Evaluation of the risk capital operations carried out by the EIB in four ACP Countries 1989-1999

A synthesis report

Evaluation

Prepared by

Seed
J.-P. Mehr
B. Meunier
WEIC
J. Bharier

EIB Evaluation Department (EV)
B. Rossert
M. Bianchi
I. Oppermann

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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.

1 INTRODUCTION

Risk capital funds are a special type of finance provided for up to EUR 1.825 billion under Lome IV by the European Development Fund (EDF) to the EIB for investment in the less-creditworthy ACP countries or for operations located in any ACP country but presenting a high risk profile. Potentially, up to 71 countries could benefit from risk capital during the period considered in this evaluation. Over these 10 years, EIB has signed about 300 risk capital operations for a total amount of about EUR 1,5 billion. Risk capital operations can take many different forms, including various types of individual loans to productive enterprises or revenue-earning infrastructure, direct or indirect equity participation and credit lines to financial intermediaries, or loans to Governments, for on-lending. In risk capital operations, the maximum interest rate on the EIB's loans is three percent; however the actual loan price can be higher if the loan remuneration includes a variable interest rate component linked to a performance indicator. The currencies disbursed are EUR or those of the Member States, and the exchange risks are shared, or sometimes borne, by the EU.

The origin of this evaluation of risk capital operations managed by the EIB in ACP countries over the period 1989-99 was a recommendation of the European Parliament which "invited the Commission, the EIB and the Court of Auditors to make regular and frequent on-the-spot audits of actions realised by the EIB under mandate". A Special Report of the Court of Auditors, adopted in October 1998, noted that "an ex post evaluation function is needed to provide information about the viability of operations having benefited from risk capital finance and their real contribution to the economic and social development of the ACP states". Under an agreement with the European Commission, the EIB's Operations Evaluation Department (EV) was given responsibility for the following evaluation.

The evaluation methodology developed by EV, which is consistent with ECG[1] evaluation criteria, was based on a detailed examination of all risk capital operations during the period under review in four countries: Burkina Faso, Tanzania and Zambia, in which all of the EIB's operations were funded by risk capital, with the last two countries among the three highest recipients of such funding, and Namibia, in which risk capital complemented lending from the EIB's own resources. These four sub-Saharan African countries were considered, as a group, to be representative of all sub-Saharan African countries receiving more than minimal amounts of risk capital through the Bank. Sub-Saharan Africa, as a whole, received 84 percent of all risk capital provided by the EIB to the ACP countries during the period under review.

In all, 31 projects were included in the evaluation (as well as two desk studies for project loans which, in the end, were never signed and one feasibility study financed with risk capital). These 31 projects were also considered to be representative of the types of risk capital operations by the EIB in the ACP countries. Nine of the operations (29%) were global loans, 11 (35.5%) were individual loans to private sector industrial firms, and 11 (35.5%) were loans to revenue-earning infrastructure projects. In all, the 31 projects represented 17% of the EIB's risk capital operations in the ACP countries during the period.

[1] The Evaluation Cooperation Group (ECG) gathers the heads of Evaluation in the Multilateral Development Banks (MDBs) in an effort to harmonise their methods and strengthen the use of evaluation towards improved effectiveness and accountability of MDBs.

For each of the four countries, the evaluation of the EIB's portfolio of risk capital operations comprised:

- A review of the large amount of available documentation relating to each of the relevant EIB projects, including internal project dossiers;
- Discussions with past and present EIB staff concerned with operations in the country and the relevant projects during the period under review;
- Visits to the promoters and/or sites of all projects financed by the EIB in all four countries, plus all financial intermediaries and a selection of final beneficiaries of global loans and venture capital funds;
- Discussions with Government officials, staff of the European Delegation, cofinancing organizations and other relevant people in each country;
- Discussions with the EC desk officers for three of the four countries, as well as the Evaluation Unit of the EC's Directorate General for Development;
- Review of a large number of published and unpublished background, general policy and evaluation reports and papers prepared in the EIB, for example on the Cotonou Agreement and global lending, as well as reports by other development agencies on the EIB's activities; and
- Preparation of a detailed and comprehensive evaluation of each project for all aspects of identification, selection, appraisal, loan processing, contractual arrangements, implementation and operation, including for each an assessment of achievements, performance, impact, sustainability and relevance.

For each country a draft report was prepared for review and comments by the EIB staff. This report began with an overview of the investment performance and needs of the economy, with particular emphasis on infrastructure and the major productive and export-oriented sectors. It then provided a review of the EIB's portfolio of operations, focussing on the selection process before comparing achievements with what was originally planned. The report continued by assessing, in turn, the performance, efficiency and responsiveness of EIB's operations, their impact on the economy, including their sustainability and resilience, the relevance of the portfolio to the country's development strategy and the relationship between EIB activities and the operations of other investors and donors. In conclusion, the report evaluated the overall performance of the portfolio, highlighting the major positive and negative aspects and making recommendations for enhancing performance where necessary.

This report synthesises the findings and recommendations of the four draft country reports.

It must be noted at the outset that the role of risk capital operations in the ACP countries is very small in the EIB's overall portfolio. In 2000 the Bank's total lending was EUR 36 billion, of which risk capital operations were just EUR 236 million. Indeed, the EIB is unique among major development institutions in that its prime business is in the advanced industrial countries. Thus, while risk capital operations in the ACP countries may be extremely important for those countries, they are a relatively minor part of the EIB's main mandate, which is to provide long-term loans for capital investment promoting the European Union's balanced economic development and integration. Moreover, operations in the ACP countries are not isolated from other EIB activities. They can, and do, draw on the overall experience and resources of the Bank. Indeed, in recent months (after the start of this evaluation) a merger has taken place of EU and non-EU lending operations to reinforce the synergies between them.

In addition, the EIB is a small recipient of overall EDF resources. Risk capital is provided by the Member States to the EDF, of which about 20 percent is managed by the EIB for investment in the productive sectors of less-creditworthy ACP countries under the Lomé Convention. Thus, the findings and recommendations of this evaluation relate to only a part of the overall distribution of EU development aid.

2 THE CHANGING ENVIRONMENT FOR LENDING IN AFRICA

During the period 1989-99, most ACP countries have witnessed economic and political changes, though many remain very poor. Three of the four countries reviewed are still among the poorest in the world despite decades of development assistance, while over 90% of Namibia's population has an extremely low standard of living. Nevertheless, during the 1990s in all four countries, changing internal politics and/or growing external pressure have persuaded governments to make considerable efforts to break out of the vicious circles of poverty. With varying levels of commitment, varying degrees of success and varying speeds of change, all the countries have moved towards greater democracy, greater recognition of their countries' comparative advantages and greater efforts to alleviate widespread poverty.

The most significant changes have been in the role of the state, macroeconomic policies and national investment strategy. In all four countries there has been a determination to divest the Governments of ownership and management of large, often monopoly, enterprises, as well as potentially profitable infrastructure. Macroeconomic policies have shifted substantially away from interference by the state in prices and towards greater reliance on free market mechanisms. National investment strategies have introduced rational priorities, such as adding value to primary products, sectoral diversification and/or earning or saving foreign exchange, and have focussed on improving the business environment by introducing essential legislation and investment incentives. All four countries can point to growing success in stimulating domestic investment and attracting foreign private investment, though it is clear that Tanzania and Burkina Faso still lag behind the other two.

Development assistance policies have also changed gradually but substantially in the period under review, particularly by major donors such as the World Bank and the European Commission. While general tendencies can be noted, such as greater emphasis on balance of payments support linked to structural adjustment and/or good governance, the changes have been different in each of the four countries. In Tanzania, a superfluity of donors has lessened the policy and development impacts of most foreign aid, while in Namibia, where the EU is the dominant provider of aid, such impacts have been much more marked. In Zambia and Burkina Faso aid coordination appears to work well, though not necessarily with an appropriate division of labour between donors.

The EU's assistance priorities are changing and are somewhat different in each country, as reflected in the relevant National Indicative Programmes (NIPs). In Burkina Faso and Tanzania, the latest NIPs concentrate on road-building programmes, assistance for basic education and social infrastructure (rural development or urban water supply). In Zambia, more than half the latest NIP is devoted to the development and diversification of the productive sectors, with one quarter for the social sectors and the rest for macroeconomic management. In Namibia, assistance is divided mainly between education and training, agriculture and rural development and support for the productive sectors.

Under the Lomé III and Lomé IVa Agreements (i.e. to the mid-1990s), the EIB was mandated by the EU to allocate guaranteed amounts of risk capital to the ACP countries, while under Lomé IVb the EIB's lending targets were simply 'indicative'. Risk capital enables the Bank to contribute to the economic development of the ACP countries in ways which would not otherwise have been possible. This has led to country lending strategies tailored to each country's development priorities, as well as a gradual evolution of the EIB's own lending strategy towards private sector investment through financial intermediaries and, in infrastructure, greater concern about market orientation, revenue-earning capabilities and efficient management.

Under the Cotonou Agreement, the amount of funds to be managed by the EIB for investment in the ACP countries will increase dramatically, from EUR 1.0 billion under Lomé IVb to EUR 2.2 billion over the five years from 2002. These resources will provide the capital endowment of the Investment Facility, which is to be managed along market-oriented principles as a revolving fund. These increased amounts are combined with a development policy which places even greater emphasis on private sector investment, revenue-earning infrastructure in both public and private sectors and financial sector development, with lending operations designed to maximise their 'catalytic effect' on attracting private financiers.

3 THE EVALUATION FINDINGS: SIMILARITIES AND DIFFERENCES IN THE FOUR COUNTRIES

3.1 The EIB's Country Portfolios and the Selection Process

The EIB's relations with Tanzania, Zambia and Burkina Faso date back to the late 1970s, so by 1989 the Bank had considerable experience of dealing with these countries. Three global loans had been made to each of the state-owned development banks in Tanzania and Zambia with reasonable results. Loans for mining development, petroleum exploration and essential infrastructure in the three countries were highly successful, while lending to large enterprises showed mixed results. Successes in Zambia (cement) and Burkina Faso (sugar and plastics) were matched by failures in Tanzania (two loans for canvas mills). Relations with Namibia began after the country's independence in 1990.

From 1989, in all four countries, many potential projects had been identified, some by the EIB's staff, some by the European Delegation, some by multilateral or bilateral financiers seeking cofinance and some by Government agencies, in addition to approaches to the Bank by project promoters themselves. Several were turned down immediately and/or informally as unviable or beyond the scope of the EIB's remit; others were logged into the Bank's data base and later turned down after further project analysis showed them to be unviable or because adequate information about the promoter, the project, its ownership status or technical feasibility could not be obtained. A few potential projects remain on hold until outstanding issues can be resolved. Initial consideration of proposed projects is highly decentralised in the Bank, which is a major advantage when compared with other development agencies. In many cases, however, the country loan officer responsible requires advice about the viability of the potential project from the EIB's technical, economic or legal staff. The time taken to receive this advice has varied substantially, from a few hours for, usually, informal responses to weeks or, at least in one case, months. There is clearly room for greater consistency and efficiency in the speed of response. Overall, 31 project loans were signed in the four countries in the period 1989-2000. All these were evaluated.

With the exception of a couple of projects eventually financed with grant money from other donors, it appears that the EIB has not missed any project with good prospects and a need for additional finance. Moreover, compared to most other major donors, the selection process in almost all cases has been relatively rapid, efficient and cost-effective, notwithstanding the delays in receiving advice noted above. In Tanzania, Zambia and Burkina Faso use of risk capital has been essential to offset these countries' lack of creditworthiness, while in Namibia judicious use of risk capital in a few cases has given the Bank additional leverage where special conditions had to be met to ensure the success of projects.

The EIB's overall project selection strategy has been quite different in the four countries. As a result, the proportion of various types of loans in the country portfolios shows marked differences:

	Burkina Faso	**Namibia** (risk capital)	**Tanzania**	**Zambia**
Global loans	0%	0%	33%	45%
Individual loans to private firms	30%	49%	13%	14%
Infrastructure	70%	51%	54%	41%

In each country the selection strategy has been different for the different types of loans. Selection of the global loans in Zambia and Tanzania, as well as the financial intermediaries involved, has shown a logical continuity closely related to the previous performance of the intermediaries and the development of the financial sector. Selection of the projects for individual loans to private industrial firms has shown continuity in some cases, in Burkina Faso, for example, where it was linked to the various stages of cotton production. However, in most other cases, selection relied on cautious consideration by the EIB's staff who could not, and did not, always foresee the various types of financial and managerial difficulties which these projects later faced. Selection of the infrastructure projects in all countries was less difficult or time-consuming as it was essentially linked to the activities of major cofinanciers which had undertaken most of the feasibility studies and other preparatory work.

For its individual loans to private firms, the Bank has focussed its selection process on revenue-earning infrastructure as well as potentially profitable and sustainable manufacturing and tourism projects which would earn or save foreign exchange. With one exception, all selected projects involved proven, conventional technologies and therefore minimal technical risks. For its global loans, as well as venture capital fund loans, the EIB appraised the capabilities of the management and staff of potential financial intermediaries, in particular their abilities to handle medium-term lending and financial supervision of the final beneficiaries. However, this has not always been easy because of changes in the management and/or lending policies of financial intermediaries as well as ongoing structural reforms in the monetary and banking systems.

The Bank has given early consideration to procurement issues during the selection process. In most cases these were resolved to the Bank's satisfaction as project promoters recognized and accepted the benefits of EIB's procurement rules primarily based on international competition. Similarly, early consideration has been given to environmental issues, in particular to ensure that Bank-financed projects will not have adverse environmental effects. As will be seen later, in many cases insufficient attention has been paid to ownership, management, project financing risks and other major issues which, in retrospect, were likely to affect disbursements, project performance or development impact. While the lending department accepts that these comments apply to older projects, it stresses that the Bank has become aware of these weaknesses and these issues are now being increasingly taken into consideration.

3.2 Achievements Compared with Appraisal

The EIB's **global loans** using risk capital in Zambia, and to a somewhat lesser extent in Tanzania, have been a major developmental success, matching that of the global loans using the Bank's own resources in Namibia. The initial achievements in Zambia were to support a thriving new non-traditional export industry able to compete in European markets for roses and high-value legumes. This came about because of the imagination and enthusiasm of EIB staff and a few far-sighted individuals prepared to take risks in the financial intermediary concerned. Later global lending led to further diversification of the economy and the creation of thousands of new jobs.

Despite political difficulties or risks in the countries, the global loans have all achieved, or are in the process of achieving, significant changes in the lending policy of financial intermediaries, particularly commercial banks. Whereas before they basically provided overdraft facilities for up to one year, they now also provide short- to medium-term loans for privately-owned productive enterprises. On the basis of their initial experience with on-lending, the financial intermediaries have made determined efforts to train staff in credit risk analysis and the supervision of sub-loans, while further measures are being taken to introduce early warning systems for problem loans and provide rescue packages for final beneficiaries in trouble. These findings are in line with similar findings made in an EIB-financed study of global lending in Kenya.

There is a rapidly expanding demand for short-term loans by the private sector in all four countries, including Burkina Faso where no global loan has been made so far[2]. Many of the ultimate beneficiaries require better information about the lending facilities and arrangements under global loans as well as assistance in preparing their sub-loan applications. In Kenya, the Government has financed a technical assistance unit to do this from its margin on foreign currency lending. This type of unit is being considered in Tanzania and is worthy of replication in other countries.

There is also a rapidly expanding demand for equity participation in the private sectors of Zambia and Tanzania. The EIB therefore made a loan in each country to a **venture capital fund**. (A suitable financial intermediary could not be identified in Namibia and so risk capital allocated for a venture capital fund had to be cancelled.) Both funds are managed by companies owned by an organisation keen to increase the expected ex-ante hurdle rate and whose investment policy for such funds in the past two years has become increasingly risk-averse, moving away from its original development objectives towards purely commercial considerations. Thus, where new investments are made (which is happening very slowly) they are for the expansion or acquisition of established, profitable businesses rather than for start-ups. The evaluation team considers that the management and performance of both funds has so far been very poor and is unlikely to improve, although this opinion is not shared by the EIB lending services. The EIB as a major shareholder has so far been unwilling to intervene or appoint it own members of the Board of Directors. It is essential that the EIB establish a consistent strategy to ensure the development impact of its venture capital lending and then identify, evaluate and if necessary assist other, more suitable, vehicles to channel venture capital.

[2] However the Lending Department considers that the demand is too small and that banks can meet it through maturity transformation without exceeding prudential regulations.

The **loans for revenue-earning infrastructure** made by the EIB in the four countries during the period under review cover electric power, water supply, a seaport, airports, a pipeline and telecommunications. In general, actual project costs were in line with forecasts, though in a few cases where the costs were originally estimated in USD, the declining value of the EUR against the USD has led to increases in EUR-denominated costs. All the projects faced delays in implementation, ranging from a few months to three years. Apart from events beyond the control of the project promoters, such as (in two cases) the withdrawal of a sub-contractor, there were two major factors creating the delays. One was the need to establish clear ownership of project assets, particularly when privatisation was in the offing, as well as to ensure an effective management team was put in place. The other was the slowness in meeting the EIB's disbursement conditions, particularly where these included cross-conditionality with cofinanciers.

Several of the revenue-earning infrastructure projects appear to be over-dimensioned, with capacity utilisation, and therefore profitability, lower than anticipated. Indeed, one energy infrastructure project is likely to have excess capacity for the foreseeable future. However, three others faced unexpected conditions, such as outbreaks of war in the hinterland, a slower exploitation than predicted of regional development potential and the dramatic success of a demand management campaign. In any event, no clear evidence exists that it would have been more cost-effective to build these three projects in stages and the existing excess capacity is almost certain to be required in the coming years.

Individual loans to private industrial companies covered manufacturing - cotton spinning mills (3), cotton oils and soap, plastics, pharmaceuticals -, agro-industry - cotton ginning (2), tannery (2) -, tourism and a cold storage plant. Project costs were substantially higher (24%) in only one project; this was largely because of a three-year delay in project implementation caused by liquidity problems and poor management. There was also a three-year delay in another project, caused by initial liquidity problems and project restructuring (supported by the EIB), while the delay was four years for a third project, primarily because of inadequate Government policies and infrastructure support. One industrial project was delayed by one year while privatisation was completed, while another was eventually annulled after three years of fruitless negotiations about ownership, management, marketing and pricing. All the other projects were completed on schedule.

The loans to all but four of the private sector companies created additional capacity in line with existing and anticipated demand. Of the other four companies two initially experienced excess capacity, and therefore financial problems, only because of unforeseen changes in world markets, and they are now operating at or near full capacity. However, the other two companies still face serious difficulties, largely because of inadequate management. One is effectively bankrupt, while the other, now operating at only 30% of capacity, has brought in new financial management but will only recover in a highly competitive market if it can secure substantial new contracts at home or abroad.

3.3 Performance, Efficiency and Responsiveness

For all projects in all four countries, loan processing inside the EIB after project selection and up to completion of the project appraisal report was generally rapid and cost-effective. Even in a sometimes frustrating and often difficult situation like Tanzania in the early 1990s, there were minimal delays in obtaining approval for appraisal missions and their arrival in the country. In general, the appraisal reports containing the technical and economic assessment of the projects were of high quality and appropriate analytical depth. Without going into unnecessary detail (or excessive length), they highlighted all the main factors pertinent to the projects, including potential procurement and environmental issues, identifying the major risks to the success of the project. Indeed, there is no evidence that the appraisal reports for risk capital operations were less rigorous than for those using the EIB's own resources, except (as noted below) in the area of detailed credit risk analysis which, until recently, had been considered as having low priority for risk capital operations.

Wherever possible the appraisal reports were used, with few or minor changes, as the basis for loan documentation to the Management Committee, the Article 28 Committee and the Board. None of the loan proposals was rejected (a finding understood by the Evaluation Team to be generally true for all ACP risk capital projects). This suggests both that duplication of documentation could be reduced and the loan approval process after appraisal further simplified and streamlined.

The EIB assessed the **risks and potential sustainability** of each proposed project to determine whether use of risk capital resources was appropriate. However, in general this was not followed up by categorizing the types of risk faced, assessing the probability of them materialising and finding ways of minimising the risks identified before the loan was signed.

In the marked absence of appropriate staff or financial resources to provide direct assistance to the promoter to mitigate the risks, resort was made to two techniques. The first was to negotiate with the project promoter and/or government, in person or through correspondence, to resolve the outstanding issues. These negotiations included requests for more information, greater detail in financial projections, greater depths in feasibility or environmental studies and assurances about asset ownership, project management or Government support and commitment. If these negotiations could not be concluded to the satisfaction of the EIB before loan signature, the second technique was applied: placing specific conditions on loan disbursement or, in extreme cases, annulling the loan. In general, the first technique led to delays before loan signature, while the second led to delays in loan disbursement.

In all four countries there has been inconsistent or inadequate justification for use of the **interest rate differential** where loans have been channelled through the Government or another agency at one rate and on-lent at a higher rate. The lack of consistency stems largely from the fact that project teams had to look on a case by case basis for ways and means to neutralise the subsidy element and avoid causing distorsions.

In five cases the use of the differential was not specified in the finance contract but was presumed to cover the foreign exchange risks. In none of these cases has the actual use of the differential been monitored or documented adequately. In two projects the differential was to be used for training, which at the time of project appraisal was considered to be of high priority. However, whether this was done was not rigorously checked. For two infrastructure projects the differential was allegedly allocated by the Government as a contribution to its 'poverty reduction' programme in its general budget, financed mainly by the World Bank Group, but no evidence of this was provided. For another it was supposed to increase the capital of the electricity company or to cover (unspecified) expenditures related to the development of the energy sector, but again it is not clear if this has been, or will be, done.

For the global loans, the differential was to be used for one or more of a variety of purposes including:

- Creation of a foreign exchange risk cover fund;
- Covering operating costs and provisions;
- Strengthening institutional capacity;
- Compensating the costs of sub-loan screening and monitoring;
- Contributing to a venture capital fund; and
- Helping the Central Bank enhance its banking supervision capabilities.

Again, in all cases, the EIB has not seriously monitored or obtained reports on the actual use of the differential, mainly because the staff believed it was the responsibility of the recipient to spend the differential in the way it felt most suitable and that the impact of some of these programmes would have been difficult to monitor.

The finance contracts for all 31 loans contained a variety of disbursement conditions. All contained **standard conditions** about tax exemptions and exchange control consents for the receipt of disbursements and repayments of principal and interest, as well as a requirement for a favourable legal opinion from the highest legal authority in the country concerned on the finance contract. All also contained standard requirements to produce evidence of expenditure incurred and contributions from the borrower's own resources. None of these conditions appear to have created any fundamental difficulties in the four countries. However, in many instances it took considerable time for such conditions to be met, i.e. for the promoter to provide the necessary evidence. For example, in the cases of two infrastructure projects nearly three years had passed before the Bank was sufficiently satisfied to make the first disbursement.

This suggests that it could, in some cases, be appropriate for the Bank to reduce such delays by negotiating a 'blanket' or 'framework' agreement with the Government of each ACP country for some, or preferably all, of these standard conditions, particularly those already covered by the Lomé agreements (even though the Bank was not a signatory of these agreements), which would apply to all future lending. This would speed up disbursement in most cases and would certainly reduce the bureaucratic workload of the loan officers.

Most of the loans also contained **special conditions** for disbursement. For the global loans and loans for the two venture capital funds these were basically to ensure that the sub-loans were made in accordance with the Bank's policies and procedures; so far these conditions have presented no problems. Five loans for infrastructure, as well as one other project, included special conditions relating to satisfactory financial agreements with, and disbursements of, multilateral or bilateral cofinanciers. These conditions have led to delays in the EIB's own disbursements. Since, in all six cases, the Bank was financing specific and clearly identifiable components of the projects, the definition and financing of a stand-alone subproject that would have an impact even in the absence of other subprojects might have been more appropriate and efficient than joint financing.

Some of the other special disbursement conditions for these loans, as well as for one other loan, have proved to be politically sensitive and extremely difficult to meet. This is because they have required major changes in organizational and management structure, asset ownership and, in some cases, the introduction of tariff-setting mechanisms. While such measures were essential to ensure the success of these projects, it would have been preferable to resolve them to the Bank's satisfaction before the loans were signed. Some EIB staff argues that these types of special disbursement conditions put pressure on the recipients to act quickly, but the Bank levies no commitment fee and the evaluation team found no evidence of recipients feeling under pressure. Indeed, the prime reason for not resolving these important issues before loan signing appears to be internal pressure from the Bank's management to sign loans, and therefore make financial commitments, as quickly as possible.

Two important elements in the EIB's performance and efficiency are its institutional memory, essentially **project documentation**, and its mechanisms for ensuring an appropriate **exchange of information** and experience about projects and problems. The evaluation team found major problems in three areas of documentation: the dossiers for projects selected, the records of projects not selected and extensive duplication of documents stored. The project dossiers in central archives are extremely cumbersome and vary significantly in content, consistency and completeness. There is a clear need to rationalise these dossiers and ensure that the EIB staff are given guidelines on what should and should not be filed, including electronic communications, and how this should be done. The initial documentation relating to the identification and rejection of potential projects, if it exists at all, is erratic and scattered throughout the Bank. A simple project request form, together with a brief attachment giving the reasons for acceptance or rejection, would assist the Bank's institutional memory without adding significantly to the workload of staff. There is also a need for guidelines and mechanisms to reduce the duplication of documentation, which may be stored in several different places depending on the personal proclivities of different types of staff.

The EIB's technical staff works in all the Bank's client countries throughout the world and can therefore draw on the experience of a range of advanced industrialised nations and emerging nations when they operate in the ACP countries. However, for the loan officers for the ACP countries, especially those in different divisions, there appears to be no formal, or regular informal, mechanism for exchanging knowledge and experience. Until recently, Project Completion Reports (PCRs) were produced, normally within one year of the completion of loan disbursement. With a few notable exceptions, these have been of generally good technical quality and contain a section on 'lessons learned' from the project. Nevertheless, it seems that these PCRs have not been widely distributed or read within the Bank. More importantly, the evaluation team found in several cases that the PCR's snapshot of a project at a certain moment in time was a misleading guide to the project's ultimate success, or the lessons to be learned, particularly when the project faced unexpected market fluctuations or was undergoing management or marketing restructuring.

3.4 Impact, Relevance and Sustainability

The EIB can point to the significant direct development impact of many of its projects in the four countries, as well as to the strategic relevance for their economies. In Burkina Faso, for example, the EIB's various loans to the cotton industry have played a major role in reviving a sluggish economy, expanding employment opportunities, providing incomes to rural communities and increasing foreign exchange earnings. In Namibia, two loans using risk capital have helped transform the policies for, and the management of, water resources, the single most important factor in the country's prospects for sustainable development.

By financing specific components of major infrastructure projects with risk capital, the EIB has made a vital contribution to the development of the relevant sectors in less-creditworthy countries. Nevertheless, since most of this type of lending has been in association with cofinanciers, it is usually difficult to differentiate the EIB's direct and specific impact on the economies from those of other donors. This is particularly true for Tanzania, where all the Bank's lending since 1989 has been directly or indirectly associated with other financiers.

The development impact of global lending has been extremely important. As noted above, the achievements in Zambia have been outstanding. The EIB was the only organization willing to be innovative and take risks with medium-term lending for rose producers, and this has led to a major new non-traditional, export-oriented industry as well as to further diversification of the productive sectors, creating much new employment. In Tanzania, though the sub-loans have performed less well, the development impact has been felt because the companies financed are still operating, even when under new ownership. For the two venture capital fund loans, however, the development impact has so far been minimal for the reasons already mentioned.

The EIB's lending operations have produced beneficial externalities in three of the four countries. In Zambia, these have been greatest, largely because of the success of the global loans. These loans had the important side-effects of greatly increasing the capability of the financial sector to evaluate and supervise medium-term loans for private businesses, as well as rationalising the financial management of these companies, enabling many of them to add to investment from their own resources. In Burkina Faso, the loans to the cotton industry helped improve the country's investment climate and prepare the ground for new private sector initiatives in a broader range of sectors. In Namibia, preparation and processing of the EIB's portfolio helped the Government of this newly independent country to understand unfamiliar financial and legal concepts as well as its own obligations to lenders.

In all four countries, the EIB's portfolio of lending operations has been consistent with the policies and country programmes of the European Commission. Indeed, in all four countries there has been collaboration and exchange of information between the EIB's staff and the local European Delegation, and there has been no overlap or duplication of activities. The only area where this might have occurred was in the finance of small and medium size enterprises, but in both Burkina Faso and Zambia agreements have been reached on the relative roles of the EIB and the EU. It seems necessary, however, for both organisations to consider additional ways of providing financial assistance to micro-enterprises, in a way which shelters these enterprises from exchange rate risks that they could not bear.

The EIB's relations with most other major donors operating in the four countries have also been good for the most part. Difficulties have emerged, however, with some aspects of cofinancing with the World Bank Group. In one infrastructure project, for example, the World Bank agreed to finance all relevant training programmes but these were completed before the World Bank even began disbursing its component of the loan. In two other infrastructure projects cross-conditionality led, in one case, to annulment of the balance of a loan which had already been 87% disbursed, and, in another, to costly and unnecessary suspension of disbursement while major political and tariff issues (of no immediate relevance to the EIB's project component) were resolved. In the case of one energy infrastructure project, the EIB relied largely on the policies and technical expertise of the major cofinanciers, thus finding itself in a position whereby it was financing part of an unviable project.

There is no obligation for the EIB to agree to cross-conditionality with other donors for the disbursement of its funds. Nevertheless, this has usually been done not as a result of an explicit policy but rather as a result of a strong tacit consensus that solidarity between donors is a good thing. On the basis of recent experience with some cofinanced projects, there are now grounds for the EIB to reconsider whether to agree to cross-conditionality in every case and also whether to specify situations in which agreed cross-conditionality can be dissolved. In Zambia, for example, these questions arose because:

- The EIB's contribution was for clearly identifiable, stand-alone components of the projects;
- The EIB's finance was a relatively small part of total project cost;
- The conditions related to Government pricing or privatisation policies over which the beneficiary of the loan had little or no control; and
- The EIB had (in one case) already disbursed a substantial proportion of its contribution before the major cofinancier announced that it was not satisfied that its disbursement conditions had been met.

It is apparent that insufficient measures have been taken in the preparation of several individual loans to ensure or enhance the sustainability of the projects concerned. This has been most clearly evident in two projects, the first of which never got off the ground because the Government failed to act on the reasonable disbursement conditions relating to markets and ownership to which it had agreed, and the second of which faced continual harassment for similar reasons and also because of the lack of cooperation from other parts of the Government. Despite extensive negotiations in both cases before the loans were signed, there were well-justified doubts in the Bank about the willingness of the Government of the time to accept its responsibilities and commitments. Signing the loans before the Bank was absolutely satisfied that the relevant conditions for project sustainability would be met was neither appropriate nor prudent.

Individual loans to private sector industries were made in the belief that these enterprises would be financially viable and sustainable, and therefore have a significant development impact. In all cases, the financial risks resulting from sudden adverse fluctuations in the relevant markets were foreseen, yet few preparations were made to minimise the effect of such fluctuations. For example, it would have been appropriate to put provisional 'rescue packages' in place to ensure that any of the enterprises facing difficulties could be helped to recover from short-term setbacks. In the absence of such 'rescue packages' in all these cases, the relevant loan officers were obliged to spend excessive amounts of time attempting to rectify the situation.

A concern expressed by Government or trade association officials in three of the four countries was that the recipients of direct lending from the EIB, as well as the recipients of sub-loans under global lending, were not necessarily representative of the population of the country, with some ethnic minorities being over-represented. The evaluation team could find no evidence of deliberate discrimination. The fact of the matter is that, with a few notable exceptions, black entrepreneurs are, at present, primarily the owners of small enterprises, which are ineligible for direct lending, and are at the lower boundaries of the Bank's present range for sub-loans.

In general, the EIB has not developed exit strategies for the projects financed. This is largely because they were financed with risk capital, and therefore off-balance-sheet items, and the Member States guaranteed the loans made from the EIB own resources. In some cases, the Bank was offered, and has taken, guarantees, but there appears to be no logical reason for doing this.

None of the 31 projects evaluated had any direct adverse environmental impact. Indeed, in those projects which were, for example, to produce deleterious effluent, the Bank took considerable care at an early stage to ensure that this was dealt with in a timely and environmentally acceptable way. However, there were at least two situations in cofinanced infrastructure projects in which concerns arose about potentially adverse effects on the environment or endangered species of project components not being financed by the EIB. In both cases, the time taken to resolve these issues delayed disbursement of the EIB's part of the loan, even though the Bank could do little more than give moral support to the cofinanciers dealing with them. For the evaluation team, this suggests that, in future cofinanced projects, the EIB's staff should primarily focus on project-related issues, while delegating or contracting out broader environmental issues of importance to the Bank's management and the Member States to the World Bank Group, or other major donors, which have the staff and resources to handle them satisfactorily. Generally, the EIB staff strongly resists this view and would not like to be singled out for showing a lack of solidarity with other donors. It is seen more as a matter of principle, and donor orthodoxy, with little debate over how much this attitude is contributing to the overall result.

The evaluation team has prepared a tentative multicriteria comparison of the 31 projects. This is given in the following table, in which '0' is 'very poor' and '3' is 'very good'.

Out of the 31 operations, nine (29%) were global loans (including two participations in venture capital funds), 11 (35.5%) were individual loans to private sector industrial firms, and 11 (35.5%) were loans to revenue-earning infrastructure.

The proposed classification is approximate, but it provides some useful indications :

It can be seen that 20 (65 percent) of the 31 projects received a total value of 8 or more (i.e. more than half the maximum possible). 13 projects (42% of the total) receive a total value of 10 or more, i.e. can be qualified at least as "good" as an average for all criteria. These projects include a majority of individual loans (7 projects), 4 global loans and only 2 infrastructure projects.

On the other hand, 11 projects are valued at 7 or below; these include 6 infrastructure projects, 2 individual loans, and 3 global loans (including the two venture capital projects). Only 4 projects would have a total value equal to or lower than 5, i.e. less than "rather poor". These include 2 individual loans, 1 infrastructure project and 1 venture capital project.

Multicriteria comparison of the 31 projects

Criteria	Processing and Implemen-tation	Capacity and Demand	Profitability	Impact and Externalities	Sustaina-bility and Resilience	Total Value
Weight of criterion Countries & Projects	1	1	1	1	1	
Burkina Faso						
1	1	3	2	2	3	11
2	2	1	1	1	2	7
3	2	2	2	2	2	10
4	2	2	1	1	1	7
5	1	0	0	0	0	1
6	3	3	2	3	2	13
7	3	3	2	2	2	12
Namibia						
1	3	2	2	3	2	12
2	2	1	1	2	3	9
3	3	2	2	2	2	11
4	1	1	1	2	2	7
Tanzania						
1	0	1	0	0	0	1
2	1	1	1	2	1	6
3	3	2	2	3	3	13
4	1	2	1	1	2	7
5	2	2	2	2	2	10
6	1	1	1	2	2	7
7	1	1	1	2	1	6
8	2	1	2	2	1	8
Zambia						
1	1	2	1	3	3	10
2	1	1	1	1	1	5
3	2	2	1	2	2	9
4	3	3	2	3	2	13
5	2	3	3	3	2	13
6	1	2	2	2	2	9
7	3	3	2	3	2	13
8	3	2	2	3	2	12
9	1	1	1	1	1	5
10	1	3	2	1	2	9
11	1	3	2	1	2	9
12	2	2	1	2	2	9

4 STRENGTHS AND WEAKNESSES OF THE EIB

The findings of this evaluation, as presented in the previous chapter, have identified several areas in which the EIB has strengths that give it a comparative advantage over other multilateral or bilateral financial institutions, as well as several weaknesses, which need to be removed or minimised. These are enumerated, summarised and explained in the following paragraphs.

4.1 Strengths

The six main areas of strength of the EIB in the context of lending to the ACP countries were found to be:

- Its streamlined, cost-effective and business-like operations and its professional, competent, dedicated and diplomatic staff working in multi-disciplinary teams including the appropriate technical and economic expertise;
- Its decentralised country lending strategy, leading to relatively rapid identification of projects for selection;
- Its willingness to be innovative and prepared to take risks and initiatives, as well as its flexibility to respond to the changing priorities of country development strategies and needs;
- Its access to EDF risk capital resources and ability to offer advantageous lending terms;
- Its capacity to use a broad range of lending instruments, which can draw on its extensive experience with European lending operations; and
- Its strategic position within the institutions of the European Union to contribute significantly to the EU's development policies.

The EIB is, primarily, a business-like organization with business-like policies, management and operations. Members of the evaluation team, who have worked with all major multilateral financial organizations and a considerable number of bilateral organizations, have, in general, been extremely impressed with the cost-effectiveness of the EIB operations in the ACP countries, notwithstanding the weaknesses noted below. Most staff working on the ACP countries, particularly most loan officers and division chiefs, have a high level of professionalism, dedication, diplomacy and competence, which has enabled them to build trusting relationships with Government officials, financial intermediaries and project promoters.

The Bank has adopted a decentralised lending strategy which works very well. Unlike most other multilateral or bilateral financial institutions, major decisions on project selection have been essentially taken at the loan officer level, in consultation with the relevant technical, economic and legal staff. With the exceptions noted elsewhere, such decisions were taken speedily and responsibly and the loan recipients were likewise informed quickly.

Moreover, the staff are, for the most part, innovative and prepared to take risks and initiatives in developing and expanding the country portfolios. The Bank can therefore be flexible in its responses to changing country development priorities and needs. In many cases it has been able to lend where other organizations with development objectives have held back or would not even have considered lending because of the risks involved. Prime examples are the initial global loans for rose producers in one country, the opening up of the cotton industry in another and the two venture capital funds (though these later faced problems).

Two major factors contribute substantially to this flexibility. The first, and most important, is the access to EDF risk capital resources. These represent a unique source of funds which have significant advantages over other types of financial resources, not least because foreign exchange risks are covered, wholly or in part, by the Member States. They are, in addition, specifically designated for use in countries which have limited creditworthiness and for projects which have high risks or little security but also have high potential development impacts. The second is the EIB's terms of lending for risk capital, which, at a maximum of three percent, are highly advantageous to the ACP countries. Even for its own resource lending, as Namibia has found, the Bank has been able to charge relatively low interest rates because of its top rating in the financial markets where it borrows as well as its non-profit status. Moreover, all these rates are fixed for the duration of the loan and there are no commitment or other fees.

The Bank can draw on a broad range of lending instruments. Unlike many other donor or investment organizations, it can lend to the public sector without sovereign guarantees as well as to the private sector without security, either directly or through financial intermediaries. It also has the advantage of being able to draw on its extensive experience in lending for projects in the Member States. This has been particularly important where successful implementation of projects in the ACP countries has depended on the transfer of technology and management skills from the EU.

Above all, the EIB is an effective and reliable member of the EU family. It has carried out its mandate in the ACP countries without fanfare and in ways which raise the prestige and reputation of the EU. The evaluation team has seen good cooperation and coordination between the EIB and the European Delegations in the four countries evaluated. The division of labour between the two has been clearly specified and the EIB, in all countries, has been making a significant contribution to the EU's development policies.

4.2 Weaknesses

The eight main areas in which weakness were identified were found to be:

- In some instances, projects were selected without paying sufficient attention to their consistency with country investment priorities or their potential development impact
- The ex-ante appraisal process has not paid sufficient attention to credit risk analysis, particularly the potential impact of risks on the project financial sustainability, and to mitigating and monitoring risks
- The EIB does not always differentiate itself sufficiently from other donors and thus does not always let the projects benefit from the EIB strengths as highlighted above; this weakness was more prominent in some of the countries evaluated
- Signing loans, though not disbursing, before outstanding issues likely to affect project sustainability, such as asset ownership and management, have been resolved;
- There are inconsistent and inadequate specifications for the use of the interest rate differential and its use is insufficiently monitored;
- Loan officers do not always receive timely support from the specialised services of the Bank, which can create delays and bottlenecks on projects;
- The EIB's institutional memory is in severe need of improvement; and
- The loan officers are often overworked which can compromise the efficiency of the EIB operations in the long run.

The evaluation has shown that when some projects were selected, in some countries, especially those which have modernised their economic policies less than others, insufficient attention was paid to the country's development priorities and therefore the potential development impact of the EIB's risk capital resources. In particular, the proportions of total lending allocated to infrastructure projects (usually as a co-financier), private sector enterprises and global loans through financial intermediaries were not always consistent with development priorities.

More generally, insufficient initial analysis was made of the various types of project and credit risks, and the likely effects of these on project sustainability, and therefore developmental impact, when the loan was being prepared. It appears that no Bank resources have been allocated either for pre-appraisal work to carry out this analysis or for post-appraisal work to help resolve outstanding issues. As a result, many loans were signed before major issues had been resolved, with the consequence that special disbursement conditions had to be imposed and the projects were inevitably delayed or faced later problems.

The relationships and division of labour between the EIB and other donors have not always been appropriate, particularly in co-financing arrangements. In some cases the EIB has had little strategic input into the preparation of projects, acting more like a 'sleeping partner'; in others it became unnecessarily embroiled in macroeconomic, pricing or environmental policy issues which, however important, had little or no direct relevance to the specific part of the project which the EIB was financing. Even though the EIB is under no obligation to agree to cross-conditionality, it usually does and a strong consensus exists among staff on the need to do so, and this has created delays and anomalies in its operations.

There has been inadequate justification for, as well as severe inconsistency in, the use of the interest rate differential in those projects where the EIB's loans were on-lent to the ultimate beneficiaries. A wide variety of uses have been specified, ranging from general support to the national budget to training schemes for targeted personnel. However, there has been very little supervision of, or even information about, how this differential was actually used in each case.

Unnecessary delays and bottlenecks have occurred in project selection, particularly when the Bank's technical, economic or legal staff, all of whom have much wider responsibilities than the ACP countries, have failed to respond promptly to requests from loan officers for advice on the suitability of projects for selection. Some delays have also occurred in loan processing because of the documentation and time requirements of the various bodies which decide on loan approval. As noted above, there have often been delays in loan disbursement, primarily because of disbursement conditions in the finance contract which should have been avoided by resolving the issues concerned before loan signature.

The EIB has an inadequate institutional memory and also makes insufficient use of knowledge management to ensure that the staff working on the ACP countries learns from each other's experience. Project documentation is erratic and incomplete, duplication of material is commonplace and the introduction of electronic communication has not been matched by appropriate filing or recording systems. Partly due to work overload, there are few formal or informal opportunities for loan officers in particular to learn from the successes and failures of other loan officers in different divisions.

Members of EIB's staff working on ACP countries are undoubtedly overworked, and the workload continues to grow with each new project selected. As a consequence, important activities such as project supervision and monitoring have had to be given lower priority. Loan officers have no back-up (except for their division chiefs, who have other responsibilities) to ensure continuity when he or she is away on mission, holiday or sick leave. They are also encumbered with a number of tasks that, in other organizations, would be delegated to assistant level staff. These include administrative chores such as following up repayments of old, mandated EU loans, as well as filing, repetitive reporting or documentation requirements.

5 *MAIN RECOMMENDATIONS*

The overall objectives of the following recommendations of the evaluation team, bearing in mind the greatly increased amounts of funds becoming available for the EIB's management under the Cotonou Agreement, as well as the underlying policies of this Agreement, are to:

- Enhance the EIB's clearly identifiable development impact in the ACP countries;
- Increase the effectiveness of the EIB's staff and financial resources for risk capital operations in the ACP countries; and
- Speed up the project cycle for the selection, processing and disbursement of loans.

Some of these recommendations reflect, or expand on, measures recently introduced, fully or partially, by the Bank to address perceived operational weaknesses in the past. Others, however, still need to be implemented.

5.1 Building on the EIB's Comparative Advantages

Building on the EIB's achievements and strengths essentially means ensuring the continuation and enhancement of its responsive, innovative, cost-effective and business-like operations. Some Member States (such as the United Kingdom in its document 'Working in Partnership with the EIB'), have argued that the EIB should begin to operate like other large multilateral financial development institutions, getting involved in a wide range of macroeconomic, sector, governance, social, environmental and other issues, participating in more cofinanced projects while producing much more documentation and justification for the development impact of its lending and the consistency of this impact with EU development policy.

The evaluation team believes, on the contrary, that for the allocation of risk capital resources in the ACP countries, the EU's development policies would be best served if the Bank enhances its development impact by concentrating on those strategies, areas and projects in which it has proved to have a comparative advantage over other donors and investors. It should continue to operate on a 'lean and mean' basis, with the maximum flexibility in the way it does business and the greatest speed it can achieve in processing and disbursing high quality loans.

This implies that, as part of its continuing cooperation with the World Bank Group and other multilateral and bilateral lenders, the EIB should clarify and strengthen the division of labour between them. This is particularly important in those ACP countries in which the Bank has developed, or could develop, a distinctive country (or even sector) lending strategy. The EIB should co-finance with the World Bank Group (or other multilateral donors or investors) only when its contribution is expected to have a distinct development impact or it can make a strategic input, by transferring European technology and project experience, or it can exert leverage to ensure the sustainability of its component of the project. Co-financing on this basis can be justified as an appropriate use of risk capital resources. Now that the guaranteed minimum lending per country that was agreed under Lome IV a) has disappeared, it is much more difficult to justify the use of such resources when the EIB is largely a passive financial gap-filler, or the main co-financier has a sovereign guarantee, especially in those countries where it is not possible for the Bank to develop a distinctive country or sector lending strategy, either because of a multiplicity of donors or because the Government does not take its obligations to the Bank seriously enough.

Where a decision is taken to co-finance, the identification of a stand-alone subproject that has its rationale even in the absence of the other components should be sought where possible to speed up loan processing. The EIB should only consider entering cross-conditionality agreements in cases where its development impact is likely to be put at risk, specifying conditions when such cross-conditionality can be dissolved. Furthermore, in its processing of cofinanced projects, the EIB should focus on project-specific issues and delegate or contract out other issues of importance to the Bank's management and the Member States, including macroeconomic policies, sectoral pricing, environmental concerns and global public goods, to the World Bank Group or other major donors which have the appropriate staff and far greater resources to deal with these issues. There may, however, still be cases in which the EIB could envisage taking the leadership on a cofinanced project because it, or the EU as a whole, has particular competence in a specific area.

The division of labour between the EIB and the European Commission is effective, with good collaboration, coordination and exchange of information, particularly at the country level, and no overlap or duplication of activities. In addition to building on this division of labour, the EIB should now begin to encourage the Delegations, which are in a much better position than the Bank because they are established locally, to likewise ensure that the activities of bilateral donor and investment agencies of the Member States are not inconsistent with the EIB's operations in matters such as investment strategy and areas of intervention. Furthermore, following the example of the mining sector in Zambia (under which the EU provides technical expertise to assist financial intermediaries appraise projects), there is also some justification for the European Delegations in the ACP countries to consider using some of their resources to finance new or improved methods of supporting and heightening the developmental impact of the EIB's independent operations in, for example, global lending.

5.2 Strengthening the Country Lending Strategy for Risk Capital Operations

Strengthening country lending strategy basically means ensuring that the development impact of risk capital operations is maximised.

The successes achieved so far with global loans, providing medium-term sub-loans to private businesses through financial intermediaries, have far surpassed expectations in terms of their development impact. In those ACP countries where the Government's development strategy is to place greater reliance on the market economy, the private sector and economic diversification, global loans will grow in importance. In such countries where the EIB has made no global loans so far, they should now be seriously considered as a major plank of lending strategy as long as the demand for financing is not adequately covered by the private sector. Where the EIB already has successful experience with global lending it is now appropriate to create even more flexibility in lending conditions. Where they are not made available by existing banks in the country, loans of one to three years to businesses, as well as medium-term loans, should be made more easily available, as there is clearly an un-met demand for them. Where there is no overlap with the activities of other financial organizations, the range of lending amounts should be widened, while refinancing and other activities should become eligible for sub-loans.

The experience of global loans in Kenya, documented by the Bank, should be drawn on more widely in two areas: first, stronger marketing of the global lending facilities in the ACP countries to 'spread the word' and ensure that the facilities are fully understood; second, greater assistance for potential borrowers, particularly in the preparation of business plans, financial projections and feasibility studies. In both areas, consulting or management companies could be contracted, preferably local if these are available and qualified.

Where appropriate, the number and variety of financial intermediaries eligible to draw on the global loans should be enlarged to promote competition between intermediaries for sub-loans. In addition, consideration should be given to use of sector-specific and/or regional financial intermediaries within countries. If necessary, the EIB should provide resources to help intermediaries strengthen their credit risk analysis and loan supervision departments. If the Bank's poor experience with the two venture capital funds evaluated is indicative of similar experience in other ACP countries, renewed efforts should be made to find suitable development-oriented intermediaries to channel equity and quasi-equity funds through and, if necessary, support and assist these intermediaries to strengthen their management, risk analysis and supervision capabilities.

It is essential to reduce the disproportionately heavy EIB staff costs of individual loans to private sector enterprises, most of which have required additional processing time and constant, time-consuming supervision. If such loans using risk capital resources are to remain a part of the EIB's portfolio in the ACP countries because they are expected to have a significant development impact, two measures need to be implemented. First, the Bank should further strengthen its credit risk analysis in project appraisal, drawing on its expertise from lending from its own resources. Second, for after loan signature, it should develop an early warning system for loans in trouble, establish trouble-shooting arrangements for such loans and exit rapidly from projects beyond redemption to cut losses. In some cases, particularly where the Bank's internal resources cannot be drawn on, supervision of the loans, including provision of management and financial assistance, or other rescue packages, to borrowers, could be delegated to local management consultants or the financial intermediaries used in global lending.

For revenue-earning infrastructure projects which are expected to contribute to the EIB's overall development impact in the country, the Bank should ensure that disbursement delays experienced in the past are not repeated. In this respect, it is absolutely essential to ensure that there are no major outstanding ownership and/or management issues at the time the loan is signed. It is also vital to ensure that the Government is fully committed to the project and has pledged to fulfil its associated obligations. Where cofinancing is involved, as noted above, it is essential to negotiate an appropriate division of labour with cofinanciers, use 'parallel financing' if possible and avoid inappropriate cross-conditionality.

For as long as there continues to be a substantial differential between the interest rate which the EIB charges for its loans and the on-lending rate to final beneficiaries (under the Cotonou Agreement it will be less significant) more serious justification should be made for how this differential is to be used. It should preferably be used in a way which contributes to the development objectives of the EU and the EIB, as well as the Government concerned. One possibility, with a clearly identifiable development impact, would be to specify that it be used for poverty alleviation by, for example, providing subsidised assistance to small indigenous (i.e. black) enterprises through competent financial intermediaries. This would respond to the concerns expressed in some countries about the paucity of assistance for such enterprises. Whatever strategy is adopted, use of the funds should be monitored directly or indirectly and appropriate reporting procedures introduced.

5.3 Speeding up the Project Cycle for the Selection, Processing and Disbursement of Loans

To improve the efficiency and speed of the EIB's project selection process in the ACP countries it is essential to ensure that the loan officer receives timely initial reactions to project proposals, whether formal or informal, from other relevant parts of the Bank, particularly the technical, economic and legal staff. These reactions should be provided within a specified time (not more than a few days) and should help determine whether, and what kind of, pre-appraisal work is necessary to resolve issues or uncertainties about the proposed project and, if this work is deemed necessary, how it should be financed and who should do it.

The rigour of project appraisal for risk capital operations should be maintained but additionally, as in other parts of the Bank, greater emphasis should be given to credit risk analysis, including classification and level of the types of potential risks, the probabilities that they will materialise, and the measures to be taken to eliminate them or reduce their impact on the viability and sustainability of the project. Where poverty alleviation is of major concern in a country, and the project will contribute to this, environmental considerations may have to be balanced against welfare benefits or alleviating social exclusion.

To help reduce disbursement delays resulting from disbursement conditions in finance contracts, as well as staff time spent on following up such conditions, greater efforts should be made to reduce the need for specific disbursement conditions in the finance contract before loan signature, primarily by early resolution of outstanding ownership, management, legal and technical issues. The finance contract should continue to specify whether any type of guarantees are required for loans funded by risk capital but also explain the justification for this. Moreover, to reduce staff supervision time on loans in trouble, the responsibilities of the project promoter, the Government and the Bank to ensure the project's viability and sustainability should be spelled out, together with the Bank's exit strategy and conditions for exit. Since the EIB is under no obligation to agree to cross-conditionality with cofinanciers, this should be avoided wherever feasible.

The current trend to reduce the amount of supervision on projects, because of the heavy workloads of loan officers, needs to be reversed. An early warning system should be introduced to signal projects and loans which are facing, or are likely to face, problems. When the system is activated for any operation, the loan officer should immediately formulate a strategy for rescue, resuscitation or exit. This should be implemented by a trouble-shooting team, or 'crisis task force' or 'stand-by experts', either from within the Bank or using local management consultants in the country.

The EIB's documentation on projects needs to be rationalized and made more directly relevant to loan processing and disbursement. To improve the Bank's institutional memory, clear guidelines for storage and accessibility of documentation should be established, including what should be maintained in electronic form, while existing archives should be consolidated. (The full review of the EIB's IT systems and a pilot project on electronic data management that are currently underway are important first steps towards this). The loan approval process after appraisal should be speeded up by reducing unnecessary duplication of project loan documents, and, if possible, streamlining the decision-making procedures.

Finally, in the area of knowledge management, there should be greater dissemination of project and country experience throughout the divisions concerned with the ACP countries. In addition, the division chiefs should determine what types of briefing and training are required by new loan officers, in addition to on-the-job training, and what assistance the new loan officer might need to help maintain continuity of the Bank's relations with the country concerned and its clients in the country.

5.4 Ensuring Greater Effectiveness in the Use of Resources

The evaluation team recognises that, even with increased efficiency, even greater streamlining of operations and minimisation of delays and bottlenecks in project processing, additional resources will be needed by the ACP Department to cope with the increased amounts of funds available for lending by the EIB to the ACP countries under the Cotonou Agreement. The EIB's performance, development impact, prestige and comparative advantages in the ACP countries are essential components of the EU's development strategy and need to be maintained and strengthened.

No attempt has been made to estimate the amount of additional professional staff required; indeed, this is beyond the scope of the evaluation and can only be determined once the above recommendations, if accepted, are implemented and the work programme for lending under the Cotonou Agreement drafted. Nevertheless, it is apparent that two types of additional resources would, in any case, be highly beneficial for enhancing the performance of the professional staff working on ACP operations.

The first is a greater availability and use of assistant level staff. This would relieve professional staff of many administrative, documentation and other chores, which currently take up valuable time which could be more effectively spent on projects and ensuring their development impact. It would also help country division chiefs provide continuity in Bank-country communications when the loan officer is on mission, holiday or sick leave.

The second is a greater availability of finance for increasing the efficiency of project processing and supervision, primarily through delegation to other parts of the Bank or, when this is not possible, to on-call specialists outside the Bank.

5.5 A Concluding Note on the Cotonou Agreement

As noted above, the Cotonou Agreement, with its creation of an Investment Facility from 2002 to be managed by the EIB, will provide the Bank with a vastly increased amount of funds for investment in the ACP countries. The prime objective of this facility is to facilitate the integration of these countries into the global economy through promoting their growth and development. Special emphasis will therefore be placed on investment in the private sector, including revenue-earning infrastructure, on projects which stimulate further development of the financial sector, and on operations which attract private investment in the ACP countries. It is expected that the facility will operate in such a way as to eventually become a revolving fund.

The Investment Facility is clearly better designed for those ACP countries which have progressed further down the road of economic development, where market mechanisms have displaced state controls, where private investment in productive enterprises is strongly encouraged and supported and where a coterie of competent project promoters and managers has emerged.

The evaluation team considers that in these countries the EIB will have the greatest opportunity to play a much larger and more strategic role than before, both in terms of amounts of funds lent and its potential development impact. The EIB's operations can be expected to build on its strengths, achievements and experience of the past decade and continue to evolve in the way that has so far been successful, with its country lending strategies showing further concentration and expansion of global lending, together with greater equity participation in the private sector.

In other, less progressive ACP countries, the EIB will necessarily play a less important role, at least until conditions become more amenable. Identifying suitable projects with a potential and distinct development impact will be more difficult and it will have to seek those niches where it has a comparative advantage and step in with innovative approaches at the first opportunity, making full use of all the lending instruments at its disposal. In particular, as has been shown in several less-creditworthy countries already, the ability to finance successful global loans even to fledgling financial intermediaries or commercial banks with little experience in medium-term lending may provide the impetus for governments to adopt more progressive, market-oriented policies.

All the recommendations made in this Synthesis Report are in line with the principles and policies underlying the Cotonou Facility and the expected evolution of the EIB's operations in the ACP countries. They reflect the views of the evaluation team that the Cotonou Facility should imply no additional involvement for the Bank in broad country policy or global issues, except where these impinge on the EIB's development impact, or any revolutionary changes in the way the Bank carries out its business and implements its mandate from the EU.

6 COMMENTS OF THE LENDING DEPARTMENT FOR OPERATIONS IN THE ACP COUNTRIES TO THE REPORT "EVALUATION OF OPERATIONS FINANCED WITH RISK CAPITAL IN ACP COUNTRIES, 1989-99"

The Lending Department in charge of operations in the ACP countries concurs with the overall thrust of the report. It wishes, however, to make a general comment with regards to some of the recommendations and to express its strong disagreement with one specific issue raised.

The general comment applies to the consultants' observations concerning the following points:

i) the scope for a greater division of labour between the Bank and other donors and enhanced co-operation with the Commission's Delegations;

ii) the consistency of Bank-financed projects with countries' development priorities;

iii) the insufficiency of risk analysis;

iv) inadequate management of interest rate subsidies;

v) and internal staffing and organisation issues.

These observations may have applied to the situation prevailing at the time when some of the projects were appraised, but they do not reflect the evolution in Bank practices that has taken place since. Over time, and with the increased emphasis on private sector operations, the Bank has itself identified these weaknesses and implemented measures to overcome them. These will be pursued further in the coming years with the entry into force of the Cotonou Agreement: the new Investment Facility for operations in the ACP countries will concentrate on private sector financing and be managed as a revolving fund along commercial principles.

Nevertheless, the importance of the consultants' recommendations is undeniable, as in many ways they represent an independent validation of the measures implemented by the Bank.

Below is a short review of these new measures.

1- Greater division of labour with other donors and enhanced co-operation with the Commission's Delegations. This issue goes well beyond Bank's activities and indeed it has already been recognised by the donor community as one of the deficiencies of aid delivery: insufficient co-ordination among donors can result in sub-optimal resource allocation and impose an unnecessary burden on recipient countries' authorities. It is being specifically addressed in the framework of the 'programming exercise', which is designed to identify priority sectors for the utilisation by the Commission and the Bank of the financial resources allocated in the Cotonou Agreement. Programming in the Cotonou context has changed considerably from past orientations which focused primarily on sectors. The Delegations in the various ACP countries elaborate now with the national authorities a general country strategy and endeavour to establish how the various donors can best use their comparative advantage to carry out this strategy. The Bank is contributing to the definition of the strategy and of its participation in the exercise (see point 2 below).

It should be pointed out, however, that each donor has its own specific terms of reference and decision-making bodies which, at some stage, inevitably limit how far co-operation can be enhanced. While overcoming these hurdles is not impossible, it is a long term process which goes anyhow well beyond the scope of this paper.

2- Insufficient consistency of Bank projects with countries' development strategies. As mentioned in the previous paragraph, this question is also being dealt with in the framework of the 'programming exercise'. The Bank specifies in which priority sector(s) its operations will concentrate and how they will fit in with the development strategy. However, a word of caution is needed on this point: while an ex-ante identification of priority sectors is feasible and even desirable for investment in infrastructure, this is not the case with respect to the financing of commercial undertakings, where the Bank responds to enterprises' reactions to market opportunities.

3- Risk analysis. With the progressive emphasis on private sector operations, the Bank has introduced a more systematic risk analysis of both the promoters and the projects throughout its operations. This aspect of project appraisal and monitoring will be strengthened further with the new modus operandi related to the Investment Facility.

4- Interest rate subsidy. In conjunction with the Member States, the Bank has progressively sought to avoid automatically applying to final beneficiaries the interest rates subsidies embodied in the Lomé Convention, on the grounds that they could easily create market distortions. In order to minimise this distorting effect, Bank staff has utilised on a case by case basis a range of solutions, such as earmarking the resulting resources for training or to hedge against foreign exchange devaluation risks. It is true that monitoring the use of these resources poses problems, in particular in the case of technical assistance, as the subsidy element builds up only gradually with every interest payment. However, while this issue was an important one under the Lomé Convention, it will become largely redundant under the Cotonou Agreement, which provides that interest rate subsidies can only be extended where a justification can be clearly demonstrated and monitored and that, furthermore, they can be in the form of a lump sum upfront.

5- Internal staffing and organisational issues. The Bank will be gearing up to manage the Investment Facility and is already implementing measures permitting greater delegation of responsibilities, notably by developing assistant level posts.

The Lending Department, however, disagrees fully with the recommendations concerning co-financing to fill a financing gap and cross-conditionality, which reflect the consultants' failure to appreciate institutional realities. By co-financing, the Bank can play a useful role in providing part of the necessary funding and in furthering co-operation among donors: many institutions have limits on what proportions of project costs they may fund. As for cross-conditionality, this is not a matter of principle and orthodoxy, as claimed by the consultants, but the only possible solution to co-operate effectively and maintain the pressure on the relevant authorities to introduce fundamental measures or reforms. The application of cross-conditionality, even if the conditions do not affect the Bank's project components, is driven by the necessity to achieve an optimal framework for the project as a whole and not for its individual component parts. In this respect no disbursements are made unless the conditions attached by the Bank have been satisfactorily met.

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, French, German, Italian and Portuguese).

These reports are available from:

Mrs. Barbara Simonelli, Information Desk
Fax: (+352) 4379-3188
e-mail: B.Simonelli@eib.org