EUROPEAN INVESTMENT BANK GROUP

Access to Finance

in the EU Neighbourhood and Enlargement Countries

European Investment Bank Group

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The European Investment Bank Group

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Management Summary

Local private enterprise development, as a major driver of economic growth, revenue generation and international competitiveness of partner countries, is a high level objective of EIB Group activities in the EU Neighbourhood and Enlargement countries. It is the main engine of poverty reduction and enables developing and emerging countries to raise standards of living and a sustainable provision of public goods and services.

A well-functioning financial sector is vital for private sector development in the region, but faces a number of hurdles. Financial systems in the EU neighbourhood are not sufficiently diversified, limiting the variety of financial instruments available for enterprises. Local deposits are insufficient to meet investment needs, or a substantial share is absorbed by local governments. The barriers faced are made even more severe by greater levels of economic uncertainty and the poor regulatory environment. These challenges hamper the ability of the banking sector to support private enterprises. Small and young firms face particular challenges in accessing finance, notably at their early stages of development due to their lack of credit history. They are often requested to provide additional collateral, which is not related to their investment.

The EIB Group disposes a range of instruments to address key issues in access to credit and other financial services in the EU neighbourhood. The bank provides comprehensive support to SMEs and mid-caps, microenterprises, large corporates as well as special purpose vehicles across all development stages from startups onwards. EIB uses its long-term banking experience in the EU to increase access to finance for enterprises in the neighbourhood and aims for an effective transfer of the EIB financial advantage (lower cost, longer maturities) to enterprises. By providing credit enhancement, EIF ensures access to finance to microenterprises and SMEs with substantial growth potential, but which lack the required collateral or business history. In 2017, the EIB signed operations in the neighbourhood region worth EUR 3.5bn, of which more than 50% was dedicated to the private sector.

In line with EU policies, EIB Group puts a particular emphasis on improving access to finance for SMEs and mid-caps through a wide range of predominantly intermediated debt-financing, risk-sharing, venture capital and private equity instruments to improve financing conditions and enable continued access to finance, further complemented by the Bank's advisory services**.** Credit lines and guarantees to SMEs and midcaps form a major part of EIB Group's activity in the neighbourhood, which will enable local intermediary banks to make more than 9000 loans this year, averaging around EUR 300,000 each. These credit lines and guarantees also allow local banks to extend the duration of the loans they offer to SMEs and mid-caps. The average loan tenor is expected to be 5.5 years, substantially more than small companies can typically access in developing economies. These credit lines and guarantees will help sustain some 240,000 jobs in final beneficiary companies in the neighbourhood. Moreover, credit lines for microfinance specifically target microfinance institutions that are specialised in extending credit and other essential financial services to the poorest groups in society, and often with a particular focus on women and vulnerable groups.

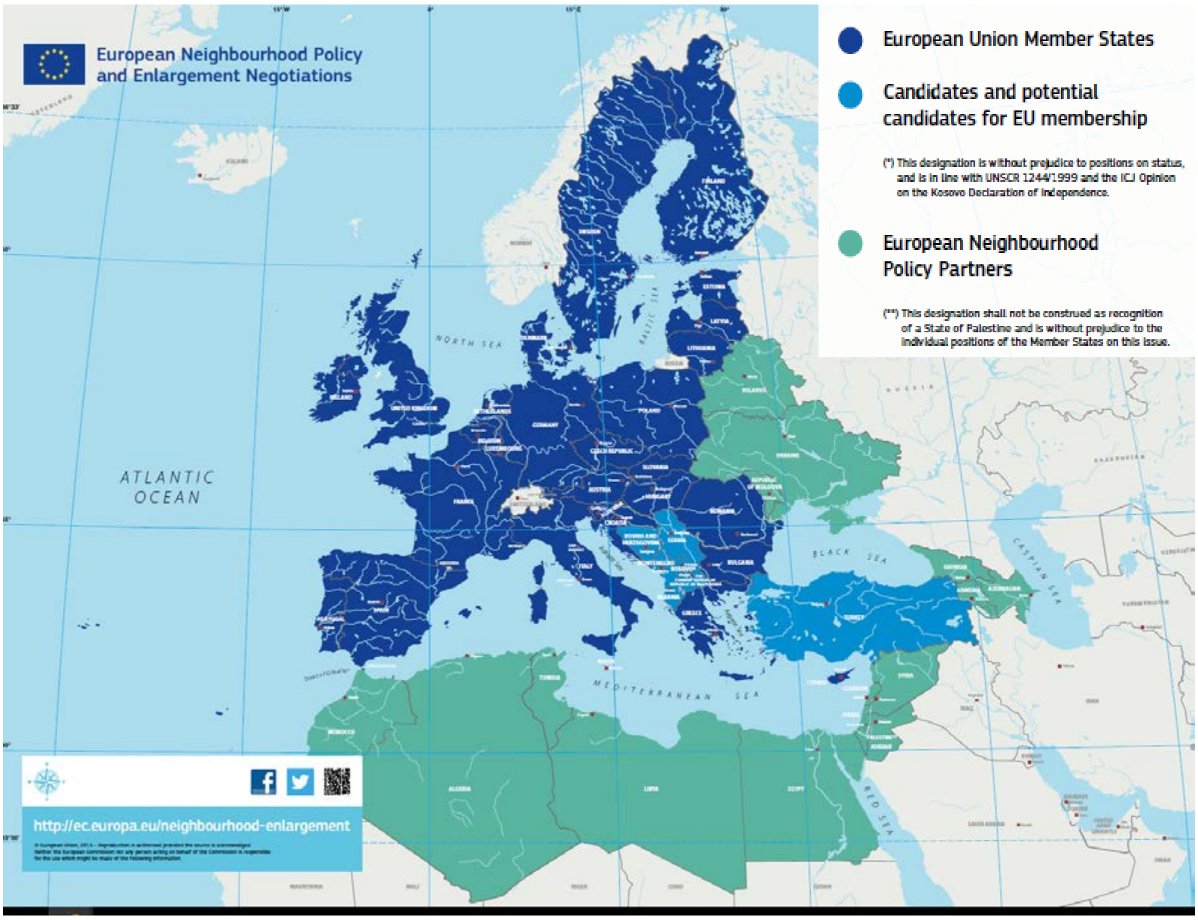
EIB lending to the private sector is complemented by support of high impact investment projects carried out by larger corporate promoters. These corporates have the competences to take risk of large investments, can implement international standards, create high quality employment and education, and thereby improve the resilience of the economy and the development of ecosystems which also benefit smaller companies. These investments often provide infrastructure, in particular transport, energy, and telecommunications which enhances the business environment for small and medium size companies. Building on several decades of experience in private sector finance, instruments such as local currency lending or equity and partial portfolio guarantees allow the Bank to address market gaps, and provide more loans to a wider range of clients in support of economic growth, job creation and financial inclusion.

Notwithstanding the notable EIB activity in the neighbourhood, the EIB and EIF can only have a significant impact in partnership with other IFIs, international donors or other relevant partners. The European Commission has a key role in consolidating cooperation and coordination of financing operations in the regions outside the EU. The EIB has developed a solid cooperation framework with International Financing Institutions (IFIs) and other international and European organisations operating in the neighbourhood. IFIs pursue a coordinated response on global issues such as climate, migration, jobs and growth, mobilising private finance. Operational cooperation most frequently consists of co-financing projects and sharing of best practices. EIB is actively pursuing opportunities of new or increased cooperation with other multilateral institutions.

1. Introduction

As early as 1962, the EIB was mandated by its shareholders – the EU Member States - to finance projects outside the Union. Since then the EIB has become an important provider of finance and assistance to EU partners. In 2017, EIB lending outside the EU reached EUR 7.9 bn, which represents just above 10 percent of the Bank's total new lending. All EIB Group activities outside the EU are guided by the EU's Global Strategy for Foreign and Security Policy and, in particular, its focus on (i) developing the resilience, including economic resilience, of EU neighbours and (ii) ensuring a "joined-up" EU where the different institutions closely coordinate and cooperate to ensure consistent action.

EU Neighbourhood Policy (ENP) covers 16 of the EU's closest Eastern and Southern Neighbours. Eastern Neighbourhood countries are Armenia, Azerbaijan, Belarus, Georgia, Moldova and Ukraine. Southern Neighbourhood countries are Algeria, Egypt, Israel, Jordan, Lebanon, Libya, Morocco, Palestine, Syria and Tunisia. EU Enlargement countries are countries in various stages of accession discussions with the EU: Turkey, and Western Balkan countries Albania, The former Yugoslav Republic of Macedonia, Montenegro, Serbia, Bosnia and Herzegovina, and Kosovo. Together, the countries are referred to EU neighbourhood countries in this report.



In the Eastern and Southern Neighbourhood the EIB and EIF (together "EIB Group") support the goals set up by the ENP. This includes support for projects that promote inclusive and resilient growth, including through better employment opportunities, and foster regional integration. In the East, EIB financed projects contribute to the so-called 4 Riga Priorities – stronger economy, stronger governance, stronger connectivity and stronger society. In the South, within the broad ENP themes of fostering economic growth and job opportunities as well as migration and mobility, EIB tailors its activities to the specific Partnership Priorities agreed between the EU and the individual countries.

In countries preparing for EU accession EIB investments and EIF credit enhancement contribute to the implementation of the EU's Enlargement Policy and foster economic development by supporting transition to fully functioning market economies, capable of coping with competition and market forces. EIB Group's current and future activities are guided by the conclusions of the EU Western Balkans Summit of May 2018 as well as the new EC strategy for the region in particular the emphasis on socio-economic development, digitalisation and connectivity. In addition to opening new markets for EU companies worldwide, EIB investments in this region play an important part in the actual enlargement of the internal market itself.

By supporting foreign direct investment to tap new markets, by lending to a large network of European clients globally, the EIB Group bolsters Europe's competitiveness while contributing to global trade and creating new opportunities for European firms to import and export. Investment outside our borders can also be a proactive measure to alleviate the risk of social and political unrest in the countries where it takes place. Resilient economies where growth is robust and inclusive – especially in terms of providing equal employment opportunities – are less likely to experience social unrest, conflict, and massive migration.

Local private enterprise development is key to economic growth and employment, and is a major pillar of EIB activities outside the EU. The 2030 Development Agenda cannot be achieved without the growth of a vibrant private sector providing decent employment and incomes to the majority of people in our societies, and to supply many of the basic services that we need. However, local private sector development is hampered by great levels of economic uncertainty and underdeveloped financial sectors. An overview of the general economic situation and the functioning of the financial systems of the relevant regions is provided in section 2.

Access to credit and other financial services can be an important enabling factor in escaping poverty and achieving greater well-being and empowerment. The EIB offers a range of financial instruments to address the financing needs of the private sector in the Neighbourhood region. Specifically, the EIB Group offers: credit lines and individual loans to promote innovation and encourage the development of SMEs, mid-caps, microenterprises and large corporates; private equity to strengthen the capital base of productive businesses; and guarantees and advisory services to improve banks' ability to deal with risky borrowers. EIF offers credit enhancement mainly thanks to EC and regional mandates. These instruments are discussed in more detail and per region in the following section.

Box 1: EIB Group

The EIB Group consists of the European Investment Bank and the European Investment Fund, which is a specialist provider of risk finance for SMEs across Europe. The EIB is the majority EIF shareholder, and the EIF deploys capital on behalf of the EIB and other shareholder such as the European Commission.

2. Market needs and EIB intervention in the EU neighbourhood

A well-functioning financial sector is vital for private sector development in the EU neighbourhood. It can facilitate the exchange of goods and services, the diversification of risk, the mobilization of savings, and the identification of good business opportunities—all of which encourage investment and entrepreneurship. These functions enable rapid accumulation of physical and human capital, boost technological advances, and thus promote faster growth and higher levels of employment. However, the financial sector's ability to play its intermediation role can be hampered if, for instance, it is not sufficiently diversified, the regulatory environment is poor, or government refinancing needs crowd out the private sector.

Financial intermediation in the EU neighbourhood takes place in an economically and institutionally heterogeneous context:

- **Southern Neighbourhood –** An average rank of 114 (out of 188) in the 2018 edition of Doing Business (Table 1), indicates considerable scope for improvement in the business environment of the region. In addition to a poor business environment, the Southern Neighbourhood is plagued by political instability, poor infrastructure quality and limited access to finance. As a result, the region is unable to generate sufficient jobs for a young and growing population. At 79% of GDP, public debt exceeds the middle-income-country average by a wide margin. There is evidence that at least in some countries government financing needs have crowded out the private sector.
- **Eastern Neighbourhood -** Most economies of the region are small and relatively undiversified. An average Doing Business rank of 45 signals the success of past efforts to improve the *de jure* business environment (Table 2). But despite the substantial efforts, a further strengthening of institutions is needed, in particular in the area of rule of law. In addition to structural shortcomings, global and regional shocks have adversely affected macroeconomic and financial stability in the region, bringing about abrupt changes in the value of some currencies. In this context, high dollarization of liabilities is of a particular concern for the region. Moreover, the funding base is constrained by low saving rates. Last but not least, governance in the banking sector could be strengthened further, aligning with best banking practices.
- **Western Balkans –** Though the business environment compares favourably to peer economies (Table 3), the region continues to suffer from structural gaps in many areas, including innovation capacity and strategic infrastructure. The region's capacity for innovation suffers from a low endowment with human capital. As a result, investment is geared more towards infrastructure and less towards R&D. Infrastructure investments, including energy, transport and ICT investments focusing on improving the connectivity among Western Balkan countries would contribute to lower firms' costs and facilitate their integration into international supply chains.
- **Turkey -** At USD 10,500 per capita GDP, Turkey easily exceeds the average of other neighbourhood countries. Turkey's main weakness is its longstanding dependence on international capital inflows, which exposes it to swings in market sentiment. The resulting macroeconomic imbalances and the ongoing deterioration in the rule of law put the country's long-term economic prospects at risk. Between mid-2016 and mid-2018 Turkish lira lost more than 50% against the US dollar, raising severe concerns about the sustainability of the country's growth model.

The financial systems of our European Neighbourhood share common features – most notably a lack of diversification limiting the choice of financial instruments. Financial systems are bank-centred and the small size of non-bank financial institutions and capital markets limits the variety of financial instruments available to enterprises. Microfinance and private equity investments are operating below potential. Capital markets remain underdeveloped despite significant growth. In addition, the availability of venture capital and leasing is limited. Though there is considerable scope to improve non-bank finance, bank debt remains the most important source of external finance for many SMEs.

The banking sectors of the European neighbourhood differ considerably in terms of size. Whereas the banking sectors of the Southern Neighbourhood are large by the standards of middle-income-countries, the opposite applies to the Eastern Neighbourhood, with the Western Balkans in between. Though deposits appear to be ample in the South, a substantial share is absorbed by local governments. Lack of deposits in the East leaves these economies dependent on capital inflows, with the associated financial stability risks. Though Turkey's banking system is more advanced, local currency deposits are insufficient to cover investment needs there as well. In economies dependent of capital inflows, the provision of local currency funding can add value.

There is scope to improve risk assessment capacity. The quality of *de jure* collateral frameworks exhibits substantial variation across the neighbourhood. Whereas the Western Balkan economies have modern rules governing secured transactions, those in the Southern Neighbourhood are in many regards deficient. Yet, Enterprise Survey[1] data suggest that also in the Western Balkans the majority of collateralized loans are secured with land. Technical assistance or portfolio guarantees may reduce banks' reliance on land as collateral and thereby facilitate access to finance for young and asset-light firms in particular.

2.1. Southern Neighbourhood

Access to Finance

The Southern Neighbourhood is characterized by a disconnect between firms and the financial system. At 23%, the share of credit-constrained firms appears low at a first glance (see Figure 1), but this mainly reflects weak demand for loans. In particular, 58% of firms report that they do not need a loan as they have enough capital to run their business. Earlier work finds that these firms, which they refer to as disconnected, behave very much like credit-constrained firms: they are less likely to invest and expand, even when they operate at full capacity, missing out on growth and job creation opportunities.[2]

The banking sectors of the Southern Neighbourhood countries differ in their intermediation capacity. Figure 1 allows to compare the supply of loans with demand. In Lebanon, Morocco, and Tunisia a significant share of firms in need of a loan are able to obtain one. In Egypt, Palestine, and to a lesser extent Jordan, the majority of firms needing a loan are discouraged from applying.

Financial Sector Constraints

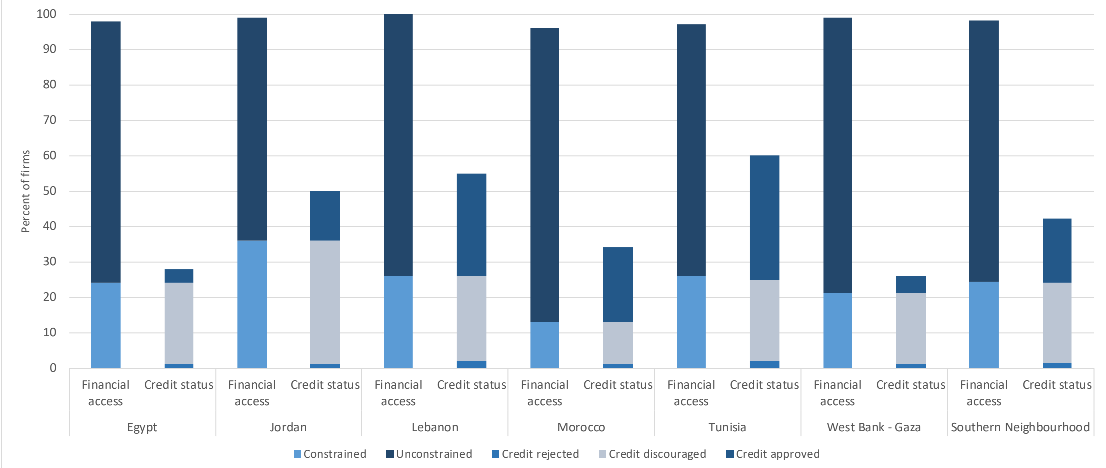
Despite current capacity constraints, the large banking sectors of the Southern Neighbourhood have a significant financial intermediation potential. The size of the banking sectors reflects the capacity

[1] Enterprise Surveys are firm-level surveys of a representative sample of an economy's formal private sector. The surveys cover a broad range of business environment topics including access to finance. In the Southern Neighbourhood, Enterprise Surveys are implemented jointly by EIB, EBRD, and the World Bank.

[2] European Bank for Reconstruction and Development, European Investment Bank, and The World Bank. 2016. What's Holding Back the Private Sector in MENA? Lessons from the Enterprise Survey. Washington, DC: The World Bank. License: Creative Commons Attribution CC BY 3.0 IGO

of banks to attract large amounts of deposits, equivalent to 98% of GDP (Table 1), easily exceeding the level of peer economies.

Figure 1: Credit constraints in the Southern Neighbourhood



Source: Enterprise Surveys

Note: The chart shows two bars per country. The first bar decomposes the population into constrained and unconstrained firms. Credit constrained firms either had their loan application rejected or were discouraged from applying in the first place. Unconstrained firms either had no need for finance or had their loan application approved. The second bar displays the composition of the subgroups. The height of the second bar shows overall credit demand.

Funding, soundness and risk assessment characteristics of banking sectors in the Southern Neighbourhood hamper their ability to support private enterprises, despite their size and potential:

- **Financial soundness:** The slowdown in economic activity following the Arab Spring has lowered the creditworthiness of the sovereigns in the region. This, in turn, has adversely affected the quality of bank balance sheets as many banks have seen their sovereign exposure increase in recent years. That said, banks have been able to keep non-performing loans on levels comparable to peer economies, with the exception of Tunisia and Algeria.
- **Exposure to sovereigns:** Though banks appear to have access to ample funding, a large share of deposits is diverted to finance countries' large stock of sovereign debt. (Table 1). Banks' exposure to their sovereigns exceeds the level observed in peer economies inside and outside the Neighbourhood by some margin. In some instances this has led to crowding out private sector lending and limit the incentive of banks to engage in more complex lending to small firms with more pronounced information asymmetry problems.
- **Funding:** With banks relying almost exclusively on deposits for funding, access to long-term loans reduces banks' maturity mismatch. While deposits have proven sticky also during episodes of high political uncertainty, provision of long-term funding can enable bank to issue loans at longer maturities. While the recipients of EIB funding need to have adequate absorption capacity, which tends to favour larger banks, the provision of funding to promising smaller players can lead to increased competition, which in turn may prompt banks to reach out to new market segments.
- **Risk assessment:** The countries of the Southern Neighbourhood perform poorly in the access to credit dimension of the Doing Business analysis, mainly because of the rules governing secured transactions (Table 1). As a result, many banks in the Southern Neighbourhood rely heavily on collateralized lending. The share of collateralized loans exceeds that of peer economies in all countries except Lebanon and Palestine. Young and small firms in particular may find it difficult to meet stringent collateral requirement. Heavy reliance on collateral can

also reflect lending technologies not attuned to the needs of SMEs. Here, the EIB can help by providing technical assistance to banks interested in starting or reforming their SME business.

Table 1: Access to Finance and the Banking Sector in the Southern Neighbourhood

Economy	GDP per capita (current prices; US$)	Doing Business Rank 2018	Bank non-performing loans to total loans (%)	Bank credit to bank deposits (%)	Outstanding deposits with commercial banks (% GDP)	Credit to the government and state owned enterprises (% GDP)	Branches of commercial banks per 100,000 adults	Strength of legal rights index (0-12, best)	Collateral loans secured with land (%)
Algeria	4292	166	11	40	48	34	5	2	N.A.
Egypt	2501	128	7	41	78	49	5	2	76
Jordan	5678	103	5	71	122	43	15	0	50
Lebanon	11409	133	5	40	270	71	24	2	64
Morocco	3151	69	7	74	86	23	25	2	65
Tunisia	3496	88	14	133	62	8	20	3	67
West Bank - Gaza	3031	114	2	50	18	N.A.	11	8	25
Southern Neighbourhood	**4794**	**114**	**7**	**64**	**98**	**38**	**15**	**3**	**58**
Upper middle income	**7597**	**99**	**5**	**99**	**66**	**12**	**23**	**5**	**55**
Lower middle income	**2481**	**123**	**10**	**97**	**47**	**10**	**14**	**6**	**58**

Source: IMF, World Bank, EIB calculations, 2017 or latest available

Box 2: What determines credit constraints in Egypt?

The small share of firms that apply for bank loans in the Southern Neighbourhood reflects the alarming low demand in formal credit markets. [3] *This box argues that this low demand is in turn driven by cyclical – including the rapid increase in bank lending to the government – and structural problems in the financial system and business environment – that are reflected in the large share of firms that do not have a checking or savings account. Addressing these problems will be critical to foster private sector development, economic recovery and inclusive growth in the region.*

The share of firms that need a loan is lower in the MENA region than in other economies of comparable income.[4] Also, the share of firms that are credit-constrained is lower in MENA than in any other region of the world.[5] But this low share of credit-constrained firms is not due to successful loan applications; instead, many firms report that they have enough capital and do not need a loan because they do not want to engage with banks.[6]

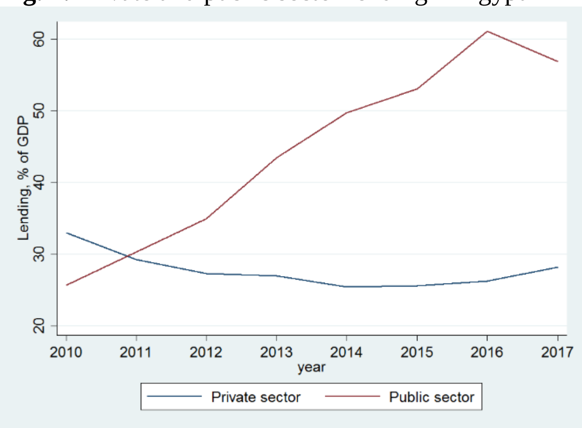
The firms that report they do not need a loan can be referred as disconnected from the formal banking system. These firms have adjusted production strategies to an environment where borrowing from banks is not really an option. Furthermore, among the firms that need a loan, the share of firms that are discouraged from applying for bank finance is higher than in peer economies. In fact, a significant share of discouraged firms do not even have a checking or saving account and are completely disconnected from the banking system.

For several reasons Egypt is a useful laboratory to answer the question "Why firms disconnect from the banking system?" using econometric analysis. First, the informal economy accounts for a significant share of overall economic activity. Even within the formal sector, many firms operate on a cash-only basis: they are excluded from the banking system *de facto*, even when they are formally registered. Second, the availability of longitudinal data makes the empirical evidence more convincing. In the case of Egypt, two waves of Enterprise Survey data are available, with about 600 firms participating and answering the same questionnaire in both 2013 and 2016.

Informality and financial exclusion play a role in explaining the low demand for credit in Egypt, but crowding out due to higher government borrowing can also discourage firms to apply for bank loans. Following the uprisings of 2011, Egypt went through a difficult period. Output growth declined to levels barely above population growth. To assuage social pressures, the authorities increased spending and subsidies, resulting in higher public debt levels, and relied on lending by domestic banks (Figure 1). This may have reduced bank lending to the private sector. The analysis uses a measure of crowding out to account for the difficult cyclical position of the Egyptian economy. In addition to bank balance sheet data, the measure exploits information on the location of firms and bank branches to proxy crowding out. A firm that is surrounded by many bank branches that heavily invest in government debt will score high on the crowding out index.

Crowding out adversely affects credit supply. Firms surrounded by bank branches that invest heavily in government debt are more likely to be credit constrained and discouraged to apply for a loan (Table 1; third column of estimates, first row).

Fig. 1. Private and public sector lending in Egypt



Source: Central Bank of Egypt and EIB calculations.

Entrepreneurial human capital and financial inclusion: entrepreneurs with a university education and with higher experience are less likely to be credit-constrained and discouraged to apply for a loan. They are also more likely to obtain an account. The analysis uses the education and experience of the entrepreneurs to proxy for the quality and quantity of human capital. The results are consistent with existing evidence on the relation between entrepreneurial human capital and informality suggesting that informal firms tend to be small and unproductive.[7] Low levels of productivity reflect a lack of skills of the entrepreneurs: unable to access loans, these are more likely to operate on an informal basis in order to save on taxes and business licences.

Efficient governance and lower administration cost: firms trade-off the costs and benefits of participating in the formal banking system. As only registered firms can access the financial system, entrepreneurs need to decide whether to operate formally. Operating formally entails costs in the form of registration costs, time consuming process and taxes; but it also comes with access to bank finance, public goods and services, such as licencing and the judicial system (Straub, 2005).[8] In this context, the Central Bank of Egypt's SME initiative or the Ministry of Investment's GAFI one stop shop have tried to decrease the administration cost and complexity of registration and improve access to public services for SMEs. This may have incentivised some firms to operate on a formal basis. Enterprise Survey data only include registered firms but one can argue that firms without a checking or savings account operate on a semi-formal basis. Operating on a cash-only basis aggravates the information asymmetries that plague SME lending, but presumably facilitates tax avoidance. The results suggest the government policy had an impact on the decision of firms to have a checking or savings account: firms that used the GAFI one stop shop were more likely to open an account between 2013 and 2016.

Table 1. Regression results

	Δ Own a bank account	**Δ Reports need for financing**	**Δ Report credit constraint**
Crowding out	-0.028	0.053	0.089***
	(0.05)	(0.06)	(0.03)
Δ CEO education	0.115**	-0.110*	-0.058*
	(0.06)	(0.06)	(0.03)
Δ CEO experience	0.050**	0.006	-0.032**
	(0.02)	(0.03)	(0.01)
GAFI one stop shop	0.101*		
	(0.06)		
Loss due to spoilage		0.238**	
		(0.11)	
Loss due to gift request		0.151*	
		(0.09)	
Loss due to power outage		0.068	
		(0.08)	
Δ Need			0.732***
			(.017)
Observations	473	486	486

Note: **The analysis is based on data of the Enterprise Survey for Egypt. The dependent variables in columns (1)-(3) are based on indicator equal to 1 if the firm, respectively, has a checking or savings account; needs a loan; or has a rejected loan application or was discouraged from applying in the first place. Variables marked by a Δ-prefix are defined as the first difference between the value in 2016 and 2013. Thus, for example, a firm which hired a university educated CEO (see definition above) is 11.5 percent more likely to open a checking or savings account. The first column of results is estimated using ordinary least squares (OLS), the estimates in the second and third columns are based on instrumental variables (IV) and refer to the first and second stage IV estimates.**
Additional explanatory variables (whose estimates are not reported) include: measures of ownership structure (whether the firm is foreign owned), firm's age, whether the firm exports, has audited financial statements. The regression analysis also controls for the location (governorate) and sector in which the firm operates.
Standard errors shown in parentheses: * denotes statistical significance at the 10% ** at the 5% and * at the 1% level.**

[3] The box is based on Betz, Ravasan and Weiss (2018), "Understanding financial constraints in the MENA region", European Investment Bank, mimeo.

[4] The MENA Enterprise Survey includes seven of the ten countries of the Southern Neighbourhood. Algeria, Libya and Syria are not covered in the MENA Enterprise Survey.

[5] Credit constrained firms are those that find it challenging to obtain credit. They typically fall into two categories: (i) those that applied for a loan and were rejected; and (ii) those that were discouraged from applying either because of unfavourable terms and conditions or because they did not think the application would be approved. The terms and conditions that discourage firms include complex application procedures, unfavourable interest rates, high collateral requirements, and insufficient size of loan and maturity.

[6] Only firms that need a loan can be credit constrained: this means that the share of credit-constrained firms cannot exceed the share of firms that need a loan.

[7] See La Porta and Shleifer (2014), "Informality and development," Journal of Economic Perspectives 28, 109–126.

[8] See Straub (2005), "Informal sector: The credit market channel," Journal of Development Economics 78, 299–321.

EIB Group Activity in the Southern Neighbourhood

To address the constraints in accessing finance identified above, the EIB has made access to finance one of its priorities in the Southern Neighbourhood. By giving these entrepreneurs the means to create and develop their businesses, the EIB is supporting the revival of growth and employment in the region. In 2017, EIB lending in the Southern Neighbourhood has reached EUR 1.9bn, an increase of more than 20% in one year. 53% of this lending volume was dedicated to the private sector.

EIB credit lines for SMEs and mid-caps will partly overcome the crowding-out effect of bank lending to governments. In a banking sector which heavily relies on collateralized lending, the provision of EIB portfolio guarantees should further incentivize banks to lend to riskier firms. The committed credit lines and guarantees in 2017 enabled local intermediary banks to make 3690 loans in the Southern Neighbourhood, averaging around EUR 428,000 each. It is expected that these credit lines and guarantees will help to sustain some 122,000 jobs in final beneficiary companies. The average loan tenor for these loans is expected to be 5.9 years, which is substantially higher than the rest of the Neighbourhood.

EIB's risk capital operations in the Southern Neighbourhood strengthen the capital base of productive companies in the private sector and foster development of local capital markets. This objective is pursued by direct investments by acquisition of equity or quasi-equity instruments or investments in private equity funds, themselves taking equity stakes in private companies with a clear focus on growth. As at end December 2017 the FEMIP Risk Capital portfolio under management consisted of 33 private equity funds, impacting more than 220 companies, and 6 direct investments. In addition, 25 co-investments were made with pre-selected local intermediaries. These instruments increase the choice of alternative financing instruments for enterprises in a poorly diversified financial market.

The EIB Group is a pioneer in financing to the microfinance industry in the Southern Neighbourhood and is one of the few IFIs providing unsecured local currency funding in the region. The EIB plays an important role in reinforcing the self-sustainability and the financial standing of microfinance institutions (MFIs), thanks to its local currency funding (on sustainable, commercial terms) and technical assistance programs. The EIB has succeeded in catalysing local commercial funding to complement the standard operations carried out by the mainstream international donors' community (e.g. subsidies and subsidised loans), and helped MFIs manage their integration into the local financial markets. At the end of 2017, the EIB had invested EUR 46m in microfinance institutions and has active loans/direct equities for a total cost of EUR 18.7m, reaching over 600,000 micro-borrowers, of which more than 60% are women.

Corporate lending in the Southern Neighbourhood focuses primarily on investments that promote the creation of high-quality jobs and contribute to economic resilience in general, for example by supporting renewable energy and contributing to the improvement of the local infrastructure. In 2017, three important projects were approved in Morocco and Tunisia in the manufacturing sector. These projects will create some 1000 temporary jobs during construction phase and lead to almost 2000 permanent jobs afterwards.

In the Southern Neighbourhood, technical assistance is a key instrument for improving the quality of lending operations and enhancing their development impact. The provision of upstream support and advisory services plays an important role in ensuring the efficient identification, preparation and implementation of projects in all sectors. The EIB supports the micro-, small- and medium-sized enterprises (MSMEs) through studies and advisory services improving access to markets and supporting the development of banking intermediation services and mobile financial services. Technical assistance is also provided to microfinance institutions to leverage the impact of the risk capital operations, notably through capacity building programmes.

Support to Egyptian SMEs (20m credit line under Economic Resilience Initiative)

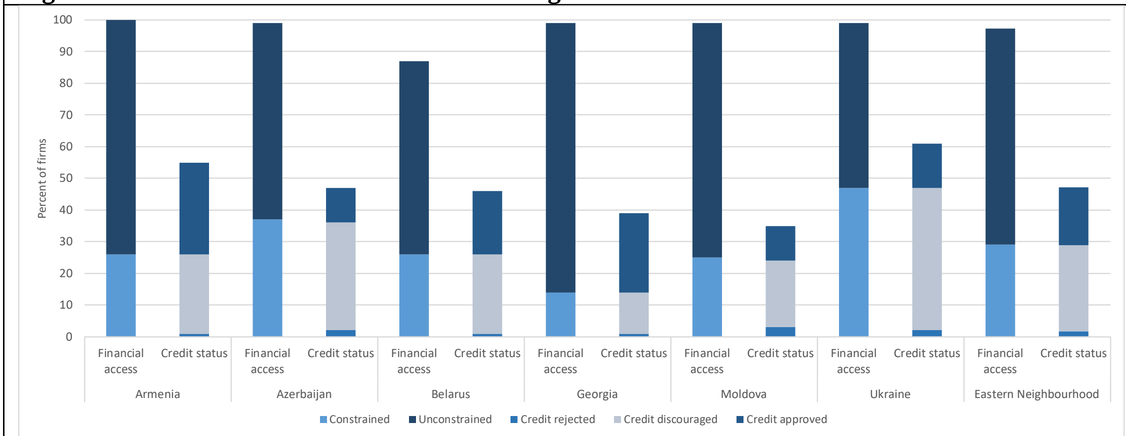
The finance agreement is the first EIB credit line for small and medium-sized enterprises provided through Alexbank. Alexbank will channel the funds at affordable rates to Egyptian businesses, thereby enhancing economic growth by catalysing and accelerating private investment. Alexbank is one of Egypt's leading private sector banks. It provides financial and non-financial services to its clients, including innovative products aiming to support development of local SMEs and reaching out to traditionally underserved groups like women, young people and entrepreneurs in rural areas.

2.2. Eastern Neighbourhood

Access to Finance

Indicators of financial access in the Eastern Neighbourhood are comparable to peer countries. At 18%, the share of successful loan applications is similar to that of the Southern Neighbourhood. Yet, in many countries, supply struggles to meet demand. As Figure 2 shows, the majority of firms that need a loan are discouraged from applying in all Eastern Neighbourhood countries except for Armenia and Georgia. The share of credit-constrained firms is particularly high in Ukraine. Additional data from Enterprise Surveys suggest that the financial systems in the region do not channel sufficient financial resources to support long-term investment and, in some countries, even working capital needs. This partly reflects the low volume of available deposits, which at 34% of GDP lags the average of lower-middle-income countries.

Figure 2: Credit constraints in the Eastern Neighbourhood



Source: Enterprise Surveys

Note: The chart shows two bars per country. The first bar decomposes the population into constrained and unconstrained firms. Credit constrained firms either had their loan application rejected or were discouraged from applying in the first place. Unconstrained firms either had no need for finance or had their loan application approved. The second bar displays the composition of the subgroups. The height of the second bar shows overall credit demand.

Financial Sector Constraints

The banking sectors of the region were severely hit by the financial crisis and not all countries managed to restore the intermediation capacity of their banks.[9] Lacklustre growth performance,

[9] For further discussion on how to build more resilient banking sector in the region, see also IMF (2018) 'Building Resilient Banking Sectors in the Caucasus and Central Asia' No. 18/08, Middle East and Central Asia Department

coupled with sharp currency devaluations, has further aggravated financial stability risks in the region. Moreover, cyclical difficulties are having an impact, in an environment of already structurally low saving rates and volatile inflation, which limit banks' ability to attract deposits. At the same time, financial infrastructure could be further improved to reduce information asymmetries and improve the allocation of funds. Last but not least, governance in the banking sector could be strengthened further to align with best banking practices.

Table 2: Access to Finance and the Banking Sector in the Eastern Neighbourhood

Economy	GDP per capita (current prices; US$)	Doing Business rank 2018	Bank non-performing loans to total loans (%)	Bank credit to bank deposits (%)	Outstanding deposits with commercial banks (% GDP)	Credit to the government and state owned enterprises (% GDP)	Branches of commercial banks per 100,000 adults	Strength of legal rights index (0-12, best)	Collateral loans secured with land (%)
Armenia	3861	47	7	87	33	2	23	6	41
Azerbaijan	4141	57	5	144	27	4	11	2	67
Belarus	5760	38	13	133	32	21	1	3	24
Georgia	4099	9	3	118	40	0	33	9	56
Moldova	2280	44	17	50	39	2	10	8	70
Ukraine	2583	76	55	120	32	4	0	8	21
Eastern Neighbourhood	**3787**	**45**	**17**	**109**	**34**	**6**	**13**	**6**	**47**
Upper middle income	**7597**	**99**	**5**	**99**	**66**	**12**	**23**	**5**	**55**
Lower middle income	**2481**	**122**	**10**	**97**	**47**	**10**	**14**	**6**	**58**

Source: IMF, World Bank, EIB calculations, 2017 or latest available

- **Financial soundness:** The legacy of the financial crisis, coupled with sharp currency devaluations, have been detrimental to financial stability in a number of countries in the region. As a result, non-performing loans increased while profitability and capital adequacy declined. Azerbaijan and Ukraine in particular still need to clean up banks' balance sheets and regain the confidence of international and domestic investors.
- **Funding:** Scarcity of funding remains a problem in all countries of the region. In order to improve it, banks have to resort to external borrowing. By providing long-term funding on favourable terms, EIB can make a valuable contribution. A related problem is the dollarization of liabilities, as a substantial portion of residents' deposits is denominated in foreign currencies. Volatile inflation and exchange rates have pushed local savers towards hard currencies, and the funds provided by foreign investors typically come also in hard currencies. Given the lack of derivative instruments to hedge currency risk, banks either bear the currency risk themselves or pass it to their clients. In the latter case, banks are vulnerable to unfavourable exchange rate movements through defaults of their unhedged clients. Such risks are especially pronounced in jurisdictions where banks' open positions are limited by regulations, while lending to unhedged borrowers is not. In this context, EIB can help by providing funding in local currency.
- **Risk assessment:** The economies in the region are relatively advanced in terms of compiling credit information. Nevertheless, weaknesses in protecting legal rights and inadequate enforceability of contracts exacerbate information asymmetries, which affect SMEs and innovation-related activities in particular. As a consequence, interest rates are high and the proportion of loans requiring collateral exceed that of peer countries. Credit guarantee schemes, which could alleviate these impediments, are not widely used.

EIB Group Activity in the Eastern Neighbourhood

The Bank's activities in the Eastern Neighbourhood promote growth and employment, intraregional trade and climate change mitigation. In 2017, EIB lending volume in the EU Eastern Neighbourhood reached EUR 734m. This demonstrates EIB's continuous support to the region after previous year's achievement of EUR 1.6bn of new loans, largely reflecting EIB's commitment to its 2014-2016 Special Action Plan for Ukraine. Lending to Ukraine represented more than 40% of total signatures in the EU Eastern Neighbourhood. The Bank has continued to support the local private sector, which represents 37% of the total lending volume there, over the last four years.

In 2017, the Bank has significantly increased its provision of portfolio guarantees to banks in Ukraine, Georgia and Moldova, under the Deep and Comprehensive Free Trade Area (DCFTA) Initiative East, managed and implemented by the EIF. The guarantees, which cover up to 70% of incurred losses, enable local banks and other financial intermediaries to improve lending terms and conditions, in particular by reducing collateral requirements. In the Neighbourhood region, known by its reliance on collateralized lending, the guarantees support lending to smaller business by absorbing a proportion of the risk involved, and incentivize intermediaries to lend to riskier projects.

Guarantees and other credit lines in support of SME and mid-caps have enabled local banks to lend EUR 423m, representing 3500 loans. It is expected that these loans, with an average loan size of EUR 120,000, will help sustain some 19,800 jobs in final beneficiary companies. The average loan tenor is expected to be 5 years, which is substantially higher than SMEs and mid-caps can typically access in the Eastern Neighbourhood. Given the scarcity of funding of local financial intermediaries, EIB's medium to long-term lending on favourable terms makes a valuable contribution to the SMEs and mid-caps of the region.

In 2017, the Bank provided its first local currency loan in Ukraine to improve SMEs' access to financing. The loan, worth EUR 60m, to ProCredit Bank Ukraine was made possible by TCX and donor resources from the EU. EU support in the form of grant funding, enabled a reduction of the high hedging costs and a competitive interest rate on the loan. Local currency loans are often offered for high prices by local banks, due to aforementioned scarcity of local currency funding and the lack of hedging possibilities. Local SMEs and mid-caps, which usually have earnings in their local currencies, take significant risks when they borrow unhedged in hard currencies. Further intervention on this field by EIB and other MDB's will be highly important for the region.

Under the DCFTA, the bank also supports local micro-enterprises by providing financing to local microfinance institutions. The initiative aims to channel resources towards 15,600 micro-enterprises in the region, creating and/or sustaining over 30,000 jobs, including integration of women in the workforce. Senior Loans are generally provided with tenors of 5-7 years, depending on the intermediaries' debt servicing capacity. In addition, financing subordinated to senior creditors typically enhance the intermediaries' capital structure. EIB Group has also equity participations through ordinary or preferred shares, typically with an investment horizon of 6-8 years.

The Bank continues to support larger corporates with direct investment loans. As in the Southern Neighbourhood, the EIB promotes high impact projects that create high-quality jobs, support renewable energy and mitigate climate change effects, and contribute to the improvement of the local infrastructure. Additionally, corporate lending aims to make entire ecosystems more dynamic, through the beneficial effect for supply-chain SMEs and the integration of high standards at governance and production levels.

Technical assistance operations in the Eastern Neighbourhood fill critical gaps for the development and implementation of investment projects. EIB assists in the identification of suitable investment projects of promoters, and finances the development of master plans. Preparation of feasibility studies are also eligible, including technical, economic and financial appraisals, environmental and social impact assessments, upstream studies to identify investment needs and priorities as well as horizontal activities addressing institutional issues and capacity building. During the implementation phase of projects, EIB support mainly addresses strengthening of project management and operational skills.

The EIB Group has signed a framework agreement with Belarus in August 2017. Belarus became an eligible country in 2016 under the External Lending Mandate by a delegated decision of the European Commission. In 2017, a number of investment projects were identified for potential EIB support, including in the private sector. The first operation was approved by the EIB Board in December 2017 and will support the upgrade of the highway from Minsk to the Lithuanian border.

2.3. Western Balkans

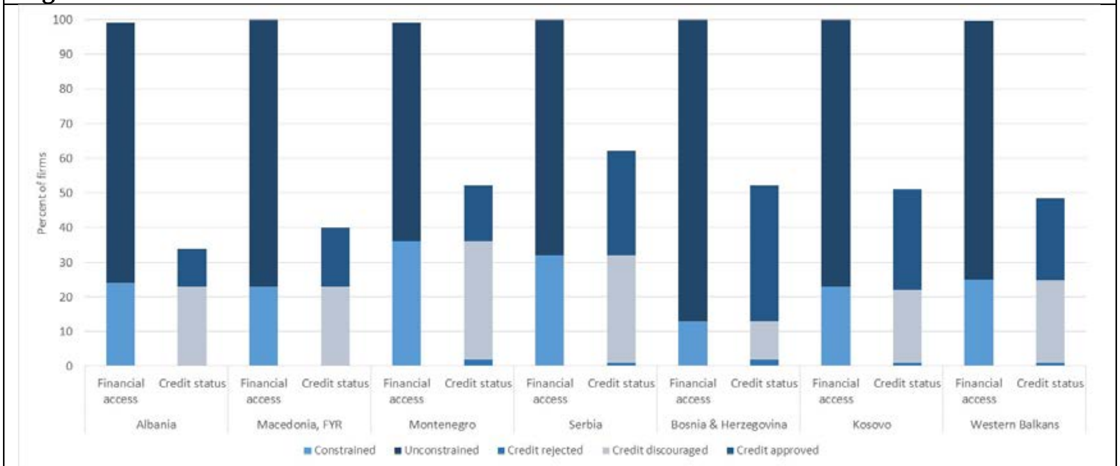
Access to Finance

Access to finance in the Western Balkans appears slightly more advanced than in the Southern and the Eastern Neighbourhood. This applies to standard indicators of financial inclusion such as the penetration of bank branches and the prevalence of checking accounts among firms, both of which compare favourably to the average of middle-income countries (see Table 3). According to Enterprise Survey data (see Figure 3), 24% of firms in the Western Balkans report a successful loan application. This exceeds the corresponding share in both the Southern and the Eastern Neighbourhood. The constrained enterprises are almost entirely those that are discouraged from applying in the first place and only 1% are rejected. The highest share of constrained firms are in Serbia and Montenegro (above 30%) while Bosnia and Herzegovina has both the lowest share of constrained firms (slightly above 10%) and the highest approval rate.

Financial Sector Constraints

Despite comparatively favourable access to finance outcomes financing of private sector appears limited by conservative lending practices. According to the getting credit dimension of the World Bank's Doing Business Report, the countries of the Western Balkans have the most advanced collateral frameworks of the European Neighbourhood. Yet, banks rely heavily on land as collateral.

Figure 3: Credit constraints in the Western Balkans



Source: Enterprise Surveys

Note: The chart shows two bars per country. The first bar decomposes the population into constrained and unconstrained firms. Credit constrained firms either had their loan application rejected or were discouraged from applying in the first place. Unconstrained firms either had no need for finance or had their loan application approved. The second bar displays the composition of the subgroups. The height of the second bar shows overall credit demand.

- **Financial soundness:** The regulatory environment for financial institutions is generally good in the region and has been improving as a whole in the last decade, partly spurred by increased adoption of EU practices. The sector's capital adequacy ratio is above the regulatory minimum of 12%, but for some smaller local banks low capital ratios are a cause for concern. The share of NPLs is close to peer economies except for Serbia and Albania, while provisioning is low in Montenegro. In Montenegro and Kosovo the authorities have limited ability to provide liquidity support due to unilateral adoption of the euro. There is also a reliance on non-resident deposits that may flow out in times of stress.
- **Exposure to sovereigns:** In Albania and, to a lesser extent, Serbia, the government absorbs a significant share of the available deposits reflecting the large footprint of the public sector in

these economies (Table 3). The problem appears especially salient in Albania as the banking sector is rather small to begin with, even though, as a share of GDP, the volume of credit directed to the government is somewhat smaller than in the average economy of the Southern Neighbourhood.

- **Funding:** Banks liquidity position has continued to improve on the back of better access to retail and corporate deposits. There is a limited supply of longer-term loans as deposits are mainly short-tem. This affects local currency loans in particular. Nevertheless, banks in Bosnia and Herzegovina', as well as Serbia, may need to resort to wholesale markets or parent funding tap in the near future as their loan-to-deposit ratios approach 100%.
- **Risk assessment:** According to the "Getting credit" dimension of the World Bank's "Doing Business" report, the countries of the Western Balkans have the most advanced collateral frameworks of the European Neighbourhood. Yet, banks in the Western Balkans rely heavily on land to secure loans. The share of loans secured by receivables is low also when compared to countries with less advanced collateral rules. There are credit guarantee schemes in the Western Balkans, but with a varying degrees of success. While IFIs offer portfolio guarantees that are extensively used, government-established guarantee funds usually provide guarantees on behalf of individual borrowers, which tends to limit their reach.

Table 3: Access to Finance and the Banking Sector in the Western Balkans

Economy	GDP per capita (current prices; US$)	Doing Business Rank 2018	Bank non-performing loans to total loans (%)	Bank credit to bank deposits (%)	Outstanding deposits with commercial banks (% GDP)	Credit to the government and state owned enterprises (% GDP)	Branches of commercial banks per 100,000 adults	Strength of legal rights index (0-12, best)	Collateral loans secured with land (%)
Albania	4583	65	13	52	74	24	22	8	81
Bosnia & Herzegovina	5149	86	10	101	50	9	29	7	66
Kosovo	3880	N.A.	3	85	48	N.A.	20	11	62
Macedonia, FYR	5474	11	6	91	53	7	25	10	65
Montenegro	7647	42	13	91	55	N.A.	44	12	67
Serbia	5899	43	21	99	48	19	30	6	27
Western Balkans	5439	49	11	86	55	15	28	9	61
Upper middle income	7597	99	5	99	66	12	23	5	55
Lower middle income	2481	123	10	97	47	10	14	6	58

Source: IMF, World Bank, EIB calculations, 2017 or latest available

Box 3: Western Balkans Bank Lending Survey

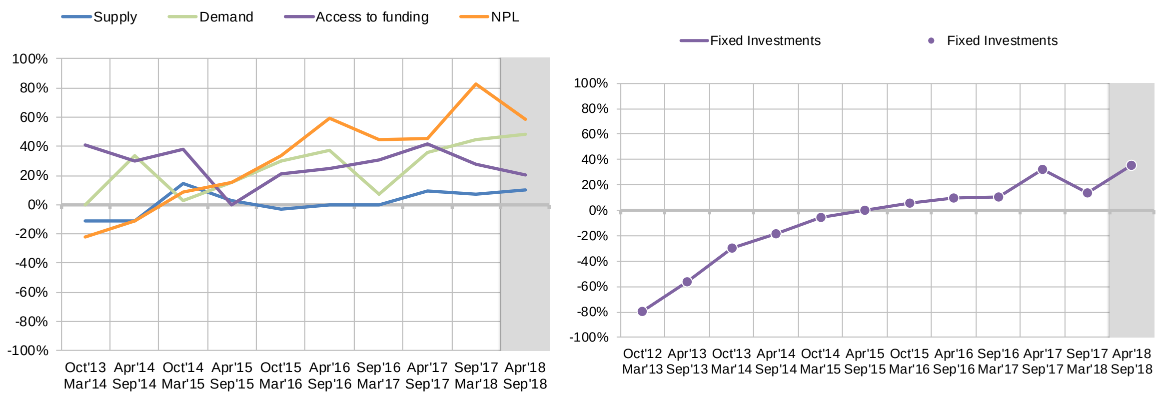
The EIB Bank Lending Survey shows positive developments in the credit market. Banking groups consider their positioning in the region to be either improving or stabilising, on the back of enhanced profitability. Regional supply conditions have improved, but still lag behind very robust demand. Survey-based quality and quantity indicators continue to progress, thus signalling further support to already positive aggregate net credit extensions.

Main results from the 2018 H1 wave

After years of negative credit growth in the Western Balkan economies, credit to the private sector turned positive at end-2015 and slightly accelerated from 2016 onwards. Credit demand has supported this positive trend. The most recent round of the EIB Bank Lending Survey for the CESEE region shows that credit demand strengthened during the first half of 2018 in the Western Balkan countries. Credit supply conditions have become more accommodative, but they are still lagging behind credit demand. Overall, the perceived credit demand-supply gap persists. Among the factors affecting loan demand, both corporate investment and housing market prospects as perceived by households remain strong drivers. The quality of loan applications has been increasing particularly for loans to SMEs.

Figure 1: EIB CESEE Bank Lending Survey: Western Balkans

a. Main results **b. Loan demand for firm fixed investments**



Source: EIB – CESEE Bank Lending Survey. Note: All indicators in net percentages.
Supply/Demand: positive figures refer to increasing (easing) demand (supply). Access to funding: positive values indicate increased access to funding. NPL: Negative figures indicate increasing NPL ratios

Financial institutions in the region tend to have conservative lending practices as they are still dealing with high non-performing loan (NPL) levels, which constrain in particular micro- and small enterprises. Nevertheless, the deleveraging process is advancing through the continued reduction of NPLs. Overall access to bank funding remains favourable, although recently less so. Access to funding for local banks has continued to improve mainly thanks to better retail, corporate and intragroup funding.

As GDP growth has been keeping its momentum in the Western Balkans, banks' profitability has generally improved. This is in turn feeding into the positive assessment of the market potential by parent banking groups operating in the Western Balkan countries.

For more information on the EIB CESEE Bank Lending Survey , visit http://www.eib.org/en/about/economic-research/surveys.htm

EIB Group Activity in the Western Balkans

In 2017 the EIB maintained its strong support for the Western Balkans with new signatures totaling EUR 330m. Around half of this lending volume was dedicated to the private sector. Credit lines dedicated to SMEs and mid-caps formed the majority of this amount, which will enable local banks to make more than 1560 loans to these entities. The average loan size is expected to be around EUR 200,000, with an average loan tenor of 6.5 years. The total jobs sustained by these loans is estimated at 78,000.

The Western Balkans Enterprise Development & Innovation Facility (WB EDIF) has leveraged EUR 225m and supported 2513 SMEs by the end of 2017. This investment platform, managed by the EIF, provides financing and business support to SMEs in the Western Balkans, leveraging upon the expertise of 27 international, regional and local market players. WB EDIF combines access to finance (equity, guarantees and loans) with capacity building measures for the benefit of SMEs, policy makers, trainers, consultants and other market players in the region.

Starting in 2016, most Western Balkan countries have become eligible for EU-28 financial instruments supporting SMEs, such as the Competitiveness of Enterprises and Small and Medium-Sized Enterprises (COSME), InnovFin, and the Employment and Social Innovation (EaSI). So far, the EIF has entered into 26 transactions under these programs, stimulating more than €1.3 bn of new SME lending in the region.

Advisory support in the SME sector in the Western Balkans aims to improve the business environment for SMEs and promote research, development and innovation in the region. The EIB coordinates the advisory services provided by financial institutions such as the World Bank, OECD, EBRD, and KfW under the WB EDIF. The EIB has also conducted several studies in the region, including a study to identify institutions that have the highest potential for success in R&D and innovation and a study to assess the funding needs of SMEs in Serbia. The EIB is additionally been working with a few institutions to identify a road map to becoming regional centres of excellence. It has also implemented a support programme to help SMEs make better use of their intangible assets and intellectual property rights. In cooperation with the EC's Joint Research Centre, the EIB is developing a programme supporting innovative SMEs and R&D organisations in developing "proofs-of-concept" through grants.

Macedonian Baker breaks out on his own and turns bread firm into a top national brand

Back in January 1986, Ilija Pavlickovski took out a lease on a small bakery in Šuto Orizari, the second-smallest municipality of Skopje, the Former Yugoslav Republic of Macedonia's capital. Both his grandfather and father had spent most of their lives working for the biggest Macedonian producer of bread and flour, Zito Luks. But Ilija felt like it was time to start his own business. "The bakery had a simple wood-fired oven, and in the beginning we could only bake around 500 loaves of bread per day," he says.

Today, Ilija manages a chain of over 20 large and 200 small bakeries across the country. His company, Bakery Dime, has become a nationally recognised brand. An EIB-funded loan helped Bakery Dime grow and diversify. The company employs 202 people today, compared with 82 about 10 years ago. Ilija and his bakery received three loans backed by the EIB worth €1.45m through the Macedonian Bank for Development Promotion (MBDP). The EIB and the MBDP have cooperated on four operations aimed at supporting small and medium-sized enterprises, as well as industrial investments in the fields of the knowledge economy, energy, environmental protection and services. These loans total € 350m. This is significant, considering that almost 280,000 people work in more than 54,000 small businesses in the country.

Fiat small cars, Serbia

The EIB provided €500m of investments to Fiat Chrysler Automobiles (FCA) to refurbish, modernise and expand the company's automotive plant in Kragujevac, Serbia. This increased production capacity from 30,000 to over 180,000 vehicles. The EIB's financing has made it possible to produce a new family of B-segment cars at this plant.

This investment is by far the largest in the history of Serbian industry, and it has helped transform an aging industrial site into one of FCA's most modern factories. The project was started to develop a competitive manufacturing platform in a country with prospects for EU accession and to instil a strong industrial culture with a qualified, well-educated and competitive workforce. The project has contributed to an increase of foreign direct investment in Serbia and has helped develop the country's automotive industry and technological advancement. This has increased local productivity and exports and strengthened Serbia's economic development. The project has supported FCA's local suppliers and helped preserve jobs at the Kragujevac plant, and it has increased the local direct employment by 2,400 people and created an additional 500 indirect jobs.

Kosovan applies Swiss knowledge and German material for a successful business

A native of Bablak in southern Kosovo, Ejup Shumolli is the owner of a factory that produces high quality vinyl windows and doors. His products are unique because he uses Inoutic, a German material which is well known for its superb thermal insulation and moisture protection.

Mr. Shumolli learned most of what he knows about his trade in Switzerland, where he used to live and work. He launched his company, Shumolli, fourteen years ago when he returned to Kosovo. At first he began production on a small scale, taking individual orders. Demand for his products gradually began to grow, so he increased his output and broadened his product range, introducing roller shutters for windows after a few years.

Today, Shumolli is a well-established company that sells its products in the city of Ferizaj and even exports them to Switzerland; the name is also a familiar brand that has become synonymous with quality and value in the market.

Mr Shumolli has, over the years, invested in industrial machinery, which has helped him rapidly expand his operations. More recently, using an EU-supported WB EDIF loan disbursed by ProCredit Bank in 2015, Mr Shumolli purchased a state-of-the-art CNC machine to produce his windows and doors. All this brings him closer to his ambitious business goal of capturing a significant share of both the domestic and foreign markets for his products.

2.4. Turkey

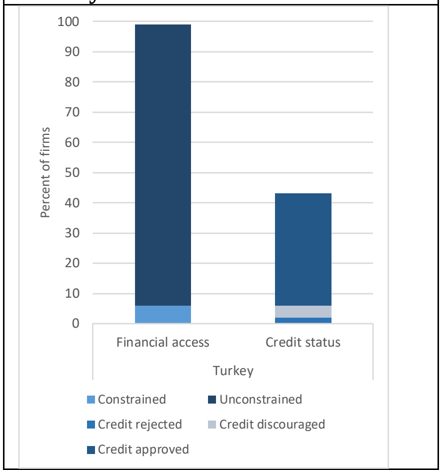
Access to Finance

The proportion of credit-constrained firms in Turkey is low. According to Enterprise Survey data, only 6% of enterprises are credit constrained, the lowest share in the European Neighbourhood (see Figure 4). Out of the 45% of firms in Turkey that applied for a loan, the vast majority received the desired funding. This indicates that the banking sector is well equipped to meet corporate demand for external finance. The use of venture capital is modest, although leasing-type products are gaining popularity.

Financial Sector Constraints

- **Financial soundness:** The loan-to-deposit ratio of 130% reflects Turkey dependence on capital inflows, as domestic saving are insufficient to finance the available investment opportunities. In other words, the banking sector's loan-to-deposit ratio mirrors the current account deficit. Capital inflows tend to be denominated in hard currency, and it appears that Turkish banks have passed the exchange rate risk to their borrowers. Though NPLs have been low until recently, the overheating of the Turkish economy followed by a sharp weakening of the lira and the severe deterioration of the economic outlook are likely to feed into problem loans, particularly as the decline of the lira makes it more difficult to service foreign currency debt. This threat is somehow mitigated by a large share of export-oriented firms, which are less vulnerable to sudden swings in the exchange rate on the back of hard-currency profits.
- **Funding:** The high loan-to-deposit ratio and the prevalence of foreign currency loans indicate a shortage of local currency funding, but the scale of the Turkish economy limits what IFIs can achieve.

Figure 4: Credit constraints in Turkey



Source: Enterprise Surveys

Note: The chart shows two bars per country. The first bar decomposes the population into constrained and unconstrained firms. Credit constrained firms either had their loan application rejected or were discouraged from applying in the first place. Unconstrained firms either had no need for finance or had their loan application approved. The second bar displays the composition of the subgroups. The height of the second bar shows overall credit demand.

- **Risk assessment:** At 30%, the share of collateralized loans in Turkey is substantially lower than in other upper-middle-income countries. In the case of secured loans, however, the value of collateral is about twice the loan value as in peer economies. Likewise, the use of land to secure loans is comparable to other upper-middle-income countries. At 27% of secured loans, receivables are more frequently used than in peer countries, which facilitates access to finance for young firms in particular.

Table 4: Access to Finance and the Banking Sector in Turkey

Economy	GDP per capita (current prices; US$)	Doing Business Rank 2018	Bank non-performing loans to total loans (%)	Bank credit to bank deposits (%)	Outstanding deposits with commercial banks (% GDP)	Credit to the government and state owned enterprises (% GDP)	Branches of commercial banks per 100,000 adults	Strength of legal rights index (0-12, best)	Collateral loans secured with land (%)
Turkey	10512	60	3	130	53	16	18	4	56
Upper middle income	7597	99	5	99	66	12	23	5	55
Lower middle income	2481	123	10	97	47	10	14	6	58

Source: IMF, World Bank, EIB calculations, 2017 or latest available

EIB Group Activity in Turkey

EIB has been supporting Turkey's development and integration with the EU since the mid-1960s. More than EUR 28.6bn has been lent since 2000 and EIB has stepped up its commitment since accession negotiations began. Loans to Turkey in 2017 alone reached EUR 507m and private sector lending accounted for almost 75% of this amount. As in many other countries, SMEs represent the lion's share of national growth and employment. Accordingly, SMEs took 58% of the total lending volume, demonstrating the EIB's active role in helping the country's main job-providing sector. The EIB also supported other important sectors of the Turkish economy, such as the RDI activities of innovative export-oriented companies, transport, telecoms, the environment, tourism, energy and urban development, in close cooperation with partner banks, comprising public, promotional and private sector intermediaries.

The EIF has signed 41 transactions in Turkey, leveraging EUR 6.7bn for the benefit of SMEs in the region, under its centralized mandates like COSME, InnovFin and Erasmus+. The EIF also operates in a number of programmes in Turkey covering guarantee and equity instruments. G43 Anatolian Venture Capital Fund and Technology Transfer Accelerator Turkey are equity programmes, focusing on regional development and commercialisation of technology intensive research respectively. In addition, two Fund of Funds are established, namely Istanbul Venture Capital Initiative (iVCi) and Turkish Growth and Innovation Fund (TGIF), with a total number of investments performed by the underlying funds of 74 and 10 respectively. While iVCi supports traditional and innovative sectors based in Turkey, TGIF supports innovation in the technology oriented sectors such as clean-tech, information and communications technology, life sciences as well as to support growth in any industry sector.

The Greater Anatolia Guarantee Facility (GAGF) in Turkey

The Greater Anatolia Guarantee Facility (GAGF), launched in 2010 and implemented by EIF, targets MSMEs operating in less developed regions in Turkey. GAGF aims to contribute to alleviation of regional development gaps within Turkey through creation of financial instruments to enhance their access to finance for MSMEs.

GAGF, co-financed by the EU's Instrument for Pre-Accession Assistance and the Republic of Turkey, together with funding provided by EIB, consists of three pillars:

Pillar 1 – the Micro Credit Counter-Guarantee: a counter-guarantee scheme implemented through Kredi Garanti Fonu, Turkey's sole specialized guarantee institution.

Pillar 2 – the SME Loan Guarantee scheme: implemented via financial intermediaries, also supported by the SME Greater Anatolia SME Loan Programme provided by EIB.
Pillar 3 – the Capacity Building and Promotion: whereby the key actors in this facility are provided with specific training and through which the facility is also promoted.

As of the end of the implementation period, December 2017, total disbursed loan portfolio supported by (counter-) guarantees provided under GAGF amounted to EUR 978.3mm supporting a total of 15,706 MSMEs.

Table 5: Market Gaps in Access to Finance and EIB Instruments by Region

	Southern Neighbourhood	Eastern Neighbourhood	Western Balkans	Turkey
Innovation in the economy	Average	Average	Unfavourable	Average
Credit concentration	Unfavourable	Average	Average	Average
Size of the banking sector	Favourable	Unfavourable	Favourable	Favourable
Competition in the banking sector	Favourable	Average	Favourable	Favourable
Exposure to the government	Unfavourable	Favourable	Average	Average
Availability of local currency	Average	Unfavourable	Unfavourable	Favourable
Financial system diversity	Unfavourable	Unfavourable	Unfavourable	Average
Long-term finance	Unfavourable	Unfavourable	Unfavourable	Unfavourable
Banking sector soundness	Average	Average	Average	Average
Collateral Frameworks	Unfavourable	Average	Average	Unfavourable
Technical capacity of banks to cope with SMEs	Average	Average	Average	Favourable

	Lines of Credit	Individual Loans	Guarantees	Private equity	Advisory Services
Lack of Innovation	x	x		x	
Credit concentration	x		x		x
Size of the banking sector	x				
Competition in the banking sector	x				
Exposure to the government					x
Availability of local currency	x	x	x		
Financial system diversity				x	
Long-term finance	x	x			
Banking sector soundness			x		x
Collateral Frameworks			x		x
Technical capacity of banks to cope with SMEs			x		x

Source: EIB.

BOX 4: EIB Investment Framework

The EIB's terms of reference outside the EU are determined by multi-annual mandates entrusted to the Bank by the EU and EU Member States. The **External Lending Mandate (ELM),** the most essential one, covers 68 countries and/or territories in different regions including the EU Neighbourhood. One of the high-level objectives of the ELM is local private sector development, in particular support to Small and Medium-sized Enterprises (SMEs). Regional integration among countries, including in particular economic integration between Pre-Accession countries, Neighbourhood countries and the Union, is an underlying objective for EIB financing under the ELM.

Following a call from the European Council, the Bank developed the implementation plan for **the Economic Resilience Initiative (ERI)**. The initiative aims to rapidly mobilise additional financing for the Southern Neighbourhood and Western Balkans regions to absorb and respond to crises and shocks, such as the Syrian refugee crisis, while maintaining strong growth. Boosting economic resilience in these regions by investing in vital infrastructure, developing the private sector and stimulating growth and job creation also contributes to addressing root causes of migration. The ERI will encompass intermediated support for SMEs, targeting particular groups (e.g. women, young people, very small businesses) or specific sectors (e.g. agro-industry, energy efficiency) and enhanced with capacity building in the intermediary banks and for improved financial literacy of the SMEs. As at end-2017, EIB had already signed and warehoused EUR 580m multi-beneficiary investment loans under ERI in the Southern Neighbourhood, for the benefit of SMEs in Palestine, Jordan, Lebanon and Egypt. These loans are expected to support more than 1,200 SMEs and help to sustain over 35,000 jobs in SMEs (and a further 18,000 in mid-caps).

As part of the re-orientation of the EU's development cooperation activity, the European Commission has established the **European Fund for Sustainable Development (EFSD)** guarantee as a new instrument in support of investment in projects with a particularly high development impact. The instrument will be complementary to the referred mandates as it intends to finance very high risk and "pre-bankable" projects at highly concessional interest rates. The EIB is playing a critical role in the implementation of the EFSD instrument: as a member of the strategic board, as a provider of an opinion on investment windows and as host and leader of GTAG (Guarantee Technical Assessment Group) it ensures the integrity of the EFSD guarantee in terms of banking and impact-related aspects.

Blending facilities, like **Neighbourhood Investment Facility (NIF)** and the **Western Balkans Investment Framework (WBIF)**, allow the bank to engage in high value/developmental activities. The EC implements regionally focused Investment Facilities that support projects contributing to the fulfilment of the EU's and partner countries' strategic development goals. The principle of the mechanism is to combine long-term financing from eligible Financial Institutions (FIs) such as the EIB with grant financing, and to attract loans or equity investments from private financiers. The facilities themselves are managed directly by the European Commission and grant financing from these facilities is accessible to multiple lead FIs

Complementary to the above-mentioned EU mandates, the EIB lends at its own risk for investment grade operations in Pre-Accession and Neighbourhood countries. Two own risk facilities complement the referred mandates in the EU Neighbourhood; **The Pre-Accession Facility** and **the Neighbouring Financing Facility**. These frameworks promote the high-level objectives of the ELM, as well as all other projects of mutual interest to the EU and partner countries which may not be covered by the ELM, including support to EU economic diplomacy.

The EIB currently manages three different trust funds, namely **Eastern Partnership Technical Assistance Trust Fund**, **FEMIP Trust Fund** in the Mediterranean Partner Countries, including its special climate action envelope **(CAMENA)** and the **Neighbourhood Investment Facility Trust Fund**. Donors provide funds as part of their Official Development Assistance budget which EIB keeps in trust through various trust funds and which are crucial for EIB's activities outside the European Union. The funds are provided to final beneficiaries directly or combined with financial products from the EIB or other international financial institutions.

The EIF manages several EU mandates in the Western Balkans and Turkey, including the **EU programme for the Competitiveness of Enterprises and SMEs (COSME), the joint EIB Group and EC initiative for innovators (InnovFin)**, **EU programme for Employment and Social Innovation (EaSI)** and **Erasmus+**.

3. EIB Group products for the private sector

EIB Group offers financial and advisory services tailored to address the market gaps in access to finance in the EU neighbourhood. Large-scale project investments, credit for SMEs, guarantees for riskier projects and technical advice to ensure optimum project design and partnerships for new entrepreneurs are some examples of available EIB products. Responding to the changing environment in the neighbourhood, the EIB continues to diversify its range of instruments in order to support growth and development.

Given the magnitude of the financing gap, the recent paradigm shift from the exclusive use of budget resources for grants to their partial deployment as guarantees for loans is a smart way of using and leveraging the scarce public resources available for development. For nearly 60 years, EU budget funds for external policies have been complemented by long-term investment from the EIB in local private sector development, infrastructure and climate action. With the adoption of the Agenda 2030 and the revised European Consensus on Development, there is increasing recognition that adding loans and financial instruments to traditional aid and grants can make the economy more credible and competitive for additional investors, helping catalyse more funds.

3.1 Investment loans

The EIB can provide direct loans to selected corporate promotors for high impact investment projects where the investment cost exceeds EUR 30m. When appraising such operations, the EIB pays particular attention to the added value of the project on the wider economy and the benefits for smaller private sector players, such as the development of critical transport or energy infrastructure, or the improvement of the production base and the upskilling of the labour force. The financing terms and structure (maturity, grace periods, security structure) are tailored to the type of investment and the circumstances of the borrower.

Kernel Group: a large corporate supporting SMEs and the rural economy in Ukraine

Kernel Group employs more than 16,000 staff as of June 2017 (+14% yoy, 60% of the staff being hired and employed in rural areas) and subcontracts with more than 40 SMEs across Ukraine (maintenance, transport, etc.). It is an important player in the country, considering employment and tax revenues. In 2018, the EIB approved a project that will support Kernel in implementing European best practices and standards.

Kernel has a clear and duly monitored corporate social responsibility strategy, making it one of the few company at the forefront of the best corporate practices. Its strategy and monitoring encompasses not only the standard environmental impact measurements and mitigation actions, but also stakeholder engagement (more than 200 staff assigned as relationship managers to ensure sustainable communication channels with residents, local communities, key opinion leaders and local councils) as well as direct support to local communities (on average, Kernel has spent USD 2m yearly over the past 5 years mostly on municipal schools and kindergartens, along with investments in local infrastructure and healthcare).

Productive asset creation for large agribusinesses in Ukraine allow for sustained and stable employment and modernization of the sector. State-of-the-art technology and governance will be a focus for the Bank’s support of the sector in Ukraine.

3.2. Intermediated loans

Intermediated loans cater for projects with an investment cost below EUR 20-25m. These credit lines are advanced to local intermediary banks and leasing bodies, which on-lend in order to finance investment undertaken by SMEs or local authorities. The intermediated lending in the EU neighbourhood allows for an effective transfer of the EIB financial advantage e.g. lower cost of funding and longer maturities, to enterprises. The aim is to crowd-in the local financial sector and other financiers and promote higher industry standards, e.g. through application of the EIB environmental and social guidelines.

Supporting rural SMEs in Armenia

Armenia has seen strong economic growth and a decline in poverty in recent years, but there is a need to diversify the economy and strengthen the SME sector, particularly in relatively underdeveloped rural areas. SMEs suffer from limited access to finance, reflecting the fact that local banks themselves do not have direct access to capital markets and are largely reliant on short-term funding sources.
The Armenia Apex Loan, signed in 2014, has helped to address this situation, providing long-term finance for local banks through the Central Bank of the Republic of Armenia. Local intermediary banks received training on how to develop products that meet the needs of agricultural and tourism SMEs. Additionally, training on financial literacy was provided to final beneficiary SMEs, including specialised training for SMEs run by women. Below are examples of 2 SMEs that received support:

The Araks-2 cooperative employs around 24 people, utilising local milk production to manufacture a range of cheeses. They used a five-year EIB-funded loan of EUR 36,000 to acquire a new pasteuriser, casting forms and inputs, enabling them to step-up production. Looking forward, they plan to invest in tripling production capacity and expanding the export share of sales to at least 35%.

A loan of EUR 180,000 with a seven-year duration financed the renovation of Hotel Alpina in the popular tourist town of Tsakhkadzor, and enabled the purchase of the hotel minibus. With 35 employees, the hotel has already achieved a 20% increase in guest numbers.

3.3. Guarantee instruments

In order to reduce foreign exchange risk and government risk exposure, EIB offers guarantees to MSMEs, large companies, domestic banks, public sector promoters as well as sub-sovereigns. The aim is to mobilise additional resources supplementing scarce public capital resources and to stimulate local capital markets. Portfolio guarantees to financial institutions enable them to offer finance to MSMEs at improved terms, specifically reducing collateral requirements that are often difficult to meet for the MSMEs as well as credit risk margin. It also allows the financial institutions to finance MSMEs that are within higher risk classes.

3.4. Equity instruments

Equity instruments are of paramount importance in the EU neighbourhood region, as they provide a much-needed stable source of funding supporting the development of the private sector in an environment with a recognised lack of equity resources. EIB Group provides equity or quasi-equity funding (participating or mezzanine loans) to reinforce the capital base of productive companies, both via funds and with direct investments. EIB also makes participating loans to selected microcredit associations. Capital injections would be temporary minority participations, committing at a very early stage to the projects that we finance. This often serves to allow the company to attract other sources of funding. EIB promotes best practices in governance and our expertise and experience provides guidance to fund managers, which is key in emerging markets. The operations supported must be sound and economically viable, having a real impact on people, creating value and jobs. EIB support also often acts to attract other potential investors and thus helping to mobilise funds.

The EIB has a demonstrated track record as a shareholder of bringing additional non-financial value by encouraging funds to follow good international market practice in terms of governance and reporting, and being involved at the board level/investment committee/advisory committee of the beneficiaries. In collaboration with the European Commission and multilateral or bilateral institutions involved in structural adjustments, the Bank, as an investor in risk capital operations, also plays a role in promoting necessary policy developments in the private equity and venture capital sector.

Badia Impact Fund: supporting start-ups in the Southern Neighbourhood

The Badia Impact Fund is a venture capital fund focusing on start-ups and high-growth, tech-enabled SMEs. The geographic focus is predominantly on Jordan, but also on Egypt and other MENA countries. The Fund held its first closing in February 2014. EIB anchored the Fund with a commitment of USD 9m (including USD 4.5m from the Kingdom of Spain – through AECID). Cisco Systems also participated in first closing together with the King Abdullah Fund for Development, Accelerator Technology Holdings and the Fund Manager. EBRD committed USD 8m at second closing in June 2015. The final Fund size is USD 33m.

The fund has to date invested USD 21.8m in 13 companies, and plans to make another 1-2 investments before the end of its investment period in February 2019. The portfolio companies are active in a large variety of sectors, including internet technologies, business related and end-user software, broadcasting/content, and medical devices.

In terms of impact, the portfolio companies have created 424 full time jobs. 72% of the employees are under 30 years of age, 39% are women, 38% are engineers and 9% studied abroad and came back to work in Jordan.

3.5. Microfinance

Microfinance represents a powerful tool to expand access to finance to economically active individuals and very small enterprises which are usually excluded from traditional financial services. Microfinance operations support several strategic objectives of the EIB, particularly in the areas of growth, job creation and sustainable development.

Outside the EU, EIB has an extensive microfinance activity across the EU neighbourhood, through intermediated lending and equity investments in local financial institutions or microfinance investment vehicles. The average loan size is typically around EUR 1000, with short loan tenors of up to 24 months. Loans are mostly collateral-free.

Microfinance for Women in Jordan

Women in Jordan make up 70% of those living in poverty. They get lower wages than men, have little control over property, and often face the dual burden of being a homemaker and the main earner for their family.

Supported by the Microfund's loans, women encourage their daughters to work and help create a sustainable future for Jordan built on entrepreneurship, opportunity and economic resilience—and equality.

The Microfund works both with Jordanian women and women among the Syrian refugees who fled across the border during that country's five years of civil war. There are 1.4 million Syrian refugees in Jordan alone.

The European Investment Bank signed a EUR 2m loan for the Microfund in 2014.

3.6. Advisory services

Within the Bank's core strategy of lending, blending and advising in support of long-term investment in the neighbourhood, the provision of upstream support and advisory services plays an important role in ensuring the efficient identification, preparation and implementation of projects in all sectors.

The Bank is increasingly taking a more integrated approach to advisory services, emphasising sector-focused initiatives rather than ad hoc project-based work. This more systematic approach will facilitate the preparation of coherent pipelines of projects in a given sector, and seeks to link upstream support and advisory services with the provision of funding, thus maximising efficiency both for project promoters and for the donors who fund these facilities

3.7. Local Currency Lending & Funding

Long-term investment by smaller companies is hindered in many parts of the EU neighbourhood due to the absence of long term financing in local currency. The financing needs for long-term investments outside the EU exceed the availability of local savings, and local capital markets are not developed enough to convert foreign funds into local currency. SMEs funded with hard currencies can be exposed to substantial currency risks, as many of them have their earnings in their local currency. Many IFI's including the EIB, therefore play a substantial role in mitigating this market failure. EIB offers local currency loans in the EU neighbourhood in particular to improve SMEs' and mid-caps' access to affordable financing. Hedging mechanisms differ per currency and the availability of locally developed solutions. The Currency Exchange Fund (TCX) is one the vehicles used, which provides local currency swaps for both international financial institutions and financing institutions in emerging markets, such as microfinance bodies. TCX allows the EIB to enhance its long-term lending in local currencies, which are normally not traded on money markets, by providing hedge solutions for high-development operations to benefit smaller companies.

The European Investment Bank has provided its first ever local currency loan in Ukraine to improve small and medium-sized businesses' access to affordable financing.

The loan to ProCredit Bank Ukraine denominated in Ukrainian Hryvnia, equivalent to EUR 60m, has been made possible by the European Union and TCX, an international currency exchange fund. It is a landmark deal combining EIB financing with donor resources.

The European Union has supported the transaction by allocating EUR 5m of grant funding which allows for an affordable interest rate on the loan. The EU contribution forms part of the European Union's wider EU4Business initiative, which brings together EU support for SME development and improving the business environment in the Eastern Partnership region.

Furthermore, the operation has been made possible by the EIB's investment in TCX – an innovative financial institution which provides long-term local currency and interest rate derivatives in emerging market currencies to its investors and their clients.

The development of local currency finance remains a challenge in Ukraine due to its high exposure to exchange rate movements. SMEs selling their goods and services domestically in local currency but borrowing in foreign currency are highly exposed to the currency risk. The EIB operation is tailored to enhance access to affordable medium- to long-term local currency funding for domestic businesses in order to ultimately strengthen their market position and competitiveness whilst mitigating their exposure to exchange rate volatility.

ProCredit Bank Ukraine is a long-standing partner of the EIB and is currently one of the key players in SME financing in Ukraine with a proven track record and significant experience supported by an extensive branch network throughout the country.

3.8. Issuance of bonds

In the last five years, the EIB has issued in 21 currencies from all over the world, including several in synthetic format. By issuing in EU partner countries' currencies, the Bank seizes opportunities to contribute to the development of local capital markets by improving liquidity, yield curve development and product diversification. Such issuance provides a platform for potential future issuance in support of lending activities. In addition to its own bond issuance schemes, the Bank is developing its support to financial intermediaries and the development of capital markets.

Bonds for SMEs in Turkey

In 2014, a EUR 150m groundbreaking operation was signed, the first ever residential mortgage covered bond in Turkey, involving EIB participation in a new programme introduced by Akbank, a long-standing partner of the EIB in Turkey. The Bank's participation is in the first bond series issued under Akbank's newly-established programme. Akbank will on-lend the proceeds of the EIB series to eligible SMEs and midcaps. Through this operation, the EIB is building on Akbank's strong position in the SME segment and leveraging its broad geographical outreach. This credit line increases the availability and maturity of funding for SMEs and midcaps in Turkey. The EIB funds have also been channelled to the real economy in the form of lines of credit through Akbank, Denizbank, Eximbank, Garanti Bank, Halkbank, ING, Vakifbank and Ziraatbank.

Building on pioneering expertise and experience with Green Bonds, the EIB has also developed an innovative instrument linked to Sustainable Development Goals (SDGs). SDG-themed bonds are bonds issued by (most likely, at first, policy-driven) financial institutions, who would use the proceeds from the bonds for projects with social objectives and aligned to certain SDGs.

In addition to issuing its own Sustainability Awareness Bonds, EIB will support selected emerging market-based financial institutions to access capital markets and issue SDG-themed bonds - through (i) technical assistance capacity building for the financial intermediary, (ii) the purchase, as an anchor investor, of a portion of bond issue, crowding-in private investors who take comfort from EIB's presence. Because the bonds incorporate an obligation to use the proceeds for specific SDG-eligible purposes, the result is increased financing flowing to the SDGs.

3.9. Securitisation

The EIF is recognised as Europe's leading provider of AAA-rated credit enhancement in SME securitisations. We benefit from Multilateral Development Bank status, which enables financial institutions to apply a 0% risk-weighting to assets we guarantee. Typically, we guarantee certain tranches of notes (senior and/or mezzanine tranches) issued through a SME securitisation transaction.

In Turkey, the EIF manages EUR 868m of exposure under the diversified payment rights (DPR) service level agreement with the EIB. On its own balance sheet, it manages EUR 70m under the DPR guarantee as of 30 June 2018.

3.10. Blending loans and grants

Projects financed by the EIB also often benefit from third-party donor financing in the form of grants which are channelled to projects, often through trust funds managed by the EIB. Such grants enable the Bank to deliver maximum impact as well as increase the viability and sustainability of EIB loans through technical assistance and advisory services to support project preparation and implementation, investment grants (including interest rate subsidies) to lower the cost of financing and diverse financial instruments to enable a better risk-return trade-off. Moreover, EIB activity through the use of blending reinforces the complementary relationship between the Bank and the European Commission, as well as other international financial institutions, and further contributes to the development impact of investment projects.

4. Cooperation with IFIs and other organisations

4.1. EU Cooperation

Over the past years, the EIB has developed a solid cooperation framework with several International Financing Institutions (IFIs) and other international and European organisations operating in the EU neighbourhood.

The European Commission has a key role in consolidating cooperation and coordination of financing operations in the regions outside the EU. The EIB requests the European Commission's opinion on all operations within the framework of the procedure provided for in Article 19 of the Statute of the EIB. The cooperation between the EIB and the European Commission in the EU neighbourhood is structured along the lines of the European Neighbourhood Policy. In this context, the EIB cooperates with the European Commission through active participation in the Neighbourhood Investment Facility and the Western Balkan Investment Framework, which pools together grant resources from the European Commission and the EU Member States and uses them to leverage loans from European Finance Institutions as well as contributions from the partner countries. Close cooperation is also ensured at institutional level, at central and decentralized levels, in order to ensure full alignment with EU priorities in investment operations. EIB has recently agreed a Joint Note on enhanced coordination and cooperation with DG NEAR outlining the activities to be undertaken to ensure the appropriate alignment between EU policies and EIB activities.

The EIB has a formal agreement for working with twelve European Development Finance Institutions on co-financing private sector projects, enhancing institution-wide coordination and joint technical work. Under the Mutual Reliance Initiative, the EIB enjoys a close relation with the French Agence Française de Développement (AFD) and German Kreditanstalt für Wiederaufbau (KfW) in co-financing operations as well as pooling resources for project appraisal and monitoring, information-sharing and consultation.

4.2. International Cooperation

The Bank cooperates closely with IFIs at both an operational and institutional level. IFIs tend to pursue a coordinated response to global challenges such as climate, migration, jobs and growth, mobilising private finance. Operational cooperation most frequently consists of co-financing projects and sharing of best practices. IFIs also act as EIB counterparts, particularly in risk sharing operations, and in some cases as borrowers.

EIB operations in the neighboorhood are carried out in close cooperation with the EBRD on the basis of a tripartite Memorandum of Understanding (MoU) between the EIB, the EBRD and the European Commission. The EIB and EBRD share appraisal work and carry out joint appraisal missions. Labour is typically divided in a manner that the EBRD performs the financial analysis / projections modelling and the security structuring, and the EIB, the project technical/economic appraisal work. The two institutions then use the work of the other institution as input to their respective, independent, credit and project evaluations.

International cooperation plays a key role especially in the Mediterranean region. Since the Arab Spring, efforts have been stepped up to increase the effectiveness of the jointly action taken by the

European Union, the G8 and the countries under the "Deauville Partnership", which was established in May 2011 to support the democratic transition of the Arab countries. Under this Partnership the EIB has been chairing the platform in 2015 for coordinating action by international financial institutions. The Bank has strengthened its partnerships with the bilateral European and multilateral funding agencies, including the regional development banks (African Development Bank and Islamic Development Bank). The EIB signed a Memorandum of Understanding with the African Development Bank and the European Commission in 2005 to enhance cooperation particularly regarding support for the private sector, regional cooperation, exchange of information on poverty reduction, macroeconomic reform and debt relief in the African continent. The EIB and the Islamic Development Bank (IDB) group signed a Memorandum of Understanding in 2012 with a view to strengthening our relationship and creating synergies between the two institutions. EIB has also signed a memorandum of understanding with the World Bank and the European Commission aimed at enhancing donor coordination in the Middle East and North Africa / Southern Mediterranean region. EIB is also taking an active role in the Arab Monetary Fund's Financial Inclusion Task Force, which supports reforms across the region in the specific area of access to finance for micro-, small- and medium-sized enterprises .

The EIB has also stepped up its involvement in and cooperation with regional cooperation platforms such as the Union for the Mediterranean (UfM) and the Marseille Centre for Mediterranean Integration (CMI). Building on the Memorandum of Understanding signed with UfM Secretariat in January 2011, it was renewed in April 2013. Constructed as a multilateral platform, the CMI aims to transform research into sound public policy recommendations. The EIB has taken the lead in three CMI programmes: Sustainable Urban Development in the Mediterranean, Innovation and Public Private Partnerships.

In addition, in April 2018, seven Multilateral Development Banks (MDBs)[10] launched a new platform to enhance their collaboration on economic migration and forced displacement, in response to a request made by the G7. The platform will advance strategic dialogue and operational coordination to maximize the impact of MDBs' growing engagement in these two areas.

[10] African Development Bank, Asian Development Bank, World Bank Group, European Bank for Reconstruction and Development, European Investment Bank, Inter-American Development Bank, Islamic Development Bank

5. Our vision going forward

The EIB Group will continue developing its operations in the EU neighbourhood, with the aim of further increasing impact, additionality and relevance for EU policy, in particular in terms of supporting economic resilience and addressing the root cause of migration. The EIB has developed substantial sector expertise, know-how and capacity to support private sector development with a variety of specific instruments for project of different size and risk levels. EIB activity in the EU neighbourhood is guided by EU policies, and EIB Lending Criteria are designed to ensure that the Bank's activities are focussed on areas with the greatest investment needs and where the EIB can have the highest value added. EIB also monitors closely regulatory reforms, which play a critical role on countries' capacity to attract domestic and international investors in priority sectors.

Traditional liquidity instruments remain highly relevant in the EU neighbourhood, as the availability of stable funding determines financial products available for SMEs and other enterprises in the region. Access to finance remains one of the biggest difficulties for SMEs, in spite of SMEs becoming the most efficient segment of the transition economies and a pillar of for growth, employment and innovation. Provision of favourable funding (maturity, cost) may broaden access to finance for enterprises that would not be eligible for bank financing otherwise. EIB Group uses its long-term SME support experience in the EU to implement best practices in the EU neighbourhood and increase access to finance for enterprises. Intermediated lending allows for an effective transfer of the EIB financial advantage to enterprises, and crowd-in local financial sector and other financiers.

Guarantee instruments have become more relevant, given their ability to reduce collateral requirements, increase loan maturities and lower the cost of borrowing for SMEs. Local banks' perception of credit risk related to SMEs and other enterprises translates into high risk margins, high collateral requirements and reluctance to lend to certain enterprise categories in general. SMEs are often requested to provide additional collateral, which is not related to their investment. These difficulties are especially present in innovative sectors, since these companies deal with complex products and technologies, unproven markets and intangible assets. Guarantee instruments, as successfully rolled out in the DCFTA, will gain more importance as alternative financial instruments, to further incentivize financial institutions to finance riskier SMEs.

Stronger demand for local currency lending has been expressed by the Bank's existing and prospective clients. The financing needs for long-term investments outside the EU exceed the availability of local savings, and local capital markets are not developed enough to convert foreign funds into local currency. Many IFI's including the EIB, therefore play a substantial role in mitigating this market gap. The EIB has recently launched a pilot project in Ukraine and is actively looking to expand its capabilities in Local Currency lending, which is a much needed instrument for local private sector development.

The increasing demand for microfinance in the EU neighbourhood region calls for more action from EIB Group. Microfinance institutions are still largely funded by foreign investors as local capital markets remain underdeveloped, and the growing deposits are not able to meet the increased needs. The main goal of EIB microfinance operations in the Neighbourhood is to develop the sector while ensuring access to finance to the most vulnerable groups of financial beneficiaries (e.g. women, refugees, youth, and individuals living in rural areas). The EIB group has a dedicated microfinance unit, predominantly focusing on operations outside the EU.

There is a continuing shortage of equity resources in the region, including (and in particular) for SMEs. The continuation of risk capital operations remain highly important in order to strengthen the private sector in the region, in particular by reinforcing the capital base of productive companies through equity and quasi-equity financing and fostering development of the local capital markets.

In addition, innovation activities of large corporates may be too low from a socio-economic point of view. Low commercial returns are low, coupled with high project-specific risks activity may deter innovation activity despite substantial social benefits. This market failure builds a rationale for IFI intervention. Institutional weaknesses in the EU neighbourhood are likely to weigh additionally on innovation activities of firms. EIB support to high impact projects of selected corporate promoters will continue to provide for an element of risk mitigation which attracts private sources of debt and equity finance.

Going forward it is vital that the coordination with European bilateral development agencies, the European Commission and the European External Action Service, is further enhanced. Based on its unique role as EU institution and bank jointly owned by the EU member states, the EIB supports the development policies of the EU and closely coordinates its policies and activities outside the EU with the European External Action Services as well as other global development banks. The EIB has a substantial track record of working together with and supporting the European bilateral development agencies and banks. The EIB stands ready to take a still more prominent role in the coordination of European development policies and to explore more ways to partner with other organisations and to co-finance projects, making better use of limited public resources. The EIB will continue to play a key role in wider initiatives, such as the European External Investment Plan in order to support private sector development and attract more capital from the private sector. Coordinated development efforts will have the greatest chances of success and have the biggest impact on people’s lives.

EUROPEAN INVESTMENT BANK GROUP

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