

13th ECOFIN/FEMIP Ministerial Meeting

Athens, 1 April 2014

EIB Strategy for the Mediterranean: Roadmap 2020

1. Introduction

Three years after the Arab Spring, economic growth in the Mediterranean region remains constrained by a series of macro- and microeconomic challenges which the countries are still striving to meet. Nonetheless, **the region's many untapped competitive advantages mean that the Mediterranean Partner Countries (MPCs) still retain the potential to transform themselves**, in the long-term, into dynamic and competitive emerging economies.

Despite their differences, Mediterranean partner countries face the common challenge of improving economic performance. The combination of low growth and a rapidly increasing working age population has caused unemployment to skyrocket, especially among the young. **Creating job opportunities for a young, well-educated and dynamic population is therefore one of the principle challenges facing the Mediterranean Partner Countries today.** Increasing growth rates and attracting foreign and domestic investments are other pressing needs that have to be met. One dimension of the response to these challenges must be in reforms to ensure a regulatory and institutional environment which fosters private sector activity. Another dimension consists in implementing investment programmes to ensure the appropriate physical and financial environment for economic development.

While the EIB, as an investment bank, is not best suited to promote regulatory or institutional change, **it is ideally placed to support the Partner Countries as they seek to realise their growth potential through long-term investments** both in infrastructure and private sector enterprises ranging from large corporates to micro, small and medium-sized enterprises (MSMEs). As the world's largest multilateral financing institution, the EIB brings sector and financial structuring expertise at the service of the Mediterranean region with the goal of promoting inclusive, private sector led growth and employment creation.

Looking to the future, the Bank expects to continue in its role as the region's large-scale financier, providing lending, blending and advisory services. Nonetheless, **the Bank will also strive to evolve, seeking to become a more adaptive tool for the region**, offering a more structured and proactive approach to sourcing and supporting operations. Such an enhanced approach will better equip the EIB to act as the Mediterranean smart bank, serving as the partner of choice for countries wishing to follow the route to transformation.

As discussions regarding the Bank's External Lending Mandate for 2014-2020 reach their conclusion, **this note presents an overview of the region's needs in terms of investment and financing, provides an indication of the Bank's core orientations for the region over the coming years and outlines the available funding schemes.** It will serve as a basis for the next EIB FEMIP Corporate Operational Plan (COP) which will include detailed figures as well as sector and country investment strategies.

2. The Mediterranean region in 2014: a needs assessment

2.1 Infrastructure needs: substantial investments required across sectors

Appropriate infrastructure is vital to achieve economic growth. **The investments needed to close the infrastructure gaps in the Mediterranean region by 2020 are estimated at almost EUR 23 billion per annum.** Energy, transport and environmental (mainly water) infrastructure remains a high priority for the region, with a need for further quality upgrades in existing infrastructure and the deepening of networks into rural and remote areas. As energy demand continues to increase, energy security, renewable energy and energy efficiency take particular importance. Cities face specific challenges, notably strong demand for transport, sewerage, education, health, housing and other urban services, both to meet the residential needs of citizens as well as to support the growth in industry and services which is necessary for employment creation. Moreover, despite high rates of access to improved sanitation, levels of pollution remain high, continuing to negatively affect standards of living in the region. In addition, the Mediterranean, in particular its Southern and Eastern rims, is expected to be one of the regions most affected by climate change. With a large proportion of the population living in coastal areas particularly susceptible to such change, mitigation and adaptation must also be addressed.

2.2 Private sector needs: availability of finance throughout the MSME life-cycle

At present, the rate of firm formation in the Mediterranean is lower than in other regions in which the EIB operates and data show that firms created in the region tend to stay small rather than achieving growth. In terms of financing, private sector-led growth depends on the ability of entrepreneurs to obtain financing to enable them to implement their business ideas. This financing must be adapted to the sector of activity and stage of development of the particular enterprise. Low levels of banking intermediation, the limited role of equity markets and poor financial inclusion are identified among the main factors limiting entrepreneurs' access to finance. **These deficiencies create a gap between supply and demand, which significantly restricts MSME borrowing and which needs to be addressed in order to enable new business opportunities to be developed.**

2.3 Capacity building needs: stronger know-how to develop, implement and monitor projects

The need for project-related knowledge in the Mediterranean region is today more urgent than ever. Lack of finance is only one barrier to investment, and even when investments are made, weak administration and limited project management capacity often have a negative impact on the speed or efficiency of project implementation. In order to help speed-up project identification and implementation, the capacity of national administrations to prepare investment projects and make them bankable needs to be developed further. Technical cooperation and more generally advisory services are also crucial for private sector projects as well as to help to strengthen the operational capacity of financial intermediaries such as commercial banks. A request for more technical assistance and transfer of knowledge and know-how was one of the main conclusions of the 12th FEMIP Ministerial Meeting (Cyprus, September 2012).

3. The road to 2020: building the next emerging economies

The Bank's 2020 roadmap for the Mediterranean considers the two core areas of activity in the region: infrastructure financing and support for the private sector. It identifies for each area *core strengths*, on which the Bank will continue to build, and *growing strengths*, where the Bank will strive to increase and improve its activity. Finally, it presents three cross-sectoral issues

that require further emphasis from the Bank throughout its operations. Applied together, these directions will allow the Bank to evolve into a well-structured but more adaptive tool, operating as the 'smart bank' for the Mediterranean region, as a proactive partner for countries wishing to transform into competitive emerging economies.

3.1 Economic and social infrastructure

The Bank has significant expertise and experience in funding major economic- and social infrastructure projects in the region. Over the next seven years, the Bank will:

Core strength

a. **Continue to support economic and social infrastructure projects, which will remain at the heart of EIB financing in the region**

The Bank will continue to support infrastructure projects in its traditional sectors of intervention: energy, transport, water and sanitation, urban development, and health and education. It is expected that the current focus on energy and transport will be maintained, given that these two sectors continue to account for a large share of the region's investment needs.

Growing strength

b. **Begin to develop, where possible, an integrated project approach via sector-focused initiatives**

Taking a more structured view to project origination and implementation, the Bank is developing advisory initiatives which provide specific frameworks to help generate pipelines of bankable projects responding to a particular market need, often including an upstream capacity building component provided in collaboration with other partners. This integrated model, successfully pioneered under the European Commission (EC)-led Horizon 2020 initiative for water depollution (MeHSIP), has already been adopted for the following sectors:

- **Renewable energies**, with the Mediterranean Solar Plan Project Preparation Initiative (MSP-PPI);
- **Transport**, with the EU Neighbourhood Technical Assistance Programme in the Transport Sector and the Regional Integration through Trade and Transport Corridors (TRANSTRAC) initiative;
- **Water**, with the renewed MEHSIP-II initiative;
- **Urban development**, with the Urban Project Finance Initiative (UPFI), in partnership with the EC, Agence française de développement (AFD), KfW and Union for the Mediterranean (UfM). Under this initiative the Bank and its partners are in the process of identifying integrated urban development projects suitable for financing across the region, which could also involve local authorities.

Part of the sector-focused programmatic approach would be to complement support for large scale operations with **targeted support to flagship innovative smaller scale projects**, notably through project bundling.

The Bank will also seek, when appropriate, to increase the participation of the private sector in infrastructure financing through Public-Private Partnerships (PPP) schemes, notably under its Med 5 P initiative for PPPs. This initiative aims to support the development of bankable PPP projects in transport, water and wastewater, waste management, energy and renewable energy, social and urban infrastructure sectors, as a result of procuring legal, financial and technical advisory services for the preparation, procurement and implementation of PPP projects.

3.2 MSMEs and local private sector development

The EIB is already providing significant amounts of funding for the SME sector in the Mediterranean partner countries, these activities will be further reinforced over the 2014-2020 period. Over the next seven years, the Bank will:

Core strength

c. Maintain its support for private sector development through credit lines to MSMEs, equity investments and lending to the microfinance sector

In particular, the Bank will continue to support the development of the local financial markets and will contribute to broadening the funding sources of firms in Mediterranean economies both through private equity funds and through the EIB's risk capital tool, taking direct equity participations to strengthen the equity position mainly of smaller companies. The Bank will also support the microfinance sector to make sure that entrepreneurs and firms which are too small to fit into the standard commercial banking model can nonetheless benefit from access to financial services.

Growing strength

d. Broaden the range of instruments to address gaps over the whole MSMEs value-chain in view of a greater developmental impact

Only by ensuring that all actors of the economy have the possibility of accessing finance can the countries in the region start building more dynamic private sectors, which is crucial to achieving more inclusive growth. New solutions to support MSMEs will be therefore developed along a value chain approach aiming to identify gaps in the market for finance to MSMEs and develop adapted instruments aiming to fill those gaps. Notably, the Bank is currently considering the introduction of new types of financing and advisory products such as:

- **First loss portfolio guarantee schemes**, drawing on the expertise developed by the Bank in the EU;
- **Innovation-related financing platforms** supporting seed accelerators, incubators and technology transfer to improve access to entrepreneurial education and seed finance;
- **Missing-middle vehicles** to finance small and growing businesses which are too big for microfinance but do not have access to bank loans or private equity.
- **Local currency lending** to better reach smaller enterprises which often lack hard currency receivables;
- **Support schemes** enabling MSMEs to access local capital markets;
- **Technical assistance, coaching and mentoring schemes** for entrepreneurs and would-be entrepreneurs, in order to help them seek and subsequently deploy finance effectively.

3.3 Stepping-up the focus on key cross-sectoral priorities

e. Job creation is a key priority for the region and employment will be better taken into account in the assessment and development of projects funded by the Bank. Under the new Results Measurement Framework, the Bank will seek constantly to improve the overall impact of its projects. Moreover, the Bank is currently analysing the impact of infrastructure operations on job creation in partnership with the International Labour Organisation (ILO) and could include this consideration more specifically in the due diligence of future potential projects.

- f. **Climate change mitigation and adaptation will be a shared strategic interest for the Mediterranean Partner Countries and the European Union, and hence the EIB.** With an expected target for 25% of new ELM financing over 2014-2020 to be in the field of climate action, the ambition is high and yet there are no comprehensive climate change frameworks or tools for action in the region. So far, the Bank has financed relatively few climate action projects in the Mediterranean region and increasing the weight of climate action in the EIB portfolio should be a priority for the upcoming period. Dedicated climate change instruments could therefore be envisaged.
- g. **Support to regional integration will be extended through infrastructure, support for foreign direct investment (FDI) and trade finance.** While most economies in the region are relatively open externally, they trade very little among themselves, with regional trade accounting for less than 10% of total trade for the majority of the countries. Improving regional ties could support regional stability and enhance competition in the region's markets. In addition to building physical connecting infrastructure such as roads and ports, the Bank could encourage commercial ties by promoting FDI. With its large network of corporate clients in Europe and long experience in the Mediterranean, the EIB is well placed for promoting European FDI into the region, to the mutual benefit of the MPCs and EU Member States. The Bank is also considering opportunities to develop local trade finance schemes.

4. **The way forward: financial frameworks and funding partnerships**

The External Lending Mandate will be the main financial framework under which the Bank will operate in order to achieve its 2020 roadmap. In addition, the EIB will rely further on blending and financing partnerships, which can enable the Bank to offer a better and more attractive financial package to its clients. Indeed the overall development finance system in the Mediterranean region is evolving, meaning that MPCs require new types of financial support. On the one hand, the limited fiscal space of governments in the region means that large government projects are increasingly difficult to develop. On the other hand, many crucial investments in for example education, health and housing, generate poor financial returns and therefore rely on grants for their realization. Finally, projects with a riskier component relating for example to MSMEs are difficult to finance without a scheme incorporating grant resources. Improved access to grant funding would enable the EIB to expand lending to projects with high social, but limited financial returns. Grant funds would also be useful to work more effectively with the private sector by developing risk taking instruments such as risk sharing facilities. This would allow the Bank to increase its risk bearing capacity and thus its ability to fund smaller and more complex projects outside of the sovereign umbrella. The development impact of such targeted resources could be substantial, especially in this period of transition following the Arab Spring.

4.1 The External Lending Mandate

The EIB operates in the partner countries primarily on the basis of the External Lending Mandate (ELM), which allows the Bank to support EU external policy objectives using its own resources, with an EU guarantee offering either comprehensive coverage, in the case of sovereign/sub-sovereign operations, or political risk coverage only, for operations in the private sector. The ELM for the period 2014-2020 is currently under negotiation between the European Parliament, the Council and the Commission, and is subject to acceptance by the EIB governing bodies, which should take place by mid-2014, when the current Mandate expires.

Whilst the size of the mandate ceiling is still subject to formal approval, it is expected that mandate amounts for the Mediterranean Partner Countries are likely to be in a

similar range as under the current one. Local private sector development, economic and social infrastructure and climate action are expected to remain the overall objectives of the new mandate. The new lending mandate is likely to reinforce the need for alignment and complementarity between EIB operations and EU external policy objectives. This will imply closer cooperation and a search for synergies between the Bank and the European External Action Service and the European Commission, particularly through further strengthening of the dialogue on policy and strategy.

4.2 Financing partnerships and blending

Blending – the mixing of loans with grants – strengthens the EIB's ability to perform its core functions. It facilitates the provision of support to projects with low financial but high social returns, as well as for financing projects in challenging environment, achieving a high catalytic effect at the level of the final beneficiaries. Over the next seven years, the Bank will:

Core strength

h. Contribute further to the development of blending mechanisms and continue to increase synergies with other international financing institutions

The availability of grant funds from the EU budget for blending with EIB loans under the new External Mandate will therefore be essential to allow the Bank to continue offering a comprehensive and integrated financing package, alongside microfinance, risk capital and technical assistance funds. The Bank will continue actively participating in the Neighbourhood Investment Facility (NIF), the European Commission's blending facility for the region. The Bank will also continue its active participation in the EU Platform for External Cooperation and Development, together with the EC, the EEAS and other relevant players. The Bank will also increase its collaboration with other European and international financing institutions, such as that with the KfW and the AFD under the Mutual Reliance Initiative, as well as the World Bank and the European Bank for Reconstruction and Development. Cooperation will be reinforced particularly between entities on the ground.

Growing strength

i. Tap into new funding sources, proactively fundraising and engaging with shareholders and donors including non-EU financiers notably from the Gulf region

Other partnerships and fora such as the Union for the Mediterranean and the Deauville Partnership can encourage a catalytic impact through co-financing of studies, projects and joint initiatives. Such efforts will notably build on the strong foundations of the FEMIP Trust Fund (FTF), as public institutions from EU Member States and bilateral institutions already approach the Bank for common initiatives where funding from the FTF and other Trust Funds could be mobilised.

5. Conclusion

The 2014-2020 period will be crucial for the Mediterranean Partner Countries, which will have to generate sustainable and efficient solutions to the many challenges they have been facing. Under the new External Lending Mandate, the EIB will embrace the transformational role which it can play in the region, building on its existing core activities within a more integrated approach to projects, thus bringing even more added-value to its partners and to the final beneficiaries of EIB-sponsored projects. Building on the solid relations developed over the years with the partner countries, the EIB will continue supporting economic integration and catalysing investment by focusing on projects that boost development, drive job creation, address climate change and connect the EU with its neighbours.