of EU Delegations to participate effectively in the management of investment-oriented development approaches. The EC should build on the experience of the DFIs that pursue policy-based lending, in particular, the EBRD with its transition indicators, as well as the AFD & Propacro, KfW, the World Bank and IFC, and others in connecting investment projects with regulatory, policy, and institutional reforms.

3. Setting Clear Guidance, Fee Structures, and Standardised Terms, and Strengthening Management

Much of the frustration experienced by the DFIs relates to the EIP's management processes, particularly those for the EFSD Guarantee. While the EC's approach of "letting a thousand flowers bloom" has encouraged ownership and commitment, now is the time to codify lessons into some simple procedures and rules of thumb to avoid reinventing the wheel. There are numerous ways of improving the consistency and transparency of deploying the guarantee. First and foremost, there must be much more clarity and guidance on the key provisions. The EC should specify the amount of the External Action Guarantee that can be allocated to third parties, as well as the amount that can remain on the balance sheets of the DFIs. It should agree standardised, general terms for the guarantee contracts to increase transparency and efficiency. And, it should clarify the fee structure across the EFSD+'s various modalities. Second, it is true that expanding access to the guarantee to non-EU DFIs has increased the range and volume of applications, encouraging collaboration and innovation. However, if the EC is serious about its intention to level the playing field between the DFIs such that the institution best placed to deliver a given investment programme receives support, it should consider removing the preference for European DFIs under the new investment framework.

The EC has suggested that it would continue to manage the guarantee in the new investment framework with support from a risk assessment group. The composition of this group is currently an open question. The EC has proposed various options, including external consultants commissioned via competitive tender and representatives from implementing partners, such as international finance institutions and development banks. However, the configuration and functions of the current G-TAG are not sufficient to manage a substantially larger guarantee fund. Rather, there needs to be a more robust and professionalised management structure with a separation of front-office, risk assessment, and client-facing functions.

Annex. List of Stakeholder Interviews

- Agence Française de Développement (AFD)
- Bill & Melinda Gates Foundation (BMGF)
- Cassa Depositi e Prestiti (CDP)
- Compañía Española de Financiación del Desarrollo (COFIDES)
- European Bank for Reconstruction and Development (EBRD)
- European Commission, EIP Secretariat
- European Development Finance Institutions (EDFI)
- European Investment Bank (EIB)
- FMO Dutch Development Bank (FMO)
- International Finance Corporation (IFC)
- KfW Group (KfW)
- World Bank (WB)

Endnotes

[i] European Commission. (2018). *Communication from the Commission to the European Parliament, the European Council and the European Investment Bank: Towards a more efficient financial architecture for investment outside the European Union.* Retrieved from: https://ec.europa.eu/commission/sites/beta-political/files/soteu2018-investment-outside-eu-communication-644_en_0.pdf

[ii] Große-Puppendahl, S. & Bilal, S. (2018). *What is the European External Investment Plan really about?* Retrieved from: https://ecdpm.org/wp-content/uploads/ECDPM-2018-BN-101-What-Is-The-European-External-Action-Plan-EIP-Really-About.pdf

[iii] Blomeyer, R., Paulo, S. & Perreau, E. (2017). *The budgetary tools for financing the EU external policy*. Retrieved from: http://www.europarl.europa.eu/RegData/etudes/STUD/2017/572708/IPOL_STU(2017)572708_EN.pdf

[iv] *Ibid.*

[v] European Commission. (n.d.). *Blending operations*. Retrieved from: https://ec.europa.eu/europeaid/policies/innovative-financial-instruments-blending/blending-operations_en

[vi] Blomeyer et al. (2017). *The budgetary tools for financing the EU external policy.*

[vii] Decision No 466/2014/EU of the European Parliament and of the Council of 16 April 2014 granting an EU guarantee to the European Investment Bank against losses under financing operations supporting investment projects outside the Union. Retrieved from: https://publications.europa.eu/en/publication-detail/-/publication/058a1996-0bee-4600-8d6a-60f7a2aa7448/language-en

[viii] Dobreva, A. & Parry, M. (2018). *Guarantee Fund for External Action and EIB external lending mandate.* European Parliament Think Tank Briefing. Retrieved from: http://www.europarl.europa.eu/thinktank/en/document.html?reference=EPRS_BRI(2018)614686
[ix] Decision No 466/2014/EU.
[x] Dobreva & Parry. (2018). *Guarantee Fund for External Action and EIB external lending mandate.*
[xi] European Commission. (2017). *Your guide to the EU External Investment Plan.* Retrieved from: https://ec.europa.eu/commission/sites/beta-political/files/external-investment-plan-guide-nov17_en.pdf
[xii] *Ibid.*
[xiii] Regulation (EU) 2017/1601 of the European Parliament and of the Council of 26 September 2017 establishing the European Fund for Sustainable Development (EFSD), the EFSD Guarantee and the EFSD Guarantee Fund. Retrieved from: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv%3AOJ.L_.2017.249.01.0001.01.ENG
[xiv] Blomeyer et al. (2017). *The budgetary tools for financing the EU external policy.*
[xv] *Ibid.*
[xvi] European Commission. (2017). *Your guide to the EU External Investment Plan.*
[xvii] *Ibid.*
[xviii] *Ibid.*
[xix] European Commission. (2018). *European Fund for Sustainable Development - 2017 Operational Report.* Retrieved from: https://ec.europa.eu/europeaid/sites/devco/files/efds-report_en.pdf
[xx] European Commission. (n.d.). *External Investment Plan – progress so far.* Retrieved from: https://ec.europa.eu/commission/eu-external-investment-plan/external-investment-plan-progress-so-far_en
[xxi] European External Action Service. (2018). *The Gates Foundation joins the External Investment Plan.* Retrieved from: https://eeas.europa.eu/delegations/un-rome/39156/gates-foundation-joins-external-investment-plan_en
[xxii] European Commission. (2018). *Communication from the Commission to the European Parliament, the European Council and the European Investment Bank: Towards a more efficient financial architecture for investment outside the European Union.*
[xxiii] *Ibid.*
[xxiv] European Commission. (2018). *Proposal for a Regulation of the European Parliament and of the Council establishing the Neighbourhood, Development and International Cooperation Instrument.* Retrieved from: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52018PC0460
[xxv] *Ibid.*
[xxvi] European Commission. (2018). *Communication from the Commission to the European Parliament, the European Council and the European Investment Bank: Towards a more efficient financial architecture for investment outside the European Union.*
[xxvii] European Commission. (2018). *Proposal for a Regulation of the European Parliament and of the Council establishing the Neighbourhood, Development and International Cooperation Instrument.*
[xxviii] Regulation (EU) 2017/1601 of the European Parliament and of the Council of 26 September 2017 establishing the European Fund for Sustainable Development (EFSD), the EFSD Guarantee and the EFSD Guarantee Fund, Article 9(2f)
[xxix] European Commission. (2017). *Your guide to the EU External Investment Plan,* p.14
[xxx] *Ibid.,* p. 14