Evaluation Report

Operations Evaluation (EV)

Evaluation of the projects financed by the EIB under the Asia and Latin America mandates

A synthesis report

European Investment Bank

Evaluation Report

Evaluation of the projects financed by the EIB under the Asia and Latin America (ALA) mandates

Prepared by

Operations Evaluation

Juan Alario
Patricia Castellarnau

External Consultants:

ProFina – Andrew J Loewenthal
WEIC – Dr. Julian Bharier

January 2004

* * *

NOTICE

The EIB has an obligation of confidentiality in relation to the owners, promoters and operators of the projects referred to in this report. Neither the EIB nor the consultants employed on these studies will disclose to a third party any information that might result in breach of that obligation, and the EIB and the consultants will not assume any obligation to disclose any further information nor to seek consent from relevant sources to do so.

* * *

GLOSSARY

BDA:
Bilateral Development Agency

Completed project:
A project is considered completed when physical implementation is finalised and operating phase starts.

FDI:
Foreign Direct Investment

Framework agreement:
The EIB has concluded framework agreements (as of end 2003) with 16 countries in Latin America[1] and 12 in Asia[2], all signatories to cooperation agreements with the EU. The framework agreement grants the Bank, among other things, the permission to lend to public and private borrowers in the host country and sets out withholding tax exemptions, as well as *dejure* Preferred Creditor Status.

Global loan:
Line of credit arranged with qualified financial institutions for financing smaller-scale investments. A global loan was considered completed when it was fully disbursed.

IFI:
International Finance Institution

MBD:
Multilateral Development Bank

PCR:
Project completion report

PPP:
Public Private Partnership, including public concessions.

---

[1] Argentina, Bolivia, Brazil, Colombia, Costa Rica, Ecuador, El Salvador, Honduras, Guatemala, Mexico, Nicaragua, Panama, Paraguay, Peru, Uruguay and Venezuela.
[2] Bangladesh, China, India, Indonesia, Mongolia, Pakistan, Lao People's Democratic Republic, Philippines, Sri Lanka, Thailand, Vietnam and Yemen.

Evaluation

Table of contents

Executive Summary

In early 1993, the Council of the European Union gave the EIB the mandate to finance projects of mutual interest in Asian and Latin American countries (ALA). This first mandate has been renewed and extended several times, with the latest mandate covering the period up to January 31, 2007. The mandates allow the Bank to operate in 35 countries that have signed cooperation agreements with the EU. However, the Bank has limited (as of end 2003) its activity to the 28 countries that have accepted to enter into framework agreements with the EIB (16 countries in Latin America and 12 countries in Asia).

This evaluation covers the loan portfolio of the projects funded by the EIB since the start of the ALA mandates up to end 2002. The evaluation was based on a general overview of EIB financing in the area up to end 2002, an in-depth evaluation of all the operations completed[3] up to end 2001 (26 in total) and a specific analysis of the approach developed by the EIB to finance private sector operations.

From 1993 to 2002 the Bank financed 65 projects under successive ALA mandates for a total loan amount of EUR 2.9 bn. Lending concentrated on countries where there was most Foreign Direct Investment from the EU, in particular Brazil (26% of total lending), Argentina (16%), Indonesia (10%) and the Philippines (10%). Sixty-two percent of the lending has gone to Latin America and 38% to Asia. The largest part of the lending has gone to public private partnerships (PPPs), especially in energy and water, followed by industrial and telecom projects. Global loans accounted for only a small fraction of EIB's total finance. Seventy-seven percent of the EIB's total finance in ALA was to private sector companies, mainly through risk-sharing loans.

EIB's loans under ALA I reached 88% of the overall ceiling of opened credits. Finance under the Interim Mandate and ALA II attained the overall ceilings. As of December 2002, finance contracts had been signed for 45% of ALA III. The proportion of risk-sharing loans in relation to EIB total finance has reached 85% under ALA II and 80% under ALA III (as of December 2002), well above the targets, which were 25% and 30% respectively in these two mandates.

Relevance

The mandate given to the EIB in ALA is to finance projects of mutual interest. However, mutual interest is not clearly defined. In this evaluation, it has been considered that projects contributing to mutual interest should involve a reciprocal direct and measurable flow of benefits between the EU and one or more ALA partner states. Based on this definition, 21 operations out of the 26 reviewed have clearly met the mutual interest criterion. All these operations involved European companies. The remaining five operations (all of which in the public sector and signed before 1998), where no European companies were involved, had limited relevance as regards the mutual interest criterion

[3] An operation is completed when the physical implementation of works is finalised. A global loan was considered completed when it was fully disbursed.

because the EU benefits appear remote and indirect. These five operations can be better classified as contributing to development cooperation rather than to economic cooperation. Four of the 5 operations had limited relevance already when they were selected for finance. This reflects the Bank's broad interpretation of the objectives of the mandate, in particular in the initial stages of the implementation of the ALA mandate.

1. Implementation and operational performance

In the majority of cases the implementation quality of the projects evaluated was satisfactory. Delays and cost overruns were observed in few cases. Most of the problems appeared in the projects developed by public authorities and were linked to insufficient project preparation or weak project management. For the projects developed by private promoters, changes in relation to the original plans reflected mostly unexpected market developments or changes in government policy. No significant environmental problems were reported for any of the projects evaluated, including sub-projects financed under the global loans, during their implementation.

Two main reasons have been identified for project operational performance to be below expectations; firstly economic and political instabilities and, secondly, market developments. Serious economic and political instabilities, such as the Argentinean or Asian crisis, have had a negative impact on the projects. On the market side, the main reason for lower development of the market was an overestimation of the capacity to pay for the new products or services offered. The apparently high market potential when the projects were launched was often not confirmed in practice.

The evaluation found significant differences in the extent to which projects were effective in achieving their specific objectives, with marked differences between projects in competitive markets and those in the public sector, including PPPs. Out of the eleven public sector projects, only three achieved or exceeded their initial objectives, while for projects in competitive markets nine out of 13 achieved the objectives. Concerning the two global loans evaluated, only one achieved its main objective in terms of financing projects of mutual interest.

The main indicator used to assess efficiency in the 24 individual projects has been the economic rate of return (ERR). The return on net fixed assets (RNFA) and the return on equity (ROE) were secondary indicators. These three indicators show that the ex-ante assessment was clearly biased towards high returns. However, the ex-post results are more evenly distributed than the ex-ante assessment, with a significant proportion of projects showing low returns. Thirty-eight percent of the individual projects evaluated were rated less than satisfactory in terms of efficiency and 4 of the projects were considered presently not to be sustainable.

To sum up, taking into account the core evaluation criteria (relevance/efficacy, efficiency and sustainability[4]) and using a 4-level rating scale, 7 operations were rated good, 10 satisfactory, 8 unsatisfactory and 1 poor.

[4] See definitions in Annex 3.

2. The Bank's contribution to the operations financed

For many ALA countries, long-term financing and political risk cover have been in limited supply or non-existent and with high transaction costs. Therefore, EIB financing, with embedded coverage of political risk, has filled a financing gap. However, the limited size of the ALA mandates has allowed for covering of only a small part of the potential needs. The access to finance in the ALA countries has experienced significant changes in the period covered by this evaluation. The Bank has had difficulties to adapt its lending strategy to these changes particularly in the private sector, due mainly to product limitations.

Private borrowers

Since 1997, the core instrument to finance private borrowers has been risk-sharing loans, which requires that commercial risks be secured by good quality external guarantees. This condition has effectively limited EIB lending in ALA to highly rated private sector entities and has made EIB financing very dependent on commercial banks' appetite for ALA credit risks.

We have found good evidence that the EIB has significantly improved the financial terms in the operations evaluated - mainly by offering political risk cover, long maturities, low all-in costs and a non-bureaucratic approach. The Bank has often provided a quality stamp for the operation that has sometimes encouraged banks to guarantee the operation and/or to provide guarantees for longer period than they would otherwise have done. An important limitation of the risk-sharing loan is that it does not offer breach of contract cover. This fact significantly reduces the value added of EIB financing in PPP projects. However, the EU Commission has recently proposed to extend the political risk cover to Breach of Contract in combination with Denial of Justice.

The product offered by the EIB to finance the private sector does not normally allow the Bank to play a critical role in facilitating the progress of the project financed, mainly due to the fact that the Bank does not take credit risk, as it requires commercial guarantees from third parties having a high qualifying credit standing. Only in one of the projects evaluated the Bank played such a critical role. Another significant constraint when financing projects in the private sector has been the non-availability of lending in local currency.

Technical additionality was very limited in the private sector projects evaluated, as the promoters have generally been very competent. However, the Bank's experts improved the implementation of 2 of the 19 projects developed by private promoters.

Public borrowers

The fact that EIB loans to sovereign borrowers (5 in total) are fully guaranteed by the Commission budget allows the Bank to offer very attractive conditions, because the EIB - like other MDBs- does not charge any risk premium. In most of the public sector projects evaluated, MDBs assisted the promoters or the government, either in the initial project preparation phase or in the implementation (this also applies to PPPs). In all cases except one, the EIB relied on the work carried out by other MDBs. In one case the Bank provided significant technical expertise. In the latter, no other MDB was involved.

3. Project cycle

The Bank has been able to very quickly develop its financing in ALA through the strong relationships the Bank has developed with EU promoters and intermediary banks, as well as with other MDBs and BDAs. The framework agreements concluded with partner countries have contributed to increasing the value added of Bank loans, mainly by granting *dejure* Preferred Creditor Status to the EIB. The EIB's initial screening of projects has allowed the selection of sound projects in most cases, but the extent to which the Bank could add value has generally not been considered as a specific criterion in the selection process. In fact, the Bank's lending has been driven by demand for finance and concentrated where its product had the highest value: i.e. where political risks were deemed medium-high. The selection policy is also reflected in the particularly strong credit quality of the ALA loan portfolio.

The Bank's appraisal was generally of good quality. The Bank's cash flow forecasts were often much closer to the actual evolution than those of the promoters. The technical, environmental and procurement analysis was generally properly done. However, for private sector operations the appraisal focused too much on the part of the investments earmarked for EIB financing and less on the company as a whole. The evaluation also found that country, political and regulatory risks were often not sufficiently analysed at appraisal.

Financial monitoring reports were generally of a satisfactory quality. However, physical monitoring reports (mainly PCRs) were frequently lacking in detail and incomplete, particularly on key issues such as implementation of the environmental measures foreseen or market developments. Monitoring of global loans was also very limited. Monitoring weaknesses have been pointed out in previous evaluations and the PJ and OPS departments are presently addressing these weaknesses.

Recommendations

Recommendations	**OP/PJ Accept or Reject proposal:**	**OP/PJ comments or reasons for rejection**
1. The Bank should define more precisely the type of projects eligible for finance considering the objectives of the mandate in order to send a clear message to potential clients (Section 2).	Accepted	The only guideline given by the Council in recent mandates is that credits should be "in support of the Community's relevant external policy objectives" (Art. 1 of the Council Decision of 22.12.99). Ops agrees that there is scope for clarification.
2. The Bank should increase the range of products available to finance private sector operations in ALA, in order to reach investments where the Bank could provide more additionality than at present (Section 4.2).	Accepted	Ops agrees that the existing products to finance the private sector are limiting the potential to provide additionality. For this reason, the Bank is at present examining the possibility to increase the range of products available. In addition, the Council is considering to include Breach of Contract under the Political Risk Cover, as requested by the EIB.
3. A greater emphasis should be placed on EIB additionality in project selection, in order to focus the activity on value added. To increase value-added, more flexibility in the lending strategy is necessary to adjust lending targets to changing market circumstances (Sections 4.2, 4.3 and 5.1). This recommendation is linked to point 2 above.	Accepted	The objective of additionality is being addressed by developing appropriate indicators to measure the value added at the different stages of the project cycle. The implementation of the previous recommendation will facilitate the achievement of this recommendation.
4. The analysis of country, political and regulatory risks should be reinforced, particularly at the appraisal stage (Sections 3.2.3, 5.1 and 5.2).	Rejected	Country risk analysis and the assessment of the likelihood of a political risk event is done on behalf of the European Community, which eventually bears these risks and covers them through its guarantee. Such analysis has kept arrears at a low level of 0.5% of total outstanding. The Bank's approach consists in a thorough ex-ante analysis of potential projects, focused on their political, economic and regulatory environment, their feasibility and their long-term effects. This recommendation appears to be brought forward under the fresh impression of the recent crisis in Argentina of which only short-term effects are known so far. Ops and PJ do not consider that there is sufficient evidence to reinforce the Bank's appraisal approach in this respect.

5. Currently, for private sector projects, the emphasis is predominantly on the project earmarked for finance and less on the entire company. The focus should be on the analysis of the overall company performance in order better to assess risks. As a result, the work distribution between OPS and PJ should be reviewed (Section 5.2).	Accepted	This issue is one of those already raised in the PJ working group on quality assurance.
6. Completion reporting should be reinforced, particularly for global loans. To avoid inconsistency and duplication, financial and physical completion reporting should be closely coordinated between PJ and OPS (Sections 3.1 and 5.3).	Accepted	Completion reporting is being reinforced, including a better coordination between Ops and PJ. For global loans, Ops will improve its monitoring, particularly by introducing a global loan scorecard.

1 Introduction

1.1 Approach followed in the evaluation

In accordance with EV's Terms of Reference, the general objective of the evaluation is to assess the quality of the operations financed and the EIB's performance. The quality of the operations is assessed using generally accepted evaluation criteria, in particular those developed by the Evaluation Cooperation Group, which brings together the evaluation offices of the multilateral development banks. The criteria are *relevance, efficacy, efficiency and sustainability*. The definitions of these criteria are given in annex 3. In addition, the EIB's performance covers both an analysis of the EIB's additionality and of the management of the project cycle (see Annex 3). Particular attention has been given to the following specific sectoral/country issues:

- Impact of economic instabilities on the projects financed, in particular currency devaluations.
- Coordination and cooperation with the EU Commission and with MDBs and bilateral development agencies (BDAs).
- For the projects in privatised/deregulated sectors, the impact of the development of the privatisation and/or deregulation process on the projects and vice versa.

The evaluation started in end 2002 and has been developed in four phases:

- A general overview of EIB financing in the ALA countries: In this phase the total finance provided up to end 2002 and the operational framework set up by the EIB in ALA have been reviewed.
- Individual evaluation of all the operations completed up to end 2001[5].
- Analysis of the approach developed by the EIB to finance private sector operations.
- Synthesis report, presenting the main findings of the previous phases and drawing conclusions and recommendations.

During the second phase, an evaluation report was produced for each individual operation completed up to end 2001. In total, 26 operations were evaluated, which represents all completed operations at the start of this evaluation.

Of the twenty-six operations evaluated, 2 were global loans and 24 were individual loans. The two global loans were used to fund 12 individual sub-projects. A significant number of the individual projects were in fact investment programmes (10 out 24), and most of these programmes were in network industries (telecoms, gas or water distribution). In these cases the Bank financed part of the companies' expected annual fixed investments, comprising several sub-investments (up to several hundred in some instances). In the other cases the Bank part-financed a stand-alone project, such as a new factory or power station.

[5] Based on information available when the evaluation started in mid-2002.

Table 1 presents the distribution of the operations evaluated by sector and by region and compares it with operations financed up to end 2002. Of the 24 individual projects, 6 were in telecoms or related sectors, 5 in industry, 7 in energy, 2 in the water sector, 2 in transport infrastructures, one in the agricultural/forestry sector and one in the environmental sector. The two global loans evaluated, concerns projects financed in the water, energy and industry sectors. Twenty of the operations were located in 8 Latin American countries and the others in 3 Asian countries. The comparison with operations financed shows that the sample of projects evaluated is a good representation of all operations financed, in both sectoral and country terms.

Table 1: Distribution of the operations evaluated by sector and region

	LATIN AMERICA				ASIA			
	Evaluated		Total ALA		Evaluated		Total ALA	
Agriculture/forestry	1	*5%*	2	*5%*	0	*0%*	0	*0%*
Energy	4	*20%*	10	*26%*	3	*50%*	12	*46%*
Global Loans	2	*10%*	4	*10%*	0	*0%*	2	*8%*
Industry	4	*20%*	10	*26%*	1	*17%*	3	*12%*
Telecommunications	6	*30%*	7	*18%*	0	*0%*	1	*4%*
Transport	1	*5%*	2	*5%*	1	*17%*	4	*15%*
Waste, water and sewerage	2	*10%*	4	*10%*	1	*17%*	4	*15%*
TOTAL	20	*100%*	39	*100%*	6	*100%*	26	*100%*

Of the twenty-six individual evaluation reports, 6 are based on a review of the information available within the EIB as well as visits to the project (3 are located in Latin America and the other 3 in Asia). For two operations, meetings were organised with the main European shareholders to discuss the project results and the EIB's contribution. For the other 18 operations, the approach followed was dependent on the information available internally. When the information was limited (8 operations), detailed questionnaires were sent to the promoters in order to obtain more information on ex-post results and 7 promoters replied. Meetings to discuss the main evaluation findings were organised with representatives of the Bank's Lending and Project Directorates, and some project issues were discussed with the clients by phone. In addition, a questionnaire was sent to three commercial banks that guaranteed several of the operations.

To ensure comparability, EV has prepared guidelines for assessing the different evaluation criteria. For each evaluation criterion, a set of standard indicators has been adopted, such as contribution to overcome a significant bottleneck to economic development, development of new business opportunities for EU companies and economic and financial profitability (Annex 1 presents a complete list of the indicators used). A framework to rate the different operations has been established and a 4-level rating scale has been used.

Most of the work was carried out by EV directly, particularly the first, second and fourth phases of the evaluation. External consultants carried out the evaluation of 5 operations: three were undertaken by WEIC and two by ProFina. In addition, ProFina carried out the third phase related to the financing of private operations by the EIB.

1.2 Financial conditions facing ALA countries in the 1990's

In the 1990s, GDP growth performance has differed substantially across the major regions in ALA. China had strong GDP growth, which has increasingly helped to foster recovery in other Asian countries. In Latin America, output significantly advanced in the 1990s, but growth rates decreased after 1996 and became negative in 2002 due to the Argentinean crisis, uncertainty about the Brazilian elections and worsening conditions in Venezuela. Finally, South Asia kept steady growth during the period.

Net debt flows have been negative since 2000 and debt flows to the private sector have been negative since 1998[6]. However, net equity flows remain significant, mainly through foreign direct investment (FDI). The high dependence on international finance has created significant problems to many ALA countries. Latin America was the prime destination of FDI-EU in the emerging markets in 2000 with about 55% of the total[7]. Asia received about 20%. In the last few years, the main EU FDI flows to Latin America have been to Brazil and Argentina. Overall, Spanish investments were almost 50% of the total in Latin America, followed by the Netherlands and France. Among the developing countries in Asia, China and the Philippines have been the leading recipients of FDI-EU in the last few years, with the main EU investors being the United Kingdom, Germany, the Netherlands and France.

Market-based debt flows have been concentrated in middle-income countries, which have also been the main beneficiaries of EIB financing[8]. To avoid foreign exchange risks, a gradual shift towards debt denominated in local currency in several ALA countries has been observed in the last years. This has impacted EIB operations since the Bank has not so far offered financing in local currency in these countries.

1.3 Overview of the ALA portfolio

From 1993 to December 2002 the Bank financed (loans signed) 65 projects under successive ALA mandates, of which 39 were in Latin America and 26 in Asia. EIB total signatures amounted to EUR 2897 m, with an average loan size of EUR 45 m. Therefore, the outstanding portfolio[9] has significantly increased in this period and had reached EUR 1752 m by end 2002. The relatively small volume of signatures during 1996 corresponds

[6] From The World Bank, Global Development Finance: Striving for stability in Development Finance 2003.

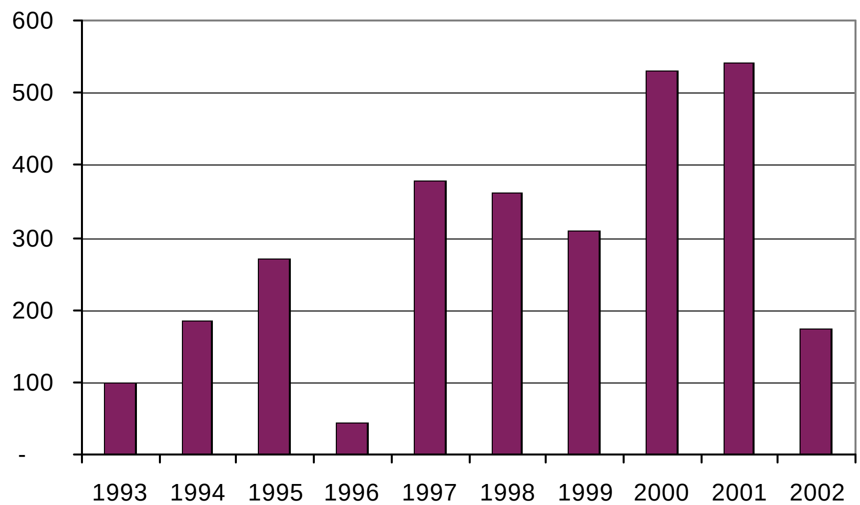
[7] Eurostat, European Union foreign direct investment yearbook 2001, 2002 edition.

[8] In terms of country risks and political risk the difference between ALA countries is substantial, with only a very few countries, at present, rated investment grade.

[9] The outstanding portfolio accounts for total disbursements minus total reimbursements.

to the Interim Mandate, which was given to the Bank by the EU Council as the negotiations for the ALA II Mandate were being delayed. Financing in ALA increased during the period to 2001, but declined significantly in 2002. This was in contrast to the other MDBs, which could behave in a counter cyclical way, filling the gap in the global debt trends. This reflects the dependence of EIB financing on the availability of good quality external guarantees.

Figure 1: EIB financing in ALA during the period 1993-2002 (total signatures in M EUR)



EIB loans under ALA I totalled EUR 662 m, while the overall ceiling of opened credits was higher at EUR 750 m. Finance under the Interim Mandate and ALA II attained the overall ceilings (EUR 275 m and EUR 900 m respectively). As of December 2002, finance contracts had been signed for 45% of ALA III.

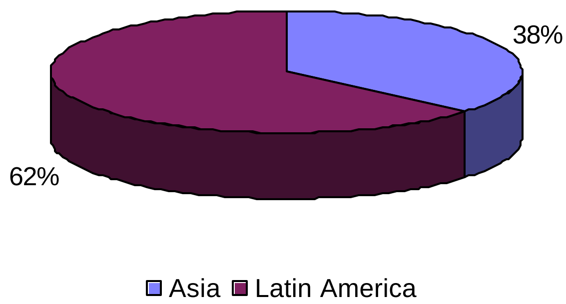
The mandate allows the Bank to operate in 35 countries[10] that have signed cooperation agreements with the EU. However, the Bank has limited its activity to the 26 countries that have accepted to enter in framework agreements with the EIB (see section 4.1).

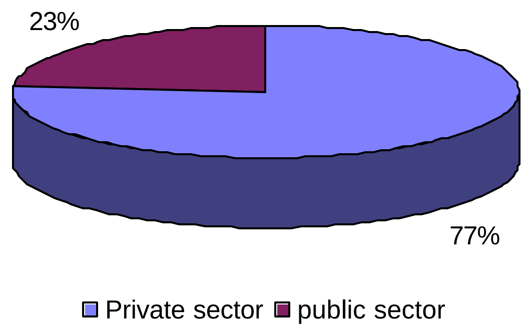
The Bank's lending has concentrated on ALA countries where there has been significant investment by European companies and where country risks were in the medium range. Four countries received 62% of lending from 1993 to 2002: Brazil (26%), Argentina (16%), the Philippines (10%) and Indonesia (10%). Energy and industry sectors had most projects (22 and 13 respectively) and the largest shares of total finance (EUR 1067 m and EUR 593 m respectively), followed by telecoms (eight projects and EUR 450 m). The largest share of lending has gone to public private partnerships (PPPs), especially in energy and water, as a result of the opening of these sectors to private participation in

[10] The number of countries where the Bank can operate has increased over time due to the fact that more countries have signed cooperation agreements with the EU and frameworks agreements with the EIB.

most of the ALA countries in the 1990s. Global loans accounted for only a small fraction of EIB's total finance under the ALA mandates (EUR 232 m), with only six operations in the Andean Countries, Brazil, Central America, Indonesia and Sri Lanka.

Figure 2: Regional and sectoral distribution (public/private sectors) of the EIB financing during the period 1993-2002





Seventy-seven percent of the EIB's total finance in ALA was to private sector operations, mainly in Latin America. Financing to the private sector has been on an upward trend. Indeed, in the last few years the Bank's project lending has almost exclusively been to the private sector, mainly through loans structured under the risk-sharing scheme. The Bank has exceeded by far the objectives set by the Council of the European Union (see section 2), with the proportion of risk-sharing loans in relation to EIB total finance under ALA II and III (as of December 2002) reaching 85% and 80% under each mandate, when the target was at least 30% in the last mandate.

IFI finance is quite significant in international finance of the private sector in developing countries. About 20% of annual long term foreign debt flows to the private sector in developing countries are provided or guaranteed by IFIs[11]. In this context, EIB finance to the private sector in Latin America has usually placed third behind IFC and IDB financing during the period 1997-2002. However, it has played a less significant role in Asia - ranking fifth or even seventh after several MDBs or BDAs during the same period. Overall, the EIB has provided around 10% in Latin America and 5% in Asia of the total Financial Development Institutions finance to the private sector by end 1990's.

Until recently, the EIB was confronted with excess demand in Latin America, which led the Bank to limit the amount per operation. After 2001 (Argentinean crisis) the situation changed and potential demand decreased due to difficulties in finding good quality guaranties. As a result, the cap per loan amount has been lifted.

[11] From IFC, The private sector financing activities of International Finance Institutions. 2001 Update. January 2002.

Twenty-six operations out of 65 financed by the Bank under the ALA mandates had been completed by end 2001, including two fully disbursed global loans. These operations are the ones covered in this evaluation.

2 The ALA Mandates

2.1 Presentation of the mandates

The Bank's operations in ALA are under the different mandates given to the EIB by the Council of the European Union (see table 2). The specific role assigned to the EIB in the mandates is to provide loans for investment projects in those ALA countries with which the Community has cooperation agreements. These mandates are part of the Union's external development cooperation policy[12].

The first two mandates state that the Bank should finance projects of "mutual interest" in ALA. However, in the last two mandates the formulation of the mandates' objective is more general and indicates that the Bank's financing should be "in support of the Community's relevant external policy objectives". This does not seem to imply a significant change of objectives in the last two mandates in relation to the previous ones. Firstly, the last two mandates are a continuation of the first two[13]. Second, the EU Commission in the mid-term review[14] of the EIB external mandates confirms that the specific policy goal to addressed in ALA is as follows: "lending in the ALA group should be directed towards projects that serve the interest of both the EU and the recipient countries"(mutual interest). A more precise definition of the EIB's role in the Community policy towards ALA would be useful.

Under the ALA mandates, the Community granted a guarantee to the EIB against losses under loans in these countries. This has been limited in the successive mandates. In the first mandate the loans were fully guaranteed. In the second mandate[15], the guarantee is restricted to 70% of the aggregate amount of the credits opened (for all areas), plus all related sums (for all mandates). The Bank is also invited to aim to cover the commercial risk on 25% of its lending under this decision from non-sovereign guarantees, to be expanded upon whenever possible insofar as the market permits on an individual mandate basis[16]. Under the third ALA mandate[17], the guarantee is reduced to 65% of the aggregate

[12] This policy can be defined as the "achievement of sustainable economic progress and social equilibrium" in the developing countries (form EC "Green Paper"-1997 cited by ICEA/DPPC, Synthesis of EC (ACP,MED,ALA, Humaninatrian Aid Evaluation May 1999.EuropeAid Evaluation)

[13] In addition, the ALA II and III mandates make some explicit reference to the objective of mutual interest "projects (in Latin America) should be of interest of both the Community and the countries concerned" (ALA III).

[14] COM(2003) 603 final of 13.10.2003

[15] Council Decision 97/256/EC.

[16] From the second ALA mandate it is explicitly mentioned that the budgetary guarantee, under the risk sharing scheme, refers only to political risks arising from currency non-transfer, expropriation, war and civil disturbance.

amounts of the credits opened, plus all related sums, and the risk-sharing target is increased to 30% on an individual regional mandate basis.

Table 2: EU mandates to the EIB for the ALA countries

Mandate	Duration	Ceiling (EUR M)	Total Finance (EUR M)	Risk-Sharing (% of Total Finance)
ALA I	22.02.93 - 21.02.96	750	662	N/A
INTERIM	1996	275	275	N/A
ALA II	31.01.97 – 31.01.00	900	900	85%
ALA III	01.02.00 – 31.01.07	2480	1114*	80%

* As of December 2002

The Bank has defined mutual interest criterion as "projects that serve the interests of both the country in which they are implemented and of the Community". The Bank's definition is in line with the definition adopted by the EU Council. According to Council Regulation N°443/92 (23 February 1992), the mutual interest criterion gives as much emphasis to promoting the interest of EU Member States as to supporting the development of the ALA countries. As mentioned in a recent evaluation on the subject[18], "serving mutual interest must involve a reciprocal direct and measurable flow of benefits between the EU and one or more partner states, as opposed to a one-way flow of support from the former to the latter". Therefore, economic cooperation, which contributes to the mutual interest of the EU and the ALA countries, is distinct from development cooperation, which focuses only on the latter.

2.2 Project relevance in relation to the objectives of the mandate

On the basis of the definition of mutual interest given in section 2.1, we have found that there were significant differences between operations involving European companies and the other operations.

All the operations involving EU companies - 21 in total including a global loan to EU banks - clearly met the mutual interest criterion, even if the European companies were minority shareholders in the borrowing company. These operations were consistent with the objectives of developing new business opportunities for the EU companies and of contributing to important policy objectives in the partner countries. The relevance of one of the operations in relation to the EU has since decreased, as no European shareholders are any longer involved in the project, but the project has still involved the transfer of European equipment and technology. All the projects are consistent with important policy objectives in the partner countries. In 12 cases the projects were a key element in the government policies to re-organize public services (telecoms, electricity, water and gas). In another two cases the projects contributed to key government policies, such as proper waste management or developing rural areas. The other projects were in competitive

[17] Council Decision 200/24/EC

[18] Eva-EU Association, Evaluation of Economic Cooperation between the European Community and partner states in Asia and Latin America. August 2001. Evaluation Unit of the EuropeAid Co-operation Office. European Commission.

markets and contributed significantly to meeting new demand and/or increasing the level of competition (new products, reduced imports from abroad, etc.).

The other five operations (including a GL), where no European companies were involved, had limited relevance to the mutual interest criterion. These operations were all in the public sector and although they contributed to important development objectives in the partner countries, their EU benefits appear remote and indirect. They can be better classified as contributing to development cooperation than to economic cooperation. This reflects the Bank's broad interpretation of the mandate's objectives, which may have been more prevalent in the initial stages of implementation of the ALA mandate (see 5.1).

Annex 2 summarizes the main benefits of the projects evaluated. Concerning the benefits to the partner countries concerned, most of the projects contributed significantly to overcome a bottleneck for the economic development and to a transfer of know how and managerial skills (about 20 out of 26). In addition, about 50% of the projects contributed directly and substantially to greater competition and competitiveness, and/or to environment improvements or the country living standards. In terms of benefits to the EU, eighteen projects out of 26 significantly fostered the development of new business opportunities for European companies and 15 resulted in a substantial transfer of technology and equipment to the partner countries.

3 Implementation and Operations Performance

This chapter analyses first the implementation performance and, second, the operational results of the projects evaluated as measured by the main evaluation criteria: efficacy, efficiency and sustainability, while the relevance criterion has been presented in section 2.2. Because of distinct characteristics, we have classified projects in two main groups, public sector projects including public sector private concessions (PPPs) and private sector investments.

3.1 Implementation Performance

Efficiency gains and improvements in the quality of service were substantial in PPPs. In all projects of this type, the new private companies have dramatically cut operating costs, covered unmet demand, improved the quality and reliability of services and increased investment efficiency.

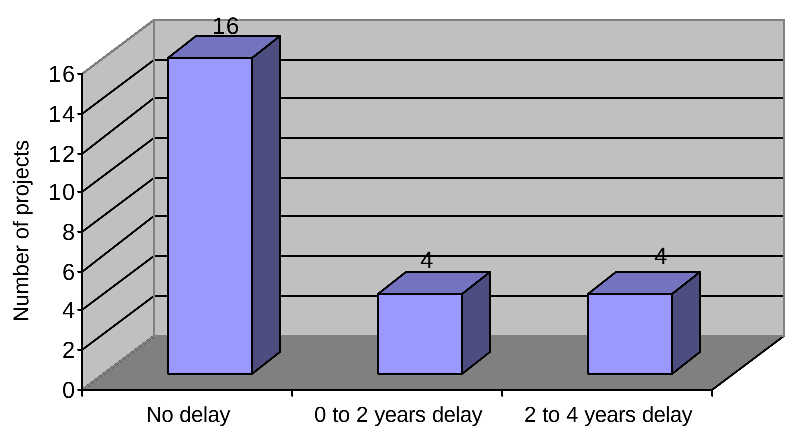
3.1.1 Scope and delays

In general, projects were well prepared. The involvement of European companies in most of the projects brought substantial improvements in terms of management efficiency and ensured considerable transfer of know-how to partner countries, contributing to good implementation results. Insufficient preparatory work occurred in only one public sector project, where substantial change to the scope of the works needed to be carried out. In this case the EIB relied on the support provided to the promoter by another MDB. In another case, the implementation of the project was poor, despite the involvement of an experienced European shareholder. In the project development phase, the EIB contributed significantly to two projects by proposing some improvements on the technical side, related mainly to environmental issues.

Despite good initial preparation, in seven of the 24 individual projects the scope of final works was different than foreseen at appraisal. Most changes in scope were in programme-type operations, where they were introduced to respond to changing circumstances. Such changes were generally related to unexpected market developments or, in PPPs, changes in government policy (investment priorities). The other 17 projects were built according to the initial plans (see figure 3).

Eight of the 24 projects experienced delays, although these delays were only significant – 2 to 4 years - for four projects. In the two projects developed by public authorities, unsatisfactory project management was the main explanation for the delays (one year and three and a half years). For the projects developed by private companies, delays were mainly linked to unforeseen events. In one case out of the eight, difficulties in securing guarantees for the project delayed construction. Another project was developed in phases to hedge against the volatility of the market. This proved very useful when the implementation of the second phase of the project had to be postponed due to a worldwide recession in the industry. The remaining four projects were delayed due to technical problems and unpredictable factors such as strikes, flooding or difficulties in obtaining rights of way from landowners.

Figure 3: Work duration of the 24 individual projects



Global loans

Among the two global loans there were substantial differences between sub-projects developed by public authorities and those of private companies. All sub-projects of public authorities experienced significant delays caused by lengthy feasibility studies and tendering procedures as well as substantial increases in project scope[19]. On the contrary, all the private sector sub-projects, except one, were implemented on time and reasonably within budget. No changes were made to the initial technical description of the sub-projects and only one sub-project had a cost increase (21% in USD terms). However, one private company became financially unsustainable following an economic crisis in the partner country, unfavorable modifications of the regulatory framework and downward market forecasts that eventually caused a considerable reduction of the scope of the sub-project.

The intermediaries for both global loans, which identified and appraised the projects, carried out satisfactory monitoring of their operations. However, information available within the Bank on the implementation of sub-projects was limited (See 3.2.2).

3.1.2 Cost overruns

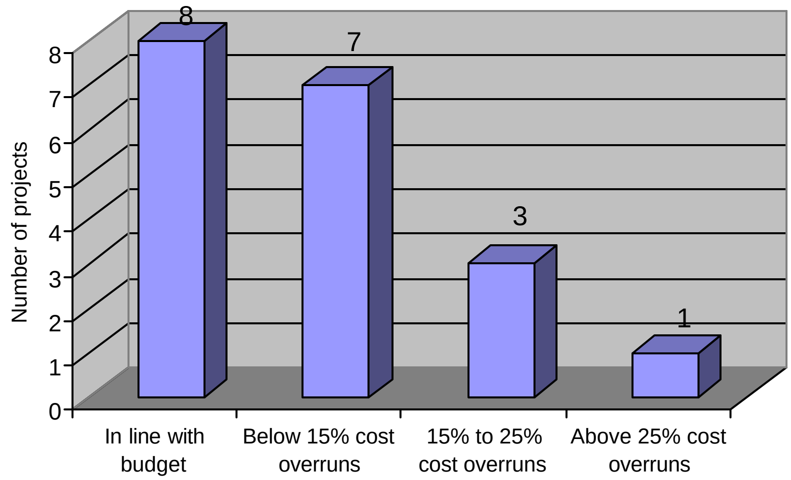
The comparison of initial estimates by the Bank[20] with outturn costs has been difficult in many of the projects evaluated because of exchange rate fluctuations and inflation. The USD has generally been the reference currency in the majority of the ALA countries and sometimes the local currency was explicitly pegged to the USD, as in Argentina and Brazil. Therefore, in this evaluation we have compared outturn costs with initial costs both in USD and local currencies in constant terms.

For 19 of the 24 individual projects evaluated this was possible because the scope of the works did not change significantly. Of the 19, 15 had outturn costs more or less in line with initial estimates (less than 15% cost overruns - see figure 4). For the other four cost overruns were above 15% for various reasons including flooding, improvements in the production process and technical problems. As noted before, both projects where the borrower was a public authority were hampered by weak project preparation, in particular lengthy and sometimes incomplete feasibility studies and bidding processes.

The implementation information presented in the Bank's project completion reports (PCRs) was not complete. Where PCRs were available, final costs, commissioning dates and scope of the works were compared with initial estimates. In one project, the Bank's PCR did not report that project scope had been significantly downscaled. PCRs systematically compared costs in EUR, which was not appropriate for most projects evaluated.

[19] The latter resulted from currency devaluations that lowered the costs of works incurred in local currency whilst it increased the face value of dollar denominated loans.
[20] The Bank's initial cost estimates often consider a slightly higher cost than the promoter because they included "contingencies".

Figure 4: Final investment cost of the 19 individual projects



3.1.3 Environmental performance

During the implementation phase, for none of the projects evaluated, including sub-projects financed under the global loans, were significant environmental problems reported. Where detailed information was available, which was the case for all the environmentally sensitive projects, environmental mitigating measures were, in general, applied as defined at appraisal. In two projects, the Bank's appraisal led to additional environmental mitigations measures. In projects co-financed with other MDBs, the Bank relied mainly on the preparatory work and environmental monitoring procedures of these MDBs.

One large project, where the Bank was a minor lender, raised criticism from NGOs. The Bank addressed the environmental concerns raised by NGOs but relied substantially on the on-site monitoring carried out by independent external experts with the involvement of another MDB. Nevertheless, this turned out to be a time consuming process for the Bank's services. Another project also raised criticisms from NGOs, but after implementation.

3.2 Operations Performance

A significant number of ALA projects have been adversely influenced by economic instabilities. In some countries currency devaluations have considerably increased the cost of servicing loans in foreign currencies, while inflation has increased local costs. In addition, low GDP per head and poor income distribution hampered the expansion of most of the target markets.

3.2.1 Efficacy

The evaluation found significant differences in the extent to which projects were effective in achieving their specific objectives, with marked differences between projects in competitive markets and those in the public sector, including PPPs.

Public sector

Of the five projects implemented by public authorities (excluding the global loan to a public finance institution), three achieved their initial objectives. They fostered the economic development of partner countries through improved traffic/transportation flows or introducing less polluting sources of energy. The other two projects only partially achieved their objectives. The market for one environmental project turned out to be substantially lower than foreseen, due to lax enforcement of environmental legislation[21]. This created significant financial problems for the company, which was later sold. A second project met only part of its objectives due to delayed implementation and political instabilities, which to date remain a major threat for the overall outcome of the operation.

Six projects – two in Asia and four in Latin America - were PPPs, of which 2 were in the water sector and 4 in the energy sector. Only one of these projects achieved and exceeded its initial objectives (i.e. extension of gas use and improvement of the quality of service). Three other projects in the energy sector partially achieved their objectives because target markets grew slower than expected[22]. The remaining two, only met to a limited extent their initial objectives. Both had significant environmental content (water and sewerage networks) and both indeed contributed, although much less than initially foreseen, to the environment, by providing good quality drinking water to people without access and by reducing pollution.

[21] This lax enforcement of the legislation led to unfair competition from other environmental facilities not complying with the environmental standards. This issue was raised by the Bank at appraisal as one of the main risks of the operation. The Bank approached the authorities and asked for a letter of comfort to ensure that the legislation would be enforced. However, the legislation was only partially enforced in practice.

[22] This resulted in one case from the Asian Crisis; in a second project from a delayed implementation of the wholesale electricity market's new regulatory framework and economic instabilities that weakened internal demand; and lastly competition from electrical household appliances reduced gas sales.

Water sector projects

In ALA, the Bank has approved financing for 7 projects in the water sector up to end 2002, two of which have been completed and are covered in this evaluation. A further 9 pipeline projects were rejected or are on-hold due to unacceptable risks. All approved projects are forms of PPP, either concessions or BOTs, with the Bank lending to private promoters. All the projects have, to varying degrees, significant problems in terms of efficacy (not meeting the original objectives) and/or sustainability. Commonly, problems relate to macro-economic impacts, non-implementation of tariff increases foreseen in the concession contract, limited willingness to pay for basic water services of the poor, inappropriate incentive structures, and the fact that the public sector did not carry out complementary investments directly related to the project. The two PPPs projects in the water sector included in this evaluation, one in Latin America and the other in Asia, experienced similar difficulties.

In one of the projects evaluated, initially the unwillingness of new customers to pay for the service (sewerage and wastewater treatment) was a decisive factor to significantly reduce the project's efficacy; later the project became financially unsustainable following an economic crisis, when tariffs increases were frozen and the contract with the public authorities is being re-negotiated. In the other case, the municipality did not honour its commitment to carry out the required expansion of water distribution and transmission networks, partly because potential new customers continued to draw on other, less satisfactory, water supplies.

Private sector

Of the five projects in the industry sector, three achieved their main objectives while the remaining two were rated poor in terms of efficacy. In one case, the promoter failed to identify market difficulties - including domestic competition - that were subsequently compounded by mounting economic instabilities. In the second, the promoter was unable to expand domestic sales and export activities, due to the Asian crisis and domestic competition. In one case, the ex-ante sensitivity analysis showed that the risk of low profitability was high, but the Bank decided nonetheless to finance the project.

The only project in a new deregulated market in the energy sector was not effective in meeting its objectives due to technical problems that considerably delayed full capacity utilization, excess capacity in the market and market disturbances (linked to a major crisis in the country). The latter led to a drop of the electricity prices in USD terms, and as a result the project is financially unsustainable at present.

The six projects in the telecoms sector were effective in meeting their main objectives, namely to foster the expansion of telecoms, in particular mobile services, by substantially increasing the customer base, market penetration rate and the overall quality of services offered. However, as explained in section 3.2.2, the growing number of subscribers or telephone lines was accompanied by higher reductions in Average Revenue per User or per line than expected at appraisal, leading to lower profitability than initially expected.

The only project financed in the agriculture/forestry sector was highly effective and contributed to the economic development of the area where it was implemented.

Global loans

The evaluation assessed the efficiency of the two global loans (one to two private finance institutions and another to a public one), and the sub-projects financed under them, using different criteria than those for individual projects. It analysed in particular whether the global loans achieved initial objectives as defined at appraisal by the Bank (i.e. target sectors and final beneficiaries). The EV team also looked into the terms and conditions of the sub-loans granted to final beneficiaries in order to assess the extent to which intermediaries passed on EIB lending conditions to final beneficiaries.

Most of the sub-projects financed through the global loans have been recently finalised or are about to be completed. Nevertheless, on the basis of the information provided by intermediaries, all completed projects can be considered effective with the exception of one - a PPP involving a European company which was rated unsatisfactory.

The global loans partially achieved their objectives in terms of contribution to the mutual interest criterion. A global loan to private finance institution achieved this objective, while the other global loan to a public finance institution did not. In the latter, as the intermediary was not able to finance projects of European interest, EIB credit line was re-channeled to reconstruction projects following a natural disaster (only one sub-project out of five had direct benefits to the EU). Most finance went to relatively large projects. This does not generally fulfill the general objective of global loans, which is to finance small projects that cannot be financed directly through individual loans.

The benefits of EIB loan in terms of longer maturity were fully transferred to final beneficiaries in the case of the private finance institutions. Information is not available to allow for judging the extent to which the public finance institution passed on EIB lending conditions to final beneficiaries. EIB lending conditions were attractive to the intermediaries, as term finance was scarce. Therefore, the evaluation team considers the global loans effective. It was noted that the Bank has only partially ensured that the benefits of EIB lending were transferred to final beneficiaries. However, in recent operations the Bank has taken additional measures to ensure that benefits are transferred.

Environmental objectives

Of the 24 individual projects, three had environment as a key objective (i.e. good quality drinking water, sewerage networks and waste treatment). In general, the initial objectives were partially met. The reasons have been covered in the relevant sub-sections above (§ Public and private sector).

Three of the sub-projects that were financed through global loans also had environment as a key objective. On the basis of the information available from intermediaries, they were all effective in meeting their objectives (sub-section on Global loans).

Projects in the industry, telecoms and infrastructure sectors did not have environmental improvements as a main objective. In the six projects in the energy sector, they were a secondary objective, i.e. promoting the use of less polluting sources of energy, which in general they did. However, in one project the low energy efficiency of household heating systems (40% on average) was noted. In a context of low energy prices, neither the Government nor the gas regulator promoted energy savings as a key environmental objective. At appraisal, the Bank did not address this issue.

3.2.2 Efficiency/sustainability

The main indicator used to assess efficiency in the 24 individual projects has been the economic rate of return (ERR). The return on net fixed assets (RNFA)[23] and the return on equity during the most recent years available were secondary indicators.

The re-assessment of the ERR has taken into account the analytical criteria and methodology used for project appraisal. In competitive markets and when there are limited economic distortions or externalities, the FIRR has been used as a proxy for the ERR. In other cases, particularly in PPP or public sector projects in general, the ERR needs to be separately assessed. The RNFA has generally been used as another indicator to assess the financial profitability of investment programmes. These indicators were not relevant for the two global loans evaluated. In addition, for the public concessions in Argentina, the information presented corresponds to the financial profitability before the crisis (up to 2001), as current profitability is negative and the new regulatory framework, in particular tariff levels, is not yet known. To estimate the ERR, the future cash flows for each project have been re-evaluated using the ex-ante cash flow projections as a reference[24]. In addition, cash flows have been established in constant terms, in USD or local currency depending on the currency used in each project in the Bank's appraisals.

Figure 5 presents the estimated ERR for 20 of the 26 projects evaluated[25]. This figure shows that there was clearly an optimistic bias in the forecasts carried out by the promoters and the Bank. However, in several cases the Bank's forecasts were less optimistic than those of the promoters and closer to the ex post. The average ex-ante ERR is 19% while the ex-post is 10%.

[23] EBIT/Net Fixed Assets (in nominal terms).

[24] The re-evaluation of the project future cash flows has taken into account the real evolution of the cash flow from project completion to 2001/2 and the reasons for the deviation in relation to the initial forecast.

[25] For some projects the ERR could not be calculated because some key economic benefits could not be measured in qualitative terms due to a lack of data. In some cases, the restructuring of the project company did not allow to obtain the necessary information to carry the ex-post analysis.

Figure 5: Ex-ante and ex-post distribution of the Economic Rate of Return (ERR)

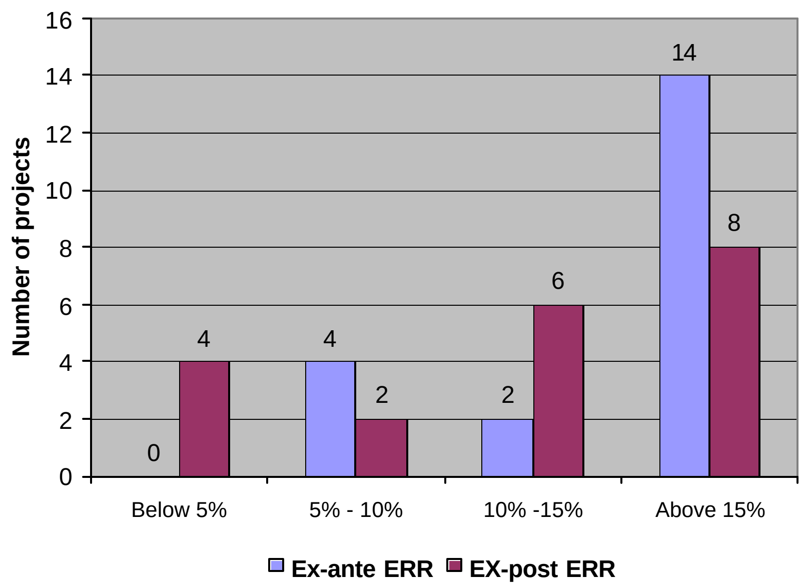


Figure 6 presents the ex-ante and ex-post distribution of the RNFA, in local currency terms, for the private sector projects and PPPs. This information was only available for 13 of the 19 projects of this kind, because in the others the activities of the company had dramatically changed after appraisal (mergers, separation of key activities, etc). The average ex-ante RNFA is 23% while the ex-post is 11%.

The conclusion concerning the RNFA of the projects is similar to the ERR. None of the ex-ante RNFA was lower than 5% and for most of the projects it was higher than 15%. The ex-post distribution is much more even, with a significant proportion of projects with an ex-post RNFA of less than 5% and a lower share of projects with an RNFA higher than 15%.

Figure 6: Ex-ante and ex-post distribution of the Return on Net Fixed assets (RNFA) for the most recent period (average 2000-2002)[26]

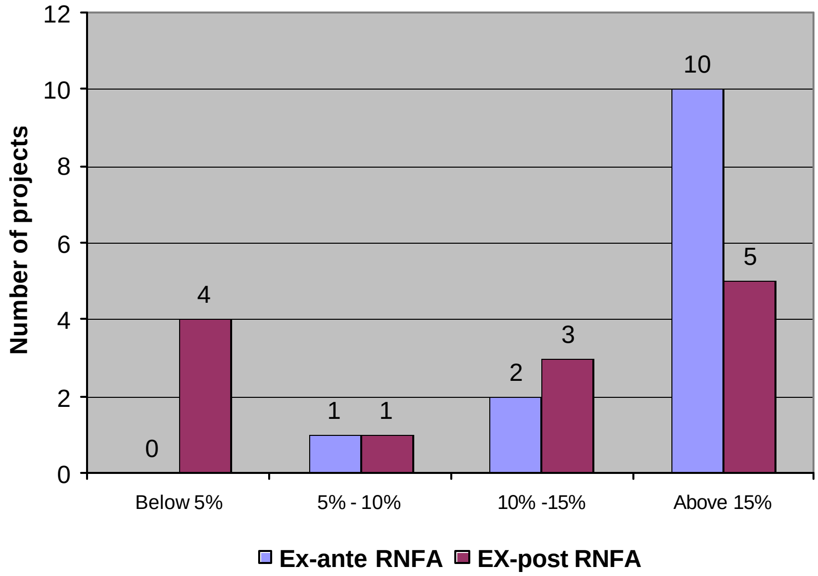
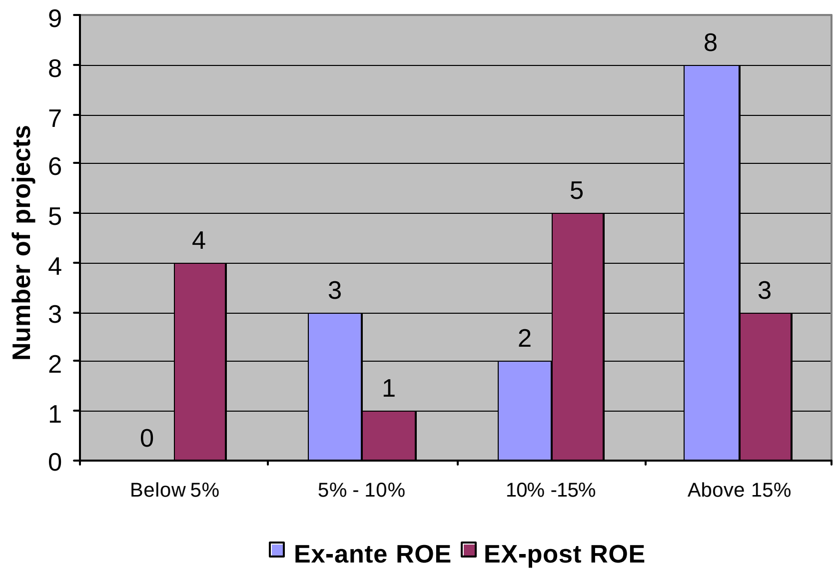


Figure 7 presents the ex-ante and ex-post after taxes return on equity (ROE). Similarly to the RNFA, the expected ROEs were generally higher than the actual. The average ex-ante ROE is 16%, and 9% ex-post. In most of the projects the ex-ante ROEs are over 15% and in none of the cases they are below 5%, while ex-post ROE of the different projects are more evenly distributed, with most of the projects achieving ROE in the 5%-15% range.

[26] Except for Argentinean projects where the average is for the period 1999-2001

Figure 7: Ex-ante and ex-post distribution of the Return on Equity (ROE) for the most recent period (average 2000-2002)[27]



Several factors explain the lower than expected profitability of the operations evaluated.

Of the 11 public sector projects including PPPs, financial profitability is similar or slightly higher than initially expected for six, while for the other five it is significantly lower.

In the case of PPPs, issues relating to the regulatory framework explained the generally lower financial profitability. Most of these projects were directly or indirectly exposed to certain levels of market risk embedded in the regulation (gas, electricity and water markets) and thus lower market growth had a negative impact on profitability. In two cases, the levels of profitability that could be achieved under the established regulatory framework was optimistically assessed ex-ante. It should be noted that in most of the PPP projects evaluated there have been regulatory problems and changes in the government policy that have had a negative impact on the financial profitability. The economic profitability was lower in many cases due to lower market developments and willingness to pay for services provided. In one case the public authority did not carry out several related investments and thus the economic benefits of the project were significantly reduced.

The six telecoms projects achieved significantly lower financial profitability than initially expected. This is explained by the substantially lower expansion of revenues in relation to initial forecasts, while capital costs increased only slightly less than initially foreseen. However, operating costs followed a similar evolution than the revenues (see box below).

---

[27] Except for Argentinean projects where the average is for the period 1999-2001

The main reason for the lower revenues is the lack of ability of a large part of the population to afford the services due to low incomes. This was even though the promoters and the Bank had studied in detail the impact of low incomes on revenues using complex models. Generally, the Bank's assumptions were more prudent and closer to the actual evolution.

For three of the five industrial projects and a project in a new deregulated market, financial profitability was significantly lower than expected due to lower market growth. In two out of 4 projects, the appraisal identified significant risks of lower profitability, confirmed later by the ex-post results, but the Bank decided nonetheless to finance them. Deteriorating economic situation, such as the Asian and Argentinean crisis, and low GDP growth in Brazil reduced the financial profitability of all projects.

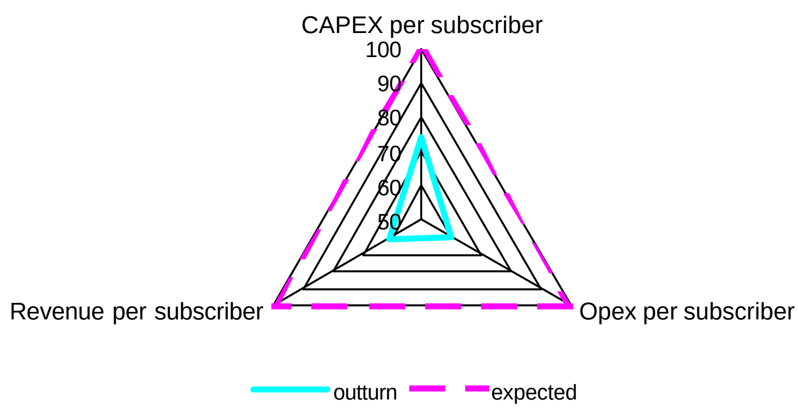
Sustainability: The evaluation concluded that four of the 24 projects (2 PPPs, one industrial and one project in a newly deregulated energy market) are, to date, not sustainable. Three of the projects rated unsatisfactory are located in Argentina. They are at present financially unsustainable and their sustainability depends on the outcome of renegotiating government contracts. The remaining project is unlikely to achieve the minimum market share that allows it to be financially sustainable. Generally, in many projects, policy, regulatory and legal uncertainties that may potentially affect project's sustainability were noted.

Telecoms projects

The evaluation assessed five operations in the telecoms sector (excluding a project in a related sector i.e. optical fiber cables). These projects were developed in the context of the privatisation of the former state-owned companies and deregulation of the sector, including creation of new regulatory authorities. All projects contributed significantly to meeting previously unmet demand (reducing waiting lists), to reducing the cost of access (connection charges and/or handset prices) and to improving the previously poor quality of telecoms services.

However, telecoms companies operate in difficult economic environments where social considerations such as the low level of GDP per inhabitant and income disparities have had a significant impact on the development of the market. As a result, growth of numbers of telecoms subscribers/lines led to a decrease in average revenue per subscriber line, which was much faster than initially forecasted. In addition, the significant devaluation of some Latin American currencies, coupled with inflation, had a negative impact on profitability.

The graph below presents the ex-ante estimates and the ex-post results of revenues (in local currency and in constant terms), capital costs and operating costs in relative values per subscriber for a sample of mobile telephone projects evaluated. The three variables are linked, as the companies can influence the development of these variables by adapting their marketing policies (particular pre-paid versus post-paid subscribers). The graph shows that lower revenue expansion was not compensated for by lower capital costs whilst operating cost were reduced in the same proportion as operating revenues. Thus, profitability turned out to be lower than forecast.

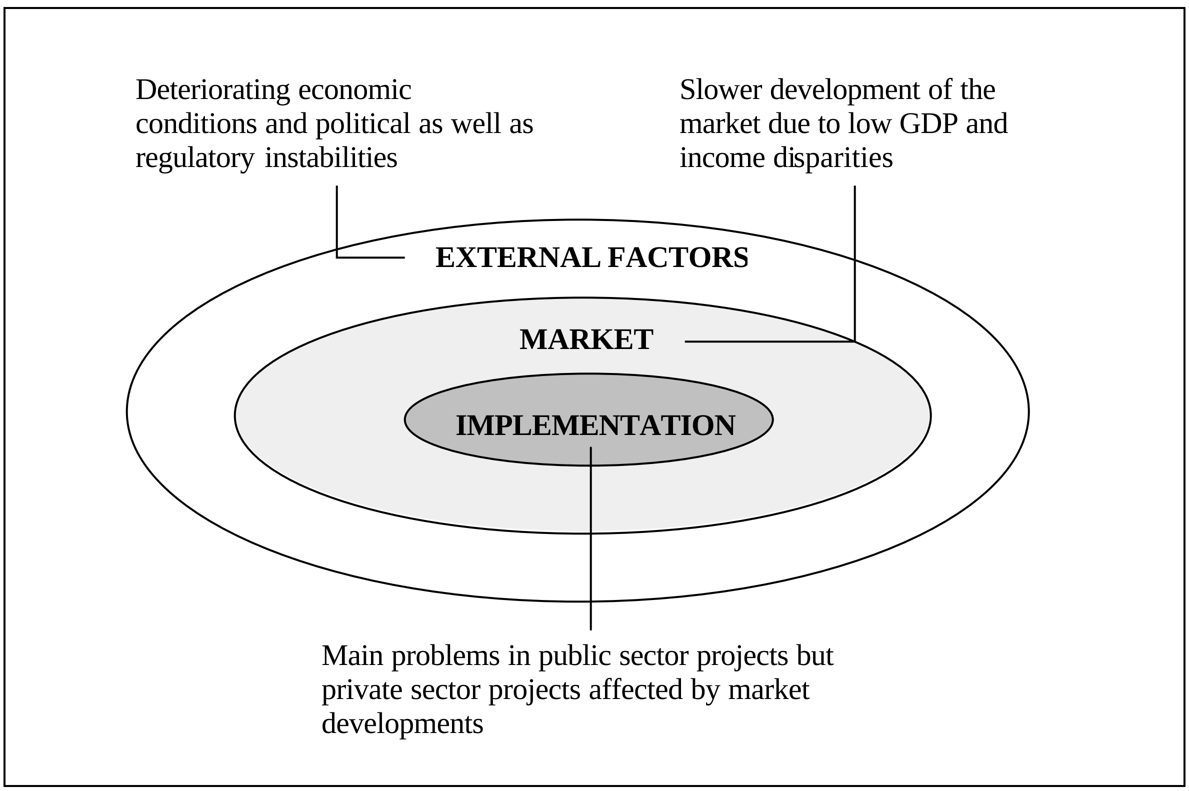


3.2.3 Aggregate project performance

Of the twenty-six operations, 7 were rated good in terms of aggregate project performance, 10 satisfactory, 8 unsatisfactory and one poor. The main reasons for the less than satisfactory ratings of the nine projects were unsatisfactory and sometimes poor efficiency and/or sustainability.

Generally, the implementation performance was satisfactory for most of the projects but, market and external factors (country, policy and regulatory issues) adversely influenced the outcome of many operations (see figure 8).

Figure 8: Issues underlying the overall project performance



4 The Bank's contribution to the operations financed

4.1 General considerations

For most ALA countries, long-term financing and political risk cover have been in limited supply or non-existent and with high transaction costs. This justifies the intervention of MDBs and BDAs, including the EIB, as well as other public organizations. However, the limited size of the ALA mandates has allowed for coverage of only a small part of the potential needs.

The Bank has concluded framework agreements with 16 countries in Latin America and 12 countries in Asia (see glossary). Typically, the agreement grants the EIB permission to lend to public and private sectors in the host country and sets out withholding tax exemptions. In addition, the Host Governments commit to make available foreign currency for the debt service of the EIB borrowers. Through the framework agreements, the Host Governments thus grant *dejure* Preferred Creditor Status to the EIB. These agreements contribute to increase the value added of Bank loans.

The EIB is rather different to the other MDBs acting in ALA because of its specific objectives and shareholdings. The following points indicate some of these differences:

- MDBs are owned by all the countries in which they operate; the EIB is owned only by the EU Member States.
- The primary objective of MDBs is economic development; that of the EIB in ALA is economic cooperation.
- MDBs have *de facto* preferred creditor status with host governments; the EIB has framework agreements with host governments which give it a dejure preferred creditor status[28]
- MDBs have extensive policy dialogues with host governments; this is hardly the case for the EIB in ALA.

The EIB seems to be generally perceived by most partner countries as another MDB, particularly where the Bank has developed a significant presence. In that sense, several borrowers or guarantors have mentioned that the Bank's intervention was considered important to provide an implicit political support to the project.

The Bank has so far not been able to offer financing in local currencies in ALA. This, together with the Bank's demanding security requirements, has limited EIB lending in several ALA countries. For projects where main revenues were in local currencies, financing in foreign currencies has exposed borrowers to significant exchange risks. Nonetheless, such FX financing may have had an interest when there was no alternative,

[28] EIB accepts payments in local currency in case of Convertibility or Transfer Restrictions, therefore from the user standpoint the EIB product is superior.

which was frequently the case. Financing opportunities in local currency is a fairly recent phenomenon in many developing countries.

4.2 Private sector borrowers

Financial additionality

Since 1997, the core instrument to finance private sector borrowers has been risk-sharing loans. It is a rather unique product and highly valued by borrowers and guarantors for its free-of-charge clear coverage of classical political risks (currency transfer restrictions, expropriation and war or civil disturbance). This product has, of course, been a very attractive option where political risks are high and where there are good private sector credit risk takers available. However, the EIB high security requirements have effectively limited lending under risk-sharing schemes to highly rated private sector entities and the need of external guarantees makes EIB financing very dependent on the commercial banks' appetite for ALA risks, limiting the possibilities to behave in a counter cyclical way (see section 1.3).

An important limitation in financing certain projects is the scope of the EIB's political risk cover. In PPPs, the key risk is that public entities breach their contracts, and this risk is not covered at present by the EIB product. This has, indeed, been a significant obstacle in financing a number of PPP projects where the Bank could have brought significant financial additionality. The EU Commission in the mid-term review (COM (2003) 603 final) propose to extend the political risk cover to Breach of Contract in combination with Denial of Justice[29]. For project finance operations, the implementation of a loan structured under the risk-sharing scheme increases the complexity of these deals[30]. This explains why the Bank was excluded from some of these operations.

EIB financing has encouraged some banks to provide guarantees, sometimes for a longer period than they would otherwise have done, on their own assessment of country and commercial risks. The Bank has thus provided a certain quality stamp – and in some cases comfort - for guarantors. Guarantors specifically value the political risk coverage of EIB loans and the EIB's MDB character (recognising its limitation of not covering breach of contract). The Bank has in some cases accepted rollover guarantees to bridge the gap between the funding needs of promoters and the duration of the commercial guarantees.

To summarize, there is good evidence that the EIB has significantly improved the financial terms of the operations evaluated. The main financial benefits provided are: political risk cover including transfer and inconvertibility cover, long maturities, low all-in cost and a non-bureaucratic approach. However, in none of the projects evaluated, with

[29] To cover cases involving breach of certain contracts (e.g. concession or off-take agreements) by the host government (or other public authorities) and a subsequent failure to enforce an arbitration award against the relevant public authority.

[30] One of the operations evaluated was project finance. In this case, the fact that the EIB does not take project risks complicated the set up of the operation. In addition, even if the Bank does not take project risk it needed to closely follow up the development of the operation, implying a significant cost for the Bank for little value added.

perhaps one exception, has the EIB played a critical role in facilitating the implementation of the project.

The potential to play such a role in private sector investment is invariably linked with the lenders' capacity to take credit or commercial risk, which is not currently a characteristic of ALA products. The EIB's products and strict security requirements to finance projects in the private sector differ significantly from the other MDBs and constrain the EIB in its capacity to supply the specialised services offered by MDBs to private sector borrowers. All such products are mainly based on the capacity of the MDB to take commercial, credit or project risk, which at present is supplied to the EIB by third party guarantors.

Smaller projects can be financed through global loans (credit lines), but this possibility is rather limited in practice in ALA as such credit lines could only be established in very few countries and for only limited amounts, given the scarcity of resources under the ALA Mandate. Direct financing of small projects by the EIB has also been constrained by cost and price considerations (EIB's internal costs for these loans are similar to larger loans).

Technical additionality

Technical additionality was very limited in the private sector projects evaluated, as the promoters have generally been very competent. However, the Bank's appraisal improved the implementation of two of the 19 projects in the private sector, in both cases by reducing adverse environmental impacts through financing additional anti-pollution equipment and, in one of these, by proposing measures to mitigate technical risks. In another case, the Bank could have contributed to reduce the technical risks, but was late intervening and the choice of technology could not be changed.

4.3 Public sector borrowers

As EIB loans to sovereign borrowers are fully guaranteed by the Commission budget, the Bank has been able to offer very attractive lending conditions, because EIB – like other MDBs – does not charge any risk premium.

In practically all public sector projects financed though individual loans, MDBs other than the EIB helped the government - either in the definition of the regulation/policy background and/or in the initial project preparation phase. This also applies to PPP projects and projects in deregulated industries (energy, telecoms).

Of five projects developed by the public sector, in three cases assistance to the promoters was necessary. In two cases, the EIB relied on the work done by other MDBs. In another, where no other MDB was involved, the Bank provided significant technical expertise to limit technical risks and to improve the environmental performance of the project.

5 Project cycle

5.1 Identification and Selection of the operations to be financed

Identification and strategy

The Bank has been able to very quickly develop its financing in ALA through the strong relationships developed with EU promoters and intermediary banks, as well as with other MDBs and BDAs.

Initially, in Latin America, the Bank identified several projects through the MDBs involved in the area; later projects were identified through direct contact with potential clients - mainly in the private sector. Several projects in Asia have been identified through contacts with the Asian Development Bank (the ADB co-financed three of the six projects evaluated in Asia).

In the initial stages of implementing the ALA mandate, the Bank has interpreted in a general way the objectives of the mandate in order to achieve the target lending volumes, pursuing both objectives of economic development and economic cooperation. This has not sent a clear message to potential clients. In recent years the Bank has given priority to private sector projects involving EU companies. The EIB's additionality, or value-added, has generally not been considered as a specific criterion in the selection process. In fact, the Bank's lending has been driven by demand for finance and concentrated where its product had the highest value i.e. where political risks were deemed medium-high.

The EIB's lending strategy has been to achieve the global lending volume set by the mandates, while limiting the maximum amount per loan in order to finance a large number of projects. In addition, the strategy tried to ensure a balanced distribution of loans among countries and nationalities of the EU companies involved, although this is not a requirement of the mandates. Mainly because of product constraints, the Bank had difficulties financing private sector projects in Asia, while at the same time it was confronted with substantial demand for financing in Latin America during most of the period covered in this evaluation. This led to financing more projects in the public sector in Asia than in Latin America[31].

The constrains in the Bank's strategy, mainly product limitations and balance distribution of lending among countries and nationalities of the EU companies involved, might have limited the EIB value added creation. This is because these constraints have reduced the possibilities to adapt the strategy to the substantial changes in the financial markets in the different ALA countries during the period covered by this evaluation. Therefore, the Bank's lending strategy needs to be more flexible in order to adjust lending targets and products to changing market circumstances, with the objective to maximize the value added.

[31] The problems in Asia are also reflected in longer periods between signature and first and last disbursements in Asia than in Latin America.

Selection

The screening of projects as they are brought to the Bank's attention is mainly informal and thus there is little information in the internal dossiers. Consultations with the operational staff indicate that a significant percentage of the projects submitted have been rejected in this early informal screening. The main reasons given for rejecting projects can be grouped under three main headings:

- EIB product limitations; mainly the Bank's high security requirements, project too small for an individual loan and in some cases, not covering breach of contract or not offering local currency financing.
- Projects not eligible for financing (mutual interest criterion) due to limited European interest.
- Project issues: mainly immature projects, weak promoters or environmental or procurement considerations.

Overall, the Bank's selection process ensured the selection of sound projects in most cases. The selection policy is also reflected in the particularly strong credit quality of the ALA loan portfolio; as demonstrated by the fact that only in one public sector operation out of all the operations financed was it necessary to call the Commission's guarantee and only in one other was the commercial guarantee called to cover part of the debt service (as of end 2003). These two cases correspond to projects affected by the Argentinean crisis.

Country risk considerations did not play a significant role in the selection policy. In Argentina, for example, the Bank agreed to finance projects when the crisis was looming, apparently with the objective of supporting projects when the appetite of commercial banks to take on Argentinean risks was low. The Bank has considered that any project in a country covered by the Mandate can be financed as long as debt service is regular and adequate guarantees can be obtained. A clearer policy seems necessary.

In most of the operations evaluated, the Bank became involved when the implementation of the project was well advanced. The problem with this approach is that it significantly reduces the EIB's potential to contribute to improving the project by bringing in technical expertise. In one project, if the Bank had entered earlier, it could have contributed to mitigate technical risks by advising the clients on the risks of the specific technology selected. In another project the Bank's early involvement did indeed encourage a significant improvement of the project (environmental performance and reduced technical risks). Therefore, the Bank should aim towards becoming involved in projects as early as possible.

Cooperation with other MDBs and the EU Commission

Cooperation with other MDBs was good in the operations evaluated. As indicated previously, the Bank relied heavily on the preparatory work and sometimes close monitoring carried out by other MDBs in many of the public sector projects financed. The EIB also has regular contacts with several European bilateral development agencies.

In some of the projects these agencies were involved through financing or, occasionally, in project preparatory work. Cooperation with the EU Commission was mainly in the context of regular contacts to discuss the formulation or adaptation of the ALA mandates or their follow up. In particular, one of the projects evaluated was prepared with ECIP funds (European Community Investment Partners) from the EU Commission.

5.2 Appraisal

The Bank carries out a detailed appraisal of each of the operations to be financed, focusing on their technical, economic, financial and environmental justification. The Bank has a deep understanding of project issues, gained mainly from its involvement in projects within the EU, as well as in the other areas where it is active, and from market/sector studies undertaken. However, the reasons for project selection given in the appraisal reports were often very general and, in most cases, the arguments advanced were closer related to economic development than to economic cooperation.

The economic justification of the operation was normally the key criterion, and in private sector operations the financial profitability was normally used as a proxy for the economic one.

The Bank's appraisals of the 26 projects evaluated are generally of good quality. The Bank's cash flow forecasts were generally less optimistic than those of the promoters. However, for private sector operations, the appraisal focused too much on the part of the investments earmarked for EIB financing, with insufficient attention to the overall company activities and strategies. This weakness was particularly evident when the EIB project was a small part of the total investment of the company. This approach reflects the traditional work distribution adopted by the Bank, where Ops analyses the company performance and PJ focus its analysis on the project earmarked for EIB finance. A better integration of the work seems necessary, in order that the PJ sectoral knowledge is better integrated into OPS financial analysis of the overall activities of the company.

The analysis of the company was generally detailed, but was not focused enough on key risks of the operations. The Bank placed a lot of emphasis on the technical and economic analysis, but did not sufficiently analyse the impacts of the country, political and regulatory risks on the projects. These issues have created substantial problems for the projects evaluated as presented in section 3.2.3. In addition, there were sometimes inconsistencies and unnecessary duplications in the Ops and PJ reports.

Environmental issues have been, in general, thoroughly analysed by the promoter and the Bank, particularly for projects with significant environmental impacts. The latter is confirmed by the fact that no significant environmental problems were identified in any of the operations evaluated. However, quite often the focus of the EIB analysis was on a part of the company's investments and the overall approach to the environment adopted by the company was in these cases only superficially analysed. In a few of the projects evaluated social impact was a sensitive issue and, in such cases, the Bank reviewed the relevant studies (such as impacts on the indigenous population) and the proposed mitigation measures.

No issues relating to procurement have been raised in the operations evaluated. When appropriate, the Bank asked the client to follow the Bank's procurement procedures, which required open international tendering procedures.

5.3 Project follow up

The Bank carries out two types of monitoring: physical and financial. Physical monitoring covers the physical implementation of the project and early operational phase (1 or 2 years after completion), while financial monitoring extends to the whole loan duration. Financial monitoring was generally up-to-date (except for global loans), but physical monitoring, mainly through project completion reports (PCR), was significantly delayed in most projects. In twenty of the 26 completed projects was a project completion report available when this evaluation started. Significant inconsistencies and weak coordination were noted between the financial and physical monitoring.

Financial monitoring reports were generally of a satisfactory quality. These reports followed the evolution of the key financial ratios and checked whether the ratios included as covenants in the financial contracts were being complied with. However, such reports rarely analysed deviations of the key financial ratios from those at appraisal, which would have enabled early detection of the deterioration of a company's performance, as has happened in most of the operations evaluated.

PCRs were frequently lacking in detail and incomplete, particularly on key issues such as implementation of the environmental measures foreseen, or market developments[32]. In addition, comparisons of ex-ante with ex-post implementation costs have often not been done properly[33]. These weaknesses in physical monitoring have been pointed out in previous evaluations and the PJ department is addressing them. In addition, since end 2000, the Bank has introduced a self-evaluation system that should allow for drawing lessons from completed operations and quickly taking these into account in future operations.

In all the operations evaluated the loans are regularly served, except in one project in Argentina. Several projects in Argentina are facing difficulties and thus the Bank has been involved in loan re-negotiations to cope with the crisis. In two cases in Argentina, the Bank, in coordination with the guarantors, introduced some flexibility in the loan servicing to give the company some breathing space during the negotiation with the Government.

[32] Most of the completed projects were covered by a simplified PCR (physical), which did not allow identifying the significant issues facing some of the projects.
[33] Normally the comparison was made in EUR

The follow-up of operations in crisis situations has absorbed a lot of operational staff time. It might be more efficient if a special unit, as suggested in previous evaluations, could be set up to handle problem projects.

Annex 1: List of standard indicators

1. RELEVANCE/EFFICACY	Rating	Comments
A. Benefits to the country		
Contribution to overcome a significant bottleneck for the economic development		
Transfer of know how or managerial skills		
Development of related business in the country		
Greater competition and competitiveness		
Develop regional cooperation		
Improve the environment		
Country living standards, particularly of poor population		
Others		
B. Benefits to the EU		
Development of new business opportunities		
Transfer of technology and equipment		
Transfer of managerial skill and know how to EU		
Improve the environment in the EU		
Others		
TOTAL Relevance/Efficacy (1)		
2. EFFICIENCY/SUSTAINABILITY		
A. Economic or financial profitability (ex-post ERR/FIRR)		
B. Sustainability		
Government commitment		
Socio-political support		
Regulatory environment		
Corporate law and judicial system		
Environmental sustainability		
Management effectiveness		
TOTAL Efficiency/Sustainability (2)		
3. AGGREGATE PROJECT PERFORMANCE (1+2)		
External factors		
Market/sector		
Implementation		
4. EIB PERFORMANCE		
A. EIB contribution		
Bank's intervention provides implicit or explicit political support		
The Bank crowds in other banks as guarantors for longer maturities		
Bank tech-economic conditions have significantly improved project performance		
EIB loan terms and conditions are better than alternative source of financing		
B. Management of the project cycle		
At appraisal		
At monitoring		

Annex 2: Main benefits of the projects evaluated

Project	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21	22	23	24	25	26
A. Benefits to the country																										
Contribution to overcome a significant bottleneck for the economic development	S	S	P.S.	S	S	S	S	N. R.	S	S	N. R.	S	S	S	N. R.	S	S	S	S	N. R.	S	S	N. R.	S	N. R.	S
Transfer of know how or managerial skills	S	S	G	N. R.	S	S	S	S	S	S	N. R.	S	S	S	S	L	S	N. R.	S	S	S	S	S	N. R.	S	L
Develpment of related business in the country	N. R.	N. R.	N. R.	S	N. R.	N. R.	N. R.	L	L	N. R.	S	N. R.	N. R.	S	N. R.	L	S	N. R.	N. R.	S	S	S	L	S	S	S
Greater competition and competitiveness	N. R.	L	N. R.	N. R.	S	N. R.	N. R.	L	S	S	N. R.	S	S	S	S	N. R.	N. R.	N. R.	N. R.	N. R.	N. R.	S	L	S	S	S
Develop regional cooperation	N. R.	N. R.	N. R.	S	N. R.	S	S	N. R.	N. R.	N. R.	N. R.	N. R.	N. R.	N. R.	N. R.	N. R.	N. R.	N. R.	L	S	N. R.	N. R.	N. R.	S	N. R.	S
Improve the environment	N. R.	S	P.S.	N. R.	N. R.	S	S	N. R.	S	N. R.	S	N. R.	N. R.	N. R.	N. R.	S	N. R.	S	N. R.	S	S	S	S	N. R.	N. R.	S
Country living standards, particularly of poor population	S	L	S	S	N. R.	N. R.	N. R.	N. R.	N. R.	N. R.	S	N. R.	N. R.	N. R.	N. R.	S	S	S	S	S	S	S	N. R.	N. R.	N. R.	N. R.
Others	N. R.	N. R.	N. R.	N. R.	N. R.	N. R.	N. R.	N. R.	N. R.	N. R.	N. R.	N. R.	N. R.	N. R.	N. R.	N. R.	N. R.	N. R.	L	N. R.	N. R.	N. R.	N. R.	N. R.	N. R.	N. R.
B. Benefits to the EU																										
Development of new business opportunities	S	S	G	N. R.	S	S	S	L	L	S	S	S	S	S	S	L	S	N. R.	N. R.	S	S	S	N. R.	N. R.	S	S
Transfer of technology and equipment	S	N. R.	N. R.	N. R.	S	S	S	S	S	S	N. R.	S	S	S	L	S	N. R.	N. R.	S	S	S	L	L	N. R.	S	U
Transfer of managerial skills and know how to EU	N. R.	N. R.	N. R.	N. R.	N. R.	N. R.	N. R.	N. R.	N. R.	N. R.	N. R.	N. R.	N. R.	N. R.	N. R.	N. R.	N. R.	N. R.	N. R.	N. R.	N. R.	L	L	N. R.	N. R.	N. R.
Improve the environment in the EU	N. R.	N. R.	N. R.	N. R.	N. R.	N. R.	N. R.	N. R.	N. R.	N. R.	N. R.	N. R.	N. R.	N. R.	N. R.	N. R.	N. R.	N. R.	N. R.	N. R.	N. R.	N. R.	N. R.	N. R.	N. R.	N. R.
Others	N. R.	N. R.	N. R.	N. R.	N. R.	N. R.	N. R.	N. R.	N. R.	N. R.	S	N. R.	N. R.	N. R.	N. R.	N. R.	N. R.	N. R.	N. R.	N. R.	N. R.	N. R.	N. R.	N. R.	N. R.	N. R.

G: good
L: limited
P.S: partially satisfactory
S: significant
U: unsatisfactory
N.R: not relevant

Annex 3: Evaluation criteria

Core criteria

Project performance is assessed using the evaluation criteria as defined by the OECD, DAC Working Party on Aid Evaluation. These are also used in the Evaluations Cooperation Group, which brings together the evaluation units of the multilateral development banks. The criteria used in all evaluations are relevance / efficacy, efficiency and sustainability.

- Relevance is the extent to which the objectives of a project are consistent with the beneficiaries' requirements, country needs, global priorities and partners' policies.
- Efficacy (or effectiveness) relates to the extent to which the objectives of the project have been achieved, or are expected to be achieved, taking into account their relative importance, while recognising any change introduced in the project since loan approval.
- Efficiency is the measure to which project benefits/outputs are commensurate with resources/inputs (funds, expertise, time, etc.).
- Sustainability relates to the likelihood of continued long-term benefits and the resilience to risk over the intended useful projects life.

Complementary Criteria

The following criteria are used dependent on their relevance to the evaluation.

1. **Institutional Development –** The extent to which a project improves or weakens the ability of a country or region to make more efficient, equitable, and sustainable use of its human, financial and natural resources, for example through: (a) better definition, stability, transparency, enforceability and predictability of institutional arrangements and/or (b) better alignment of the mission and capacity of an organization with its mandate, which derives from these institutional arrangements. Such impacts can include intended and unintended effects of a project.

2. **Other Impacts –** This criterion can include other areas of special focus, including:
    a. Poverty reduction - extent to which project achieved planned poverty reduction impact; unintended impact should also be considered.
    b. Transition impact
    c. Environmental impact
    d. Other impacts

3. **Borrower Performance** – Adequacy of Borrower's assumption of ownership and responsibilities during all phases. Main focus on effective measures taken by Borrower to establish basis for project sustainability, especially – and right from the identification stage – through fostering participation by the project's stakeholders, in addition to its own support.

EIB Performance

- Management of the project cycle: Quality of services provided by the EIB during all project phases. Main focus is on the EIB's role in ensuring project quality at entry; that effective arrangements were made for satisfactory implementation and future operation of the project.

- EIB additionality: Additionality is the extent to which EIB financing induces benefits that would otherwise not occur[34]. There are two main types of additionality: financial and technical

[34] See the Inter Agency Round Table on Additionality of Private Sector Development Programs and Operations supported by the International Financial Institutions held at Washington DC in May 2002.

THE EUROPEAN INVESTMENT BANK

The European Investment Bank (EIB) is owned by the fifteen European Union (EU) Member States and has its headquarters in Luxembourg. It supports EU policies on a self-financing basis, raising its resources on the world's capital markets for onlending to sound capital investment projects that promote the balanced development of the European Union.

Set up in 1958 by the Treaty of Rome, the EIB has its own administrative structure and decision-making and control bodies (Board of Governors - usually the Finance Ministers of the Member Countries - Board of Directors, Management Committee and Audit Committee).

As a major international borrower, which has always been awarded the highest "AAA" credit rating by the world's leading rating agencies, the EIB raises large volumes of funds on fine terms; it onlends the proceeds of its borrowings on a non-profit basis.

The volume of the EIB's operations has grown steadily and the Bank is today one of the largest financing institutions of its kind in the world. While the bulk of its loans are within the European Union, the Bank has also been called upon to participate in the implementation of the Union's development aid and cooperation policies through financing for the benefit of some 120 non-EU countries. It therefore supports:

- Economic growth in the African, Caribbean and Pacific States and the Overseas Countries and Territories, as well as in the Republic of South Africa;
- A stronger Euro - Mediterranean partnership;
- Preparations for the accession of the Central and Eastern European Countries and Cyprus;
- Industrial cooperation, including the transfer of technical know-how, with Asia and Latin America.

The EIB began carrying out ex-post evaluations in 1988, mainly for its operations in non-EU Member Countries. In 1995, the Bank established an Evaluation Unit to cover operations both inside and outside the Union. Ex-post evaluations take a thematic approach and are intended for publication. To-date the bank has published:

1. Performance of a Sample of Nine Sewage Treatment Plants in European Union Member Countries (1996 - available in English, French and German)
2. Evaluation of 10 Operations in the Telecommunications Sector in EU Member States (1998 - available in English, French and German)
3. Contribution of Large Rail and Road Infrastructure to Regional Development (1998 - available in English, French and German)
4. Evaluation of Industrial Projects Financed by the European Investment Bank under the Objective of Regional Development (1998 - available in English, French and German)
5. An Evaluation Study of 17 Water Projects located around the Mediterranean (1999 - available in English, French, German, Italian and Spanish).
6. The impact of EIB Borrowing Operations on the Integration of New Capital Markets. (1999 – available in English, French and German).
7. EIB Contribution to Regional Development A synthesis report on the regional development impact of EIB funding on 17 projects in Portugal and Italy (2001 – available in English (original version), French, German, Italian and Portuguese (translations from the original version)).
8. Evaluation of the risk capital operations carried out by the EIB in four ACP countries 1989-1999 (2001 - available in English (original version), French and German (translations from the original version)).
9. EIB financing of energy projects in the European Union and Central and Eastern Europe (2001- available in English (original version), French and German (translations from the original version))
10. Review of the Current Portfolio Approach for SME Global Loans (2002 – available in English (original version), French and German (translations from the original version)).
11. EIB Financing of Solid Waste Management Projects (2002 – available in English (original version), French and German (translations from the original version)).
12. Evaluation of the impact of EIB financing on Regional Development in Greece (2003 – available in English (original version)).
13. Evaluation of Transport Projects in Central and Eastern Europe (2003 – available in English (original version)).
14. EIB Financing of Urban Development Projects in the EU (2003 – available in English (original version)).
15. Evaluation of the projects financed by the EIB under the Asia and Latin America mandates (2004 - available in English (original version), French, German and Spanish).

These reports are available from the EIB website: http://www.eib.org/publications/eval/
or by e-mail: EValuation@eib.org