

CEE Bankwatch Network, Concord, Counter Balance and Eurodad – July 2019

Submission to the High Level Group of Wise Persons on the European financial architecture for development

Preliminary statement:

Over the last few decades, the European financial architecture for development has undergone significant changes, including an expansion of its geographical coverage and an increase in overall volumes. As a result, the European Union has become a significant player in the development field and development finance is currently a central piece in the EU's toolbox. At a time when resources allocated to development purposes are scarce, a serious assessment of how EU development finance could play a stronger and improved role in contributing to the well-being and equitable development of people and territories outside of Europe is necessary.

As civil society organisations, we welcome the European Council's initiative to review whether the EU's financial architecture is fit for development and is delivering on development results, but we have concerns about the set-up of this High Level Group.

We would like to highlight that the composition of the Group weakens its credibility as an advisory body. The geographic balance between smaller and larger Member States is uneven, and the presence of representatives from Central and Eastern Europe is too limited, especially considering the institutions in question are highly active within this region. Furthermore, the group is comprised of six men and two women, which is far from gender-balanced. EU Member States also failed to include representatives of civil society such as NGOs, Trade Unions or grassroots organisations in the set-up of the Group. Without questioning the character or intent of those in the group, its composition reinforces inequalities in representation and decision-making.

Considering the scope of the Group's mandate, the timeline is limited and we regret the absence of a transparent, open and inclusive consultation process with relevant stakeholders. Consultations appear to have been made on an ad hoc basis with few NGOs, and were focused on soliciting input from development banks and EU institutions. It remains unclear whether partner country representatives, non-EU based NGO networks or trade unions have been part of this process. This is regrettable, as the views of countries and peoples most impacted by the scenarios put forward by this Group must be taken into account. This potentially erodes the credibility of this Group and the scenarios it will propose.

Nevertheless, the signatories to this input (CEE Bankwatch Network, Concord, Counter Balance and Eurodad) take this opportunity to convey the following messages:

1. *Enhancing and improving the development impacts of EU development finance should be the core objective of the Wise Persons Group's recommendations*

The institutions responsible for the European development finance architecture should have a clear development mandate, focus on development additionality and should target finance where it is needed most, avoiding competition for low-hanging fruit projects. A key reason to improve the functioning of development banks is that the commercial financial sector is unlikely, of its own accord, to provide the finance needed to support sustainable and equitable

social, environmental and economic development, nor to support participatory, transparent and accountable governance. For more information, please refer to Eurodad's [report](#) "Public Development Banks - Towards a better model" which sets out an institutional and governance reform agenda which challenges existing institutions and the governments backing them, to get better at supporting development, become more accountable and learn from past mistakes.

In addition, development banks at the core of EU development finance should ensure that development outcomes take precedence over profitability. The financial sustainability of the institutions should not undermine their ability to invest in higher risk areas, or focus on projects where development returns are high but profitability may be low.

The EU financial architecture for development should prioritise development impacts and adopt a pro-poor agenda with a strong gender lens, focusing on poverty reduction, tackling inequalities and leaving no one behind. The institutions part of this architecture should support the ability of countries to reach the Sustainable Development Goals, the Paris climate agreement and other international human rights and labour standards and not be seen as a means to deliver on commercial or foreign affairs objectives of EU countries.

It is key that this architecture be delinked to the political trend of using scarce ODA to focus on border management and migration control. Similarly, the concept of economic diplomacy should not be at the core of this architecture, since it may contradict development effectiveness principles and support of civic space for local actors.

Alignment with development effectiveness principles is crucial; therefore, support for national strategies should be reinforced in future European financial architecture for development.

Finally, climate action should be central to this architecture and EU funding should be fully aligned with the Paris Agreement's objectives to limit global warming to 1.5°C and avoid fuelling climate disasters through support of fossil fuels.

2. *The rise of blended finance mechanisms especially in the context of the EU External Investment Plan raises growing concerns among civil society*

The use of ODA to leverage private finance carries risks that have to be considered at a systemic level. These days, ODA money is scarce and it is of very important value for many Low Income Countries. While private finance has a role to play in development, it cannot be a substitute for the shortfalls in public expenditure, including in infrastructure. The experience with blended finance so far indicates that it is concentrated mainly in Middle Income Countries and in 'hard' economic sectors (i.e. physical infrastructure) with very little focus on social sectors (health, education and social protection). As a result, there is an opportunity cost when using ODA to subsidise private finance, as this can result in diverting further concessional public finance away from the poorest countries and from public sector projects, which usually support women and the most vulnerable groups. This strategy can undermine efforts focused on reaching those who have been left behind (see these two Eurodad reports: ['Mixed messages'](#) and ['Can PPPs deliver gender equality?'](#)). In addition, the use of blended finance can potentially increase the debt vulnerability of developing countries in a situation in which some of them are already showing signs of debt distress.

A 2019 [report](#) from ODI ("Blended finance in the poorest countries. The need for a better approach") states that "*expectations that blended finance can bridge the SDG financing gap are unrealistic: 'billions to billions' is more plausible than 'billions to trillions'. There is much talk by policy-makers of the potential of blended finance to mobilise significant sums of private finance. High financial leverage ratios are at the core of their arguments for investing ODA in blended finance, but our research shows that real leverage ratios are actually very low*". The

authors conclude that “each \$1 of Multilateral Development Bank and Development Finance Institution invested mobilises on average \$0.75 of private finance for developing countries, but this falls to \$0.37 for LICs.”

Civil society is increasingly concerned about the promotion of blended finance mechanisms globally and at EU level, which increases the role of Development Finance Institutions (DFIs). In particular, we have focused on the European External Investment Plan (see for example this [report](#) by Counter Balance) and its financial pillar, the European Fund for Sustainable Development (EFSD).

Our concerns are centred on the development and financial additionality of these projects, among other points, as well as their potential to exacerbate inequalities, including gender inequality. There can be tensions between generating a return on investment and delivering for people living in poverty, as increasing evidence on the failure of PPPs in Europe as well as in the Global South demonstrates (see this [report](#) by Eurodad presenting 10 PPP projects undertaken in both developed and developing countries across four continents, as well as this critical [report](#) from the European Court of Auditors). There is also the risk of encouraging the privatisation of public services and exposing developing countries to debt risk – which is already having a tremendous impact on inequality and livelihoods for hundreds of millions of people in the developing world.

DFIs face significant challenges when it comes to designing, implementing, monitoring and reporting their investments, particularly if they are to be considered as development actors that actively contribute to achieving the SDGs and internationally recognised human rights. There are still many barriers for affected people, beneficiaries and the broader public to participate in the decision-making on investment, and the direct impacts and benefits for these people are both understudied and poorly reflected in DFI’s results reporting.

This does not mean that subsidising the private sector should be banned, but it should not be a goal in itself and should be done carefully and consciously when public alternatives are not available, dependent on the type of projects and context. In this regard, the EU should not give a blank cheque to development banks to access EU guarantees. Instead, the control by the European Commission on how its guarantees and technical assistance are used would gain from being reinforced, including in terms of additional due diligence to be carried out by the Commission’s services and appropriate accountability and remedy mechanisms.

3. *There is little rationale to the set-up of an EU Development Bank, as the reform of current institutions and instruments should be a top priority for the EU*

We think that financial and human resources at EU level should rather be devoted to the recalibration and reform of currently existing institutions and financial instruments, rather than setting up a new institution. As highlighted above, there are important avenues for reforms at the level of the EIB, EBRD and for the EU External Investment Plan, as well as its successor under the next EU budget (2021-2027). Enhancing complementarity between these institutions and instruments should be an objective. If the EU is not able to make existing institutions more transparent and accountable, with stronger environmental, social and Human Rights standards at its core, it is doubtful that it would manage to set up a model new development bank.

In this regard, a key step forward would be for the EU to establish a centralised grievance appeal mechanism for all supported projects under the EU financial architecture for development to ensure accountability for breaches of international social, environmental, Human Rights and labour standards. An option in this regard could be to expand the mandate of the European Ombudsman so that it can deal with all grievances from citizens outside of Europe affected by EU-supported projects.

4. Fundamental reforms are needed in already existing financial institutions: the EIB and the EBRD

Some of the documented evidence that the EIB and the EBRD fall short of adequately fulfilling their development mandates are listed as annexes to this paper. The creation of this High Level Group represents an opportunity to draw lessons from the EIB and EBRD's track records and address structural problems linked both to their business model and practices, in a forward-looking manner.

Recommendations and "avenues for reforms" for the EIB and the EBRD

- **Development mandate:** For the EIB, it is high time to proceed to a fundamental reform of the Bank and reconsider its investment focus. At this stage, the EIB is not a development finance institution, even though it has been operating outside of Europe under a development mandate awarded by the EU institutions.

The EBRD has revised its transition methodology to focus on qualities such as Inclusion and Governance, however, their application is very limited and still appears secondary to qualities such as Competitiveness.

In order to maximize the positive impact of the Banks' action on the sustainable development of their countries of operation, a more rigorous investment selection prioritising quality over quantity appears necessary. EU public finance will be key for the EU to achieve the Sustainable Development Goals, but with that objective in mind, business as usual is no longer an option.

- **EIB's ELM requirements re-enshrined:** The binding requirements of the External Lending Mandate (ELM) of the EIB have brought incremental changes to the transparency, social and environmental standards of the Bank. Therefore, previous requirements included in the ELM should not be diluted and rather be re-enshrined into the future mandates of the EIB under the NDICI.

- **Make the EIB and the EBRD climate leaders:** Truly aligning with the Paris Agreement will contribute to global sustainable development. In this context, supporting fossil fuels, including natural gas projects, is no longer justified. Instead the banks' Climate Action should step up investments in energy efficiency and sustainable small-scale renewables with enhanced local and regional impacts, especially for local communities.

- **Further democratise the EIB and the EBRD:** Efforts to strengthen public participation in the policy-making of the banks should be enhanced. In addition, the banks need to further ensure that local communities and citizens affected by their operations are meaningfully consulted and have access to effective and independent complaints mechanisms, including the right to effective redress. The right of local communities to Free, Prior Informed consent (FPIC) should be upheld for all land-related projects. Ultimately, lawmakers should ensure that the EIB and the EBRD have a duty of care to those affected by projects they finance.

The EIB's governance structure is 60 years old and has barely evolved since its creation. It fails to fulfill the core criteria of effective development cooperation as expressed in the Paris Declaration and Accra Agreement (ownership, alignment, harmonisation, results and mutual

accountability). The EIB should bring more dialogue, transparency and accountability to its governing bodies.

In addition, the external scrutiny over the EIB and EBRD should be reinforced. The European Commission, Parliament and Court of Auditors (in the case of the EIB for the latter) should be awarded stronger competences to oversee and influence the strategic orientations, policies and operations of the two banks.

- **Prioritise Human Rights:** The protection and promotion of Human Rights must become a priority for the EIB and the EBRD. The existing social safeguards neither sufficiently prevent intimidation, threats and forced evictions nor protect the existence and well being of the most vulnerable project stakeholders. The Banks need to adopt overall Human Rights strategies and reinforce their due diligence at project level via Human Rights Due Diligence and Human Rights Impact Assessments to ensure the projects they support respect the core values of the EU external action and do not directly or indirectly contribute to Human Rights violations.

Recent moves to push the EIB to be more active in the defense and security fields, as well as into migration management and border control, are not in line with the EIB's primary missions and should not be part of the mandate of a socially and environmentally responsible lender.

- **Raise the bar on transparency:** The EIB and EBRD need to step up transparency at both governing bodies as well as project level. Instead of hiding systematically behind business confidentiality, the Banks should let the public interest prevail. Particular focus should be placed on raising the transparency of the Banks operations via financial intermediaries.

- **Strengthen due diligence and control over investments:** It is high time for the EIB and the EBRD to really implement the self-proclaimed "zero tolerance to fraud and corruption" policy. A series of investments in projects under corruption investigations cast doubt over the banks' practices in this regard. For example, the recent Dieselgate shows that the EIB needs to improve its monitoring and due diligence for all the projects it supports, especially when public support is granted to the private sector.

- **Cease the problematic financing of Public Private Partnerships:** The experience of PPPs in Europe has been controversial and EU development finance institutions should review their approach to PPPs. The EIB and EBRD's role goes beyond ensuring financial profitability for the Banks and project promoters, and the public interest should prevail in all EBRD and EIB-managed financial instruments. Therefore, the EIB should not promote a failed development model outside of Europe, especially when it comes to investments leading to the commercialization and privatizations of the health and education sector.

ANNEX 1: Current shortcomings at the EIB

In November 2016, Counter Balance and CEE Bankwatch Network published the report "[Going Abroad](#)" taking a closer look at projects the EIB supported under its External Lending Mandate. The report found a dismal track record on a range of issues from transparency to human rights. The findings presented in the report raise serious concerns about the EIB's overseas development role including transparency and access to information practices, the bank's approach to tax evasion and tax dodging, enforcement of sustainability standards, support to fossil fuel projects, and Human Rights due diligence.

The EIB, as both the EU Bank and a key actor in development finance under several EU mandates, has the legal and moral duty to give adequate consideration to the human rights context of the projects it finances and to better assess and mitigate the Human Rights impacts that these projects may cause. Still, the EIB does not have a Human Rights strategy or proper

Human Rights assessment and monitoring system at project level, and the bank has repeatedly failed to guarantee sufficient and meaningful community participation in projects it supports.

Over the last years, we welcomed both the EIB's recognition of the need to protect Human Rights which resulted in an enhanced integration of Human Rights considerations in the EIB's social standards, adoption of the Strategy on Gender Equality and the recent announcement that the Bank is developing a specific guidance on how to deal with risks of reprisals against Human Rights defenders and others for their opinions or activities related to EIB-financed activities.

However, still too often the EIB is involved in projects that cause or contribute to Human Rights abuses as well as threats and attacks against local communities and Human Rights defenders. Bankwatch and Counter Balance have for example documented cases from [Madagascar](#), [Nepal](#), [Kenya](#) and [Ukraine](#). Additionally, experience from the ground demonstrates that EIB standards on information disclosure and public participation are not properly implemented. In its 2017 report on corporate social responsibility, the EIB indicates that, during that year, it did not undertake a single Human Rights impact assessment, implying that the quality of its projects did not make it necessary. But we rather think this demonstrates a black hole in the EIB's due diligence. At the same time dozens of complaints have been submitted regarding a single project in Mombasa regarding human rights abuses, which included forced eviction with the armed police.

This operational weakness is unfortunately matched by a lack of political willingness – Human Rights issues have been given a low priority by the EIB Management Committee for some years already. Too often, the bank hides behind the political greenlight to operate in a given country, ignoring its responsibilities at project level.

Therefore a review of the EIB's environmental and social policies and how they are implemented is much needed and urgent. Establishing a coherent strategy on Human Rights would be a first step in this regard. Such strategy should integrate systematic Human Rights risk assessment as a basis for due diligence, as well as specific policies on Human Rights defenders and protocols to prevent and respond to risks of reprisals, ensuring meaningful access to information, and robust free, prior and informed consent of indigenous peoples as well as consultation of other affected communities.

Finally, there are important concerns about the **use of financial intermediaries by the EIB**. It is high time for the Bank to create a state-of-the-art Standard for Financial Intermediaries that will enhance the environmental, social and transparency performance of these operations while maintaining economic benefits. The scale of intermediated operations in the EIB's portfolio (36% of its entire lending in third countries) highlights the need for a sound and ambitious Standard.

By outsourcing part of its lending, the EIB also outsources its due diligence and monitoring. It is assumed that since the final beneficiaries receive relatively small investments, there is limited scope for social and environmental impacts to take place. However, the cases of small [hydropower](#) in biodiversity rich areas of the Western Balkans and a recent internal EIB [evaluation](#) on intermediary investments in Africa tell a different story.

At the moment the EIB does not proactively share any information on the final beneficiaries of the Financial Intermediaries. The EIB Environmental and Social Handbook contains clauses for Global Loans and Funds that require financial intermediaries to publish environmental data, however this does not happen in practice, due to ambiguous transparency clauses inserted in contracts. We ask the EIB to actively disclose the following information on financial intermediaries: at least the name of the final beneficiary, the amount, the type of project and related environmental information. Moreover, we ask to clarify contract clauses with intermediaries to better require the consent for sharing environmental information about final projects that needs to be embedded in the contracts with final beneficiaries.

ANNEX 2: Current shortcomings at the EBRD

Transition methodology

In 2016 the EBRD adopted a new transition methodology. The new transition qualities that the EBRD promotes through its investments are competitiveness, good governance, green economy, economic inclusion, resilience, connectivity. The application of these transition qualities raises several questions. For example green economy investments often fail to reconcile the need for rapid deployment of renewables with ecological limits and lack of social licence for projects. Hydropower investments in the Balkans and Georgia have provided numerous examples, including through reviews by the bank's accountability mechanism, of unsustainable projects with significant adverse and badly mitigated impacts on people and nature.

The application of the good governance quality to corporate investments is yet to show examples of improved transparency and stakeholder engagement by EBRD clients. In fact, corporate level investments and financial intermediary lending tend to be the least transparent and with limited requirements for compliance with the EBRD's Environmental and Social Policy and Performance Requirements. With regards to institutional governance, in spite of the recent increase in sovereign lending and investments in the public sector, and increased policy dialogue and technical assistance attached to projects, examples of improvements are hard to find. For example, at the Annual Meeting in May in Sarajevo, Balkan civil society groups raised concerns about high corruption risks, non-transparent and top-down planning process, limited consultations and public participation in the preparation of the Green City Action Plans and projects in the Municipal Environmental Infrastructure sector.

Political mandate and protection of Human Rights

To deliver on its mandate to invest only in countries committed to multiparty democracy, the EBRD conducts political assessments of its countries of operation. The bank has recently clarified its political assessment methodology, yet it remains unclear how the improved political assessment informs the country strategies and investment approach. The recently approved country strategies for Azerbaijan is a case in point. The "more for more" approach was very visible in Uzbekistan, where the investment portfolio rose significantly even before the new country strategy was approved in 2018. Yet new country strategies, eg the one for Turkey under revision at the moment, will be a test for the application of the converse "less for less" approach.

The space for civil society and Human Rights defenders (HRDs) is shrinking in the EBRD's countries, but due diligence and Human Rights risk assessments are not properly carried out at project level. Quality gender impact assessments are practically never done for controversial projects, a question that the Project Complaints Mechanism (PCM) has been asked to review in two compliance reviews on hydropower projects in Georgia. The implementation of resettlement plans continues to be very problematic (see link below on case in Bulgaria).

Cases of retaliation against activists and HRDs are on the rise and, while the EBRD has clarified its approach to retaliation, the existing procedures are not tested. For example, apparently the EBRD Office of the Chief Compliance Officer has never carried out an investigation on coercive practices by its clients, although civil society has signalled several problems in Ukraine and Georgia.

Support for fossil fuels

During the revision of the EBRD Energy Sector Strategy in 2018 Bankwatch produced a series of case studies showing EBRD's investments in fossil fuel heavy companies (see [here](#) and [here](#)).

While the EBRD has limited direct financing for coal since 2013, the bank has continued to invest in coal-heavy utilities, even when the companies plan to expand lignite mines and construct new thermal power plants on coal. For example, investments in state energy utilities are done at the corporate level: such as the corporate restructuring loan for Serbia's Elektroprivreda Srbije (EPS) or bond issuance loans for the Bulgarian Energy Holding (BEH). These loans promise strategic sectoral reforms, but end up freeing company's resources to continue business as usual. Bankwatch demanded that such investments are banned, if the company is in the process of constructing new thermal capacities, or conditioned on mandatory decarbonisation plans.

With regards to environmental and social sustainability, Bankwatch has challenged the investment in EPS at the EBRD PCM. In the April 2019 Compliance Review on the EPS Restructuring project, the PCM presented a highly worrying picture of the EBRD environmental and social due diligence (ESDD), risk analysis, preparation and monitoring of the implementation of the Environmental and Social Action Plan for the corporate level investment in EPS. The PCM report finds that the EBRD has done a poor job at assessing and mitigating risks and potential harm, *"which do not adequately mirror the magnitude of some of the environmental and social challenges faced by EPS, especially as they continue to be reflected in the series of PCM complaints against EBRD operations supporting EPS"*. The PCM report presented no evidence of the added value of the EBRD loan in achieving environmental and social sustainability objectives, or in supporting decarbonisation and compliance of EPS operations with national regulation, EU standards or good international practice.

In the case of BEH, its daughter company Maritsa East Mines has received a grant from the Kozloduy Decommissioning Fund, managed by the EBRD, to improve the efficiency of the lignite extraction. The bank's redress mechanism, the PCM, is currently facilitating a dialogue process between the mines and the last remaining people from the community of Beli Briag that should be resettled voluntarily by the end of the year. More on the story can be seen [here](#).