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Technical Regional Operational Guidelines for EIB operations under Decision 1080/2011/EU

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ON 2011 ACTIVITY UNDER THE EIB EXTERNAL MANDATE

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Technical Regional Operational Guidelines for EIB operations under Decision 1080/2011/EU

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List of Acronyms

ACP	African, Caribbean and Pacific
AFD	Agence Française de Développement
AIF	Asian Investment Facility
ALA	Asia and Latin America
ARF	ASEAN Regional Forum
ASEAN	Association of South-East Asia Nations
ASEM	Asia-Europe Meeting
CBR	Central Bank of Russia
CCM	Climate Change Mandate
CEB	Council of Europe Development Bank
CSP	Country Strategic Paper
DABLAS	Danube and Black Sea Initiative
DCFTA	Deep and Comprehensive Free Trade Area
EaP	Eastern Partnership
EaPIC	Eastern Partnership Integration and Cooperation
EBRD	European Bank for Reconstruction and Development
EC	European Commission
ECOFIN	Economic and Financial Affairs Council
ECS	Energy Community Secretariat
EDIF	Enterprise Development and Innovation Facility
EEAS	European External Action Service
EPPF	Environmental Project Preparation Facility
EIB	European Investment Bank
EIF	European Investment Fund
EN	Eastern Neighbourhood
ENC	Eastern Neighbouring Countries
ENP	European Neighbourhood Policy
ENPI	European Neighbourhood Policy Instrument
ESF	Energy Stability and Security of Supply Facility
EU	European Union
EWBJF	European Western Balkans Joint Fund
FEMIP	Facility for Euro-Mediterranean Investment and Partnership
FWA	Framework Agreement
GDP	Gross Domestic Product
GFM	Green Financing Mechanism
GHG	Green House Gas
HELCOM	Helsinki / Baltic Marine Environment Protection Commission
ICJ	International Court of Justice
ICT	Information and Communication Technology
IFC	International Finance Corporation
IFCA	Investment Facility for Central Asia
IFI	International Financial Institution
IMF	International Monetary Fund
IMO	International Maritime Organisation
IPA	Instrument for Pre-Accession
IPP	Independent Power Producers
JASPERS	Joint Assistance to Support Projects in European Regions
KfW	Kreditanstalt für Wiederaufbau

LAIF	Latin America Investment Facility
MCCI	Mediterranean Climate Change Initiative
MEHSIP	Mediterranean Hot Spot Investment Programme
MENA	Middle East and North Africa
MFF	Multiannual Financial Framework
MIPD	Multi-Annual Indicative Planning Document
MoU	Memorandum of Understanding
MRI	Mutual Reliance Initiative
MSME	Micro, Small and Medium-sized Enterprise
MSP	Mediterranean Solar Plan
NGO	Non-Governmental Organisation
NIF	Neighbourhood Investment Facility
ODA	Official Development Assistance
OECD	Organisation for Economic Co-operation and Development
PPP	Public-Private Partnership
RCF	Risk Capital Facility
SAARC	South Asian Association for Regional Cooperation
SARB	South African Reserve Bank
SARi	South African Renewables Initiative
SEETO	South-East Europe Transport Observatory
SME	Small and Medium-sized Enterprise
SPRING	Support to Partnership, Reform and Inclusive Growth
SWM	Strategy for Water in the Mediterranean
TEN-T	Trans-European Transport Network
TEU	Treaty on European Union
UfM	Union for Mediterranean
UfMS	Secretariat of UfM
UNEP-MAP	UN Environment Programme-Mediterranean Action Plan
UNSCR	United Nations Security Council Resolution
UDPFI	Urban Development Platform Financial Initiative
VEB	Vnesheconombank
WB	World Bank
WBIF	Western Balkans Investment Framework
WTO	World Trade Organisation

1. Introduction and Objectives

The mid-term review of the External Mandate of the European Investment Bank (EIB) resulted in a revised Decision[1] granting an EU budgetary guarantee for EIB's activity outside the Union ("the Decision"). This Decision introduced harmonised high-level objectives for financing across the regions and pushes for a stronger alignment of EIB external activity and EU external policies and actions. To ensure that these rather broad definitions provide sufficient guidance regarding the scope of the EIB's interventions in different regions, they are complemented by Technical Regional Operational Guidelines. These guidelines aim at strategic prioritisation of the objectives, broken down on a regional level, and the establishment of practical measures for ensuring that EIB financing under this Decision is complementary to corresponding EU assistance policies, programmes and instruments. These guidelines are being drawn for the first time and should be valid until the expiry of the current mandate.

The EIB undertakes operations outside the EU in support of EU external relations policies, including development and cooperation, either based on a mandate from the EU with an EU guarantee, referred to as the "external mandate"[2], or at its own risk under dedicated facilities, referred to as "facilities". Both taken together have traditionally made up around 10% of the Banks total lending activities.

Following a mid-term review, the Decision established a revised mandate for the remainder of the 2007-2013 Multiannual Financial Framework (MFF), ensuring the continuation of the EU guarantee for EIB external financing, whilst introducing a number of new elements with the view in particular to better align EIB external activity with the Union external policy's objectives. The Decision replaces Decision 633/2009/EC and defines the basic principles and goals for the EU mandate under the remaining of this period.

In particular, Decision 1080/2011/EU establishes a general mandate with an overall ceiling of EUR 27.484bn for all EU guaranteed loans and loans guarantees in favour of eligible countries as listed in Annex III of the Decision for the period 2007-2013. This overall ceiling is broken down into regional ceilings and sub-ceilings as laid down in Annex I of the Decision. According to Article 2 of the Decision, within the ceilings for individual regions, the EIB shall progressively ensure a balanced country distribution[3]. In addition to this general mandate, the Decision also foresees the release of an optional mandate of EUR 2bn for climate change operations.

In order to enhance the coherence of the mandate and strengthen the focus of the EIB external financing activity on supporting Union policies, and for the maximum benefit of beneficiaries, the Decision replaces the previous system of regional objectives for operations under EU guarantee with horizontal high-level objectives applicable to all regions covered by the external mandate, building on the comparative strengths of the EIB in areas where it has a well-proven track record. These high-level objectives are defined in Article 3 of the Decision and are the following:

[1] Decision 1080/2011/EU of 25 October 2011 granting an EU guarantee against losses under loans and loans guarantees for project outside the Union.
[2] This activity is complemented by activities carried out in ACP countries under the Cotonou Agreement with European Development Fund resources or with a guarantee of Member States.
[3] It should be noted here that the Decision also introduces the possibility for 10%-flexibility between the regional ceilings (previously, it was only within them).

i. **Local private sector development**, in particular support to Small and Medium-sized Enterprises (SMEs);

ii. **Development of social and economic infrastructure**, including transport, energy, environmental infrastructure[4] and information and communication technology; and

iii. **Climate change mitigation and adaptation**[5], in particular avoiding or reducing greenhouse gas emissions in the areas of renewable energy, energy efficiency and sustainable transport, or increasing resilience to the adverse impacts of climate change.

Besides this, the EIB shall consider increasing its activity in support of health and education infrastructure, when there is clear added value in doing so.

Regional integration among partner countries, including economic integration between pre-accession countries, neighbourhood countries and the Union, shall be an underlying objective for EIB financing operations within areas covered by the general objectives.

Moreover, the EIB should be able to **support Union presence** in partner countries through foreign direct investment that contributes to promoting technology and knowledge transfer either under the EU guarantee for investments within the aforementioned areas or at its own risk.

Furthermore, Article 6 of Decision 1080/2011/EU requires EIB financing activities to comply with the general guiding principles of Union external action, and to contribute to the achievement of its objectives and policies. This includes general principles guiding Union external action, as referred to in Article 21 Treaty of the European Union (TEU), as well as the implementation of international environmental agreements to which the Union is a party. In case of EIB financing in developing countries, as defined in the list of official development assistance (ODA) recipients established by the OECD, these include development objectives such as reducing poverty through inclusive growth and sustainable economic and social development.

The Commission, together with the EIB, is required to **develop regional technical operational guidelines** for EIB financing under the Decision. In particular, these guidelines should set out the practical measures linking the Mandate objectives and their implementation. Moreover, they shall be consistent with the wider Union regional policy framework set out in Annex IV of Decision 1080/2011/EU and ensure that EIB financing under this Decision is complementary to corresponding Union assistance policies, programmes and instruments in the different regions.

The present document sets out these regional technical operational guidelines for EIB financing under the Decision. It has been drafted by the Commission and the EIB, in consultation with the EEAS. In this context, it should be noted that in that Decision 1080/2011/EU also requires the Commission and the EIB to amend the existing Memorandum of Understanding (MoU) on cooperation and coordination in the regions covered by the mandate, and, as appropriate, to extend it to the European External Action Service (EEAS), in particular as regards the regular and systematic dialogue between the Commission and the EIB at the strategic level, which should include the EEAS, and other aspects within the latter's competence.

[4] Including water and sanitation

[5] Note that the first two objectives may also contain climate projects. For instance, energy efficiency loans to SMEs or development of a wind park or adaptation measures in infrastructure.

The guidelines are structured according to four regional fiches as follow:

I. Pre-Accession

II. EU Neighbourhood and Russia

III. Asia and Latin America

IV. South Africa

The regional chapters follow a uniform structure. They start with the description of the general context, followed by the regional macroeconomic situation and the current business climate. This is followed by an overview of the EIB activity to-date, which amongst others gives a sectoral split of signatures for EU guaranteed and own-risk operations covering the period of 2007-2011. The figures refer to the actual implementation period of the current mandate which started on 01/08/2007 (implementation of the former mandate continued until 31/07/2007, which makes a significant difference with full year 2007, especially in Pre-Accession). Since many climate action activities serve more than one objective, these activities were reported under the respective sectors (e.g. energy, transport). Detailed separate recording of Climate Action lending was formally carried out only from 2010 onwards; the share of Climate Action lending (mitigation and adaptation) in the total lending during the period 2010-2011 gives a good indication about the actual situation. The next section focusses on the EIB's contribution to EU regional policy framework, including the cooperation with the EC, the EEAS and other IFIs. The last section sets the operational focus for the remaining period of the mandate, along the three high-level objectives. Although the choice of financial products is closely interlinked with the operational focus, the guidelines do not aim at addressing the adequacy of the financial products for achieving the high level objectives in general and in specific sectors or regions. The extent to which the Bank will be able to deploy blended products will depend, at least in part, on the availability of grant finance from EU budget and other donors, and on the flexibility in using such grant finance to develop new financial products.

Decision 1080/2011/EU also calls the EIB i) in coordination with the Commission, to present a strategy on how to gradually and steadily increase under its external mandate the percentage of projects promoting the reduction of CO_2 emissions and phase out financing projects detrimental to the achievement of Union climate objectives (Article 6(4)) and ii) in consultation with the Commission, to develop a clear and transparent allocation policy for deciding upon the source of financing of operations which are eligible both for coverage by the EU guarantee and for EIB own-risk financing (Article 10(4)). Both documents will complement and be additional to the aspects included in these regional technical operational guidelines.

2. EIB Financing in Pre-Accession region

2.1 General context

Currently, the EIB operates in 6 EU candidate countries and 3 potential candidates. By the end of the current mandate, one candidate country (Croatia) should become a Member State. The countries in the Western Balkans are still relatively young states formed after the disintegration of the former Yugoslavia. Political stability, the full establishment of the principles of democracy and the respect of human rights and good governance – all fundamental values of the EU – still need to be strengthened.

These countries cannot sustain alone all the efforts and cost of meeting the criteria for joining the EU. There are encouraging signs of their ability to reduce debt and attract foreign investment, but nevertheless most of them lack the capacity to finance alone the public investments and reforms necessary to stabilize their societies and economies and put them onto a sustainable development path, including climate change mitigation and adaptation measures. Like in the previous enlargement rounds, the EU should continue to offer them technical and financial assistance to overcome their difficult situation and develop sustainably, gradually aligning on EU rules and standards. EIB financing should be critical in supporting this process. The key challenge will be how best to focus the limited funds in relation to the new challenges faced by the EU and the future members and the political response to these challenges taking into account also the Europe 2020 Strategy.

The cooperation with Kosovo[6]

Article 10 of the revised external mandate stipulates that "Kosovo is represented by the United Nations Mission in Kosovo or by an administration designated in the regional technical operational guidelines referred to in Article 6". Such administration should be the Government of Kosovo. The resuming of EIB financing operations would be facilitated by the establishment of a new Framework Agreement (FWA) directly with the Government of Kosovo following legal due diligence and the approval of the signature of such new FWA by the governing bodies of the EIB.

The cooperation with Iceland

Iceland was granted the status of candidate country by the European Council in June 2010. The Framework Agreement with Iceland, which is a pre-requisite for the financing of future eligible projects, is currently in negotiation and is expected to be signed in 2012. The Bank's operational focus will be on lending to the energy sector, to infrastructure projects and programmes (e.g. hospitals, transport), as well as to SMEs in the coming years. Providing financing to larger municipalities is also envisaged.

2.2 Regional macroeconomic situation / business climate situation

In general, the accession and pre-accession countries are affected by the deterioration in the external environment in 2012, which however is expected to improve during 2012 and in 2013. The main factors are decelerating external demand, partly due to a slowdown of the growth dynamics in particular in Asia, high oil prices, but also more difficult access to finance, reflecting the need of many international and national banks to improve their capital adequacy

[6] This designation is without prejudice to positions on status, and is in line with UNSCR 1244/99 and the ICJ Opinion on the Kosovo declaration of independence.

ratios and the quality of their credit portfolio. Furthermore, the still high uncertainty related to the global but also the European economy impedes foreign and domestic investment but also private consumption. With the exception of Croatia and Serbia, the other pre-accession countries so far weathered the global financial crisis relatively well, partly benefitting from rather small (and underdeveloped) financial sectors, low debt ratios and the stabilising effect of resilient workers remittances.

However, following a better-than-expected economic performance in 2011, all candidate countries are expected to face a slowdown in 2012. Overall, economic growth of the group as a whole is set to decelerate significantly from nearly 8% in 2011 to 2¾ in 2012, and to rebound to some 4¼ in 2013. The aggregated figure masks diverse growth dynamics at a country level. For Turkey, the largest economy in this group, the current economic outlook is for a sharp slowdown from 8½% in 2011 to 3¼% in 2012 on the back of a more restrictive monetary and fiscal policy mix and decelerating external demand. In 2013, GDP growth is expected to accelerate to 4½%. For most other candidate countries, the expected slowdown is more moderate. In the acceding country Croatia, where annual GDP growth was close to stagnation in 2011, a moderate contraction is expected in 2012, mainly on the account of weak domestic demand, in particular investment activity. In 2013, the economy is anticipated to enter a subdued recovery process.

2.3 Brief overview of EIB activity to-date

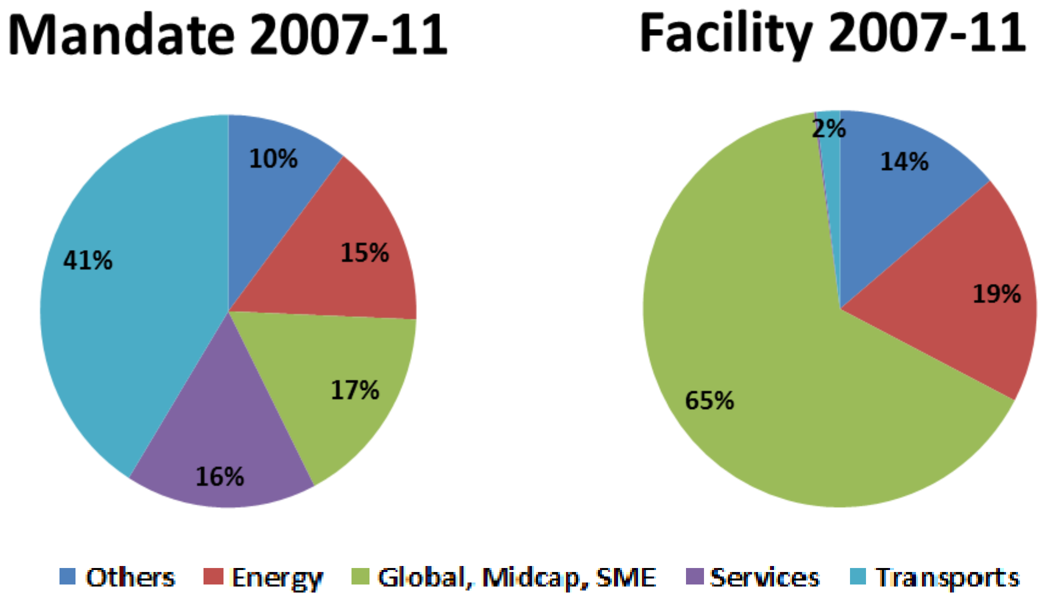
The EIB currently lends in Pre-Accession region on the basis of an EU budget guarantee (the “mandate”) and at its own risk, via its Pre-Accession Facility.

The mandate for the Pre-Accession countries had an initial volume of EUR 8.7bn over the period 2007-13. Decision 1080/2011/EU increased the current mandate ceiling to EUR 9bn and released an additional Climate Change Mandate providing an extra envelope of up to maximum of EUR 800 mn for climate change operations in the Pre-Accession region.

Regarding the EIB own risk activity, the Pre-Accession Facility has been established in 1998. It has been renewed in 2000 and subsequently extended in 2003, 2004, 2007 and 2011. Following the latest extension, the amount authorized for 2000-2013 is EUR 25.2bn in the current Pre-Accession countries.

1) EIB activity in Turkey

Sector (2007-11 in EUR mn)	Mandate	%	Facility	%	Total	%
Others	500	*10%*	722	*14%*	**1,222**	*12%*
Energy	725	*15%*	985	*19%*	**1,710**	*17%*
Global, Midcap, SME	800	*17%*	3,413	*65%*	**4,213**	*42%*
Services	785	*16%*	10	*0%*	**795**	*8%*
Transports	1,963	*41%*	100	*2%*	**2,063**	*21%*
Grand Total	**4,773**	***100%***	**5,230**	***100%***	**10,003**	***100%***



The EIB has been involved in lending operations in Turkey since the mid-1960s. During more than 40 years of experience in Turkey, the Bank has invested throughout all key sectors of the country's economy, in both the public and private sector, to support the country's economic development and assist Turkey during its pre-accession phase.

Over the last 5 years (2007 – 2011), the EIB has achieved total signatures of some EUR 10bn in Turkey. Lending volumes increased significantly as from 2005 onwards, reflecting the opening of the accession negotiations at the end of 2004 and the increasing efforts of the Bank to step up its support to the country in a widening range of sectors, thus underpinning the status of Turkey as a Candidate Country.

In this context, and in line with the requirement of the Mandate and the recommendation of the Mid-Term Review, the Bank has significantly stepped up its lending on its own risk under the Pre-Accession Facility for private sector lending as a complement to the implementation of the Pre-Accession Mandate mainly in support of the public sector. Whilst the remainder of this section on Turkey will focus on the Mandate operations, it should be noted that certain Mandate priorities such as support to private sector development, in particular SMEs, are not captured as these are largely implemented under the Bank's Pre-Accession Facility, i.e. at the Bank's own risk.

Infrastructure, and in volume terms more particularly the *railway sector*, has historically been a key sector for EIB's intervention in the country, to underpin its growing economy and a more sustainable transport system.

The EIB has also stepped up its lending in favour of *SMEs,* especially since 2008. The focus on SME lending for EIB's activity in Turkey was endorsed by the EU and the Turkish authorities and highlighted in the framework of the Joint IFI Action Plan to support the banking sector in the Central and Eastern Europe region hit by the global economic crisis.

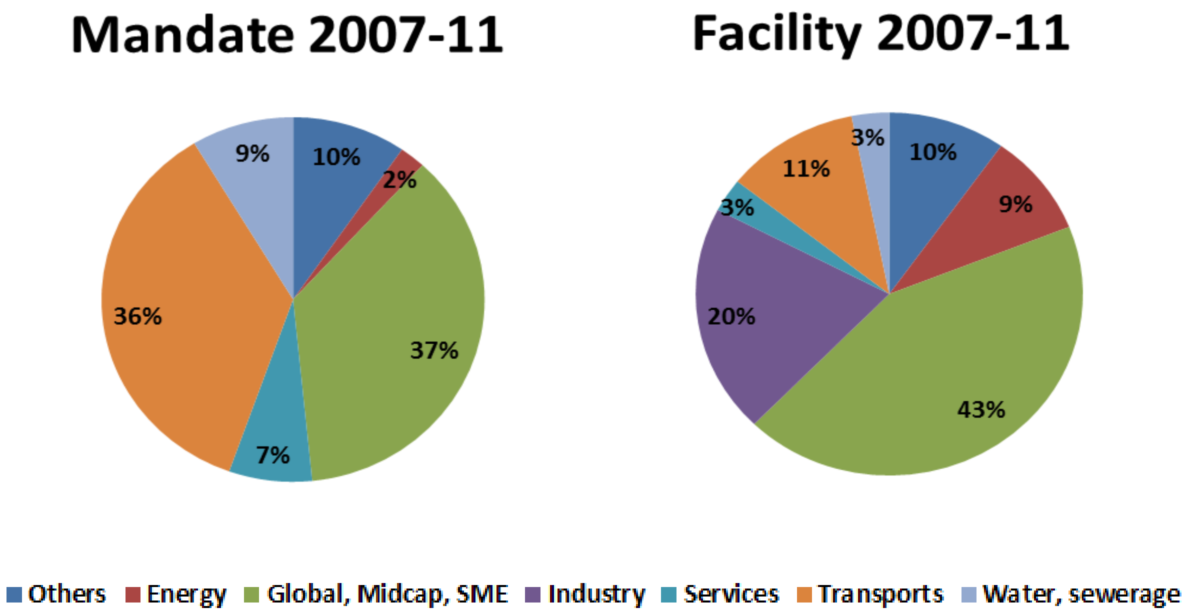
One of the main challenges of the Turkish economy is its low average productivity, underpinning the need for high import levels and the significant current account deficit. One important tool to address this weakness is the strengthening of the *knowledge economy*. In this context, EIB has financed several R&D programmes by leading public research institutes in the country, particularly in the field of scientific research, tertiary education, and private sector innovation. These investments are orientated towards concrete applications with the potential to strengthen the productivity and competitiveness of the economy.

Over the last years, the *energy* sector is confronted with strong demand growth coupled with limited and declining production capacity. The Bank supports investments in this sector with a focus on the strengthening of the electricity grid and investments in renewable energy under the Mandate (complemented by support to high energy efficient power generation capacity to the private sector under the Pre-Accession Facility).

Other projects supported include the first operation under the Climate Action Mandate in favour of Afforestation and Erosion control. For the period 2010-2011, Climate Action operations (mitigation and adaptation) accounted for 31 % of EIB financing in Turkey.

2) EIB activity in the Western Balkans

Sector (2007-11 in EUR mn)	**Mandate**	**%**	**Facility**	**%**	**Total**	**%**
Others	295	*10%*	257	*10%*	**552**	*10%*
Energy	67	*2%*	240	*9%*	**307**	*5%*
Global, Midcap, SME	1,120	*37%*	1,135	*43%*	**2,255**	*40%*
Industry	-	*0%*	534	*20%*	**534**	*9%*
Services	215	*7%*	78	*3%*	**293**	*5%*
Transports	1,101	*36%*	294	*11%*	**1,395**	*25%*
Water, sewerage	264	*9%*	82	*3%*	**345**	*6%*
Grand Total	**3,062**	***100%***	**2,619**	***100%***	**5,681**	***100%***
	Mandate	***54%***	**Facility**	***46%***		



The EIB has been involved in lending operations in the Western Balkans since the mid-1970s. During this period, the Bank has supported all key sectors of the economy, in both the public and private sectors. Following intervention in support of urgent rehabilitation and reconstruction of war damaged infrastructure at the beginning of the 2000s, the EIB focussed in supporting the region economic development and assisting individual countries on their path to EU accession.

Over the last 5 years (2007 – 2011), the EIB has achieved total signatures of some EUR 5.7bn in the Western Balkans. Lending volumes increased significantly as from 2009 onwards, reflecting the use of EIB financing as a tool to fight the impact of the global financial and economic crisis.

In this context, in line with the mandate decision, the Bank has significantly stepped up its lending on its own risk under the Pre-Accession Facility for private sector lending and, where possible, in line with its credit policy, in support of the public sector in credit-worthier countries (e.g. in Croatia). As a complement, the Pre-Accession Mandate was mainly oriented to the support of the public sector in weaker countries.

Transport infrastructure has historically been a key sector for EIB's intervention in the region, which includes several Pan-European Transport Corridors, whose completion will support regional integration, integration of the individual countries with the EU and support economic development.

Especially since 2008, the EIB stepped up its lending in favour of *SMEs*, highlighted in the framework of the Joint IFI Action Plan to support the banking sector in the region hit by the global economic crisis. This support has taken place either directly by supporting commercial banks in all countries of the region (including Kosovo), or through public sector development banks (Croatia, Former Yugoslav Republic of Macedonia, Bosnia and Herzegovina) operating in turn through local commercial banks, government guarantees for EIB loans in favour of local commercial banks (Montenegro) or loan to government then on-lent through local commercial banks (Serbia).

As for Turkey, one of the main challenges of the economies of the region is its low average productivity, which calls for a strengthening of the *knowledge economy*. In this context, EIB has financed several education projects (Albania and Serbia) and an ambitious Public sector R&D programme in Serbia.

For the period 2010-2011, *Climate Action* lending (mitigation and adaptation) was 1 % of EIB lending in Western Balkans.

2.4 EIB contribution to EU regional policy framework, including cooperation with the COM, the EEAS and with other IFIs

1) EIB Contribution in Turkey

The Commission has spelled out its priorities in the Multi-Annual Indicative Planning Document (MIPD) for Turkey in line with the provisions set out in the Instrument for Pre-accession (IPA). In this context, the enhanced strategic nature of the MIPD 2011-2013 and its clearer sector-based prioritisation as compared to the previous planning documents are helpful in better identifying the key priority sectors. Given the nature of EIB's lending support to the real economy, the Private Sector Development, Environment and Climate Change, Transport and the Energy sector are considered the most relevant for EIB's activity. Regarding component 3 of the MIPD (Regional Development), operational programmes for Environment, Transport and Regional Competitiveness are among the most important areas for contribution by EIB.

According to the Multi-Annual Indicative Financial Framework, Turkey will receive some EUR 2.6bn in pre-accession funds over the years 2011-2013. Whilst the amount of IPA funds is considerable and increasing, it remains relatively modest as compared to the size of the Turkish economy. A close EC-EIB co-ordination will enable to leverage the impact of the EU in Turkey. Several initiatives have been taken over the last years to bundle IPA and EIB funds through closer co-ordination and blending in co-operation with the Commission, the EU Delegation and the Turkish Authorities, the latter given also the increasing importance of the decentralised management of IPA funds. The EC-EIB co-operation has been particularly successful in the areas of railway financing, SME support as well as in the sector of Renewable Energy and Energy Efficiency.

Co-operation with IFIs and co-financing has increased significantly over the last years, following the co-ordinated anti-crisis efforts of the IFIs (2008-2010) and as EBRD has started operations in the country. The co-operation with EBRD is based on the new Tripartite MoU between the EC, the EIB / EIF, and the EBRD signed in early 2011. Excluding SME credit lines for partner banks (where co-funding with other IFIs is not meaningful), some 60% of the EIB transactions in 2011 included co-financing arrangements with other IFIs. In particular, co-financing with EBRD in the field of renewable and energy efficiency has developed significantly over 2010 and 2011. Also in terms of the development of local capital markets, other IFIs (and bilaterals) have teamed up with EIB/EIF to support innovative operations. The strong co-operation with IFIs / bilaterals is however mainly in the field of private sector operations, which EIB finances on its own risk and not under the Mandate.

2) EIB Contribution in the Western Balkans

Building on the experience of collaboration with European Agency for Reconstruction and several EC funded programmes (EPPF, DABLAS, etc.), as well as co-financing with other IFIs (EBRD, World Bank and CEB) and bilateral agencies (in particular KfW), the EIB has played a major role in the establishment of the *Western Balkans Investment Framework*

(WBIF), a major blending initiative designed to coordinate investment for the region[7]. The priorities of the WBIF are in line with those highlighted in the Multi-Annual Indicative Planning Document (MIPD) 2011-2013[8] (Private Sector Development, Transport and Energy Infrastructure, Environment and Climate Change, and Social Development).

The WBIF blends EU grants with contributions of the 3 Partner IFIs (EIB, EBRD and CEB), as well as grants from some 18 bilateral donors gathered in the *European Western Balkans Joint Fund (*EWBJF*)*, co-managed by the EIB and the EBRD. The WBIF grants support mainly preparation activities for priority projects to be financed by all participating donors but also capital investment.

Started in December 2009, the WBIF has so far supported 123 activities, with grants of 220mn. Of these EUR 167mn came from the EU budget, EUR 20mn from IFI contributions and EUR 33mn from bilateral grant sources of the EWBJF. . To date the 123 activities approved by the WBIF cover projects of a cost of EUR 10.6bn, for which EIB, EBRD, CEB and KfW have committed some EUR 6.2bn of loans. These projects represent already a significant share of the total EIB pipeline activity for 2012 (at the exclusion of loans for SMEs), and should represent a growing share in 2013 and 2014.

In the context of the WBIF, the EIB Group promoted the establishment of the Western Balkan Enterprise Development and Innovation Facility – EDIF – an innovative platform designed to enhance access to finance of SME in the Western Balkans. Through four different components of EDIF (two equity/quasi equity funds, a guarantee facility and a technical assistance facility), it will support the expansion of innovative and high growth SMEs in particular. EDFI is supported also by EBRD, who focuses on the high growth SME segment. The European Commission is the main donor of the Facility. The EU budget is expected to commit through the WBIF more than EUR 60 m of EU grants to the EDIF, or some 50% of the resources dedicated to the platform, which will be complemented by IFIs funding, other public donors (local) and private resources.

2.5 Operational focus for the remainder of the mandate period

1) Operational focus in Turkey

Local private sector development, in particular support to SMEs

Turkey has a strong entrepreneurial culture and SMEs are the backbone of the Turkish economy in terms of total number of enterprises and employment. These companies provide employment to approximately 64% of the workforce and represent some 36% of GDP.

Because of their lean organizational structure, SMEs can respond to changes faster than larger corporations. However, Turkish SMEs are faced with a number of structurally weaknesses, including lack of technology, R&D, innovation, and marketing techniques; lack of harmonisation to global standards, lack of quality and trademark concepts; and more generally an insufficient level of education. Notwithstanding the significant growth in the country’s banking activity and the increasing interest in SME financing, the lack of equity, as well as insufficient access to finance and credit guarantee systems remains a significant hindrance to their development. Whilst these weaknesses are faced by SMEs in many countries, the low development of the domestic financial markets exacerbates the problem of the lack of longer-

[7] Cf. http://www.wbif.eu
[8] http://ec.europa.eu/enlargement/pdf/mipd_multibeneficiary_2011_2013_en.pdf

dated debt. The longer duration of the EIB funded SME loans provides a much better match between the investment assets and liabilities for project promoters, thus reinforcing the economics and the financial sustainability of their investments.

The financing of *mid-sized companies* (mid-caps) should also be considered as part of the local private sector development. Mid-caps are typically more productive than SMEs and contribute significantly to employment, increases in competitiveness of the economy and exports. Mid-Caps have also a more developed corporate structure and as such are more capable of upholding environmental concerns.

SME and private sector lending should remain a high priority of the Bank in Turkey in the years to come, both in corporation with the public and private sector banking partners. The Bank, in close co-operation with the EIF should continue to seek opportunities for co-financing and blending in co-operation with EU Regional Programmes and the Turkish Ministry of Science, Industry and Technology Ministry to maximise the efficiency, impact and visibility of common action in favour of SMEs. Operations enhancing the development of local capital markets should also be considered in this context.

Investments in *research and development* orientated towards the strengthening of productivity and competitiveness of the economy is another critical tool in combating the low average productivity of the Turkish economy. In this context, EIB should consider further support to R&D programmes by leading public research institutes or private sector entities to underpin the country's growth potential.

Development of social and economic infrastructure

Notwithstanding the significant increase over the last decade, Turkey requires massive additional investments in social and economic infrastructure to underpin its economic growth and to meet the EU Acquis.

In the *transport* sector, the priorities will remain focused on the railway sector, including the priority transport corridor between Ankara to Istanbul, and on urban infrastructure schemes (e.g. Eurasia Tunnel, light rail). Further priorities will be projects that support the extension of TEN-T networks and promotion of safety.

The *environmental infrastructure* especially at local authority level requires huge investments in the areas of water, water treatment and waste management to meet the EU acquis. Whilst the Bank has financed a number of investments by the largest metropolitan centres, it should pursue its discussions with the Turkish Treasury and domestic partners to further widen its reach to include medium-sized municipalities in this respect.

The *energy* sector requires significant investments also in terms of storage, distribution and transmission capacity, the latter more in particular given the central role of Turkey in the context of the EU Energy Policy. Renewable Energy and Energy Efficiency should remain a priority sector for further Bank's support, also through a widening network of financial intermediaries to strengthen the Bank's support in favour of medium-sized investments.

Turkey is fundamentally vulnerable to earthquakes because of its geographical location between the tectonic plates of Eurasia and Africa/Arabia. The eastern provinces of the country along the East Anatolian Fault have been recently hit by major quakes, but also the Istanbul area stretching to Izmit and Duzce on the North Anatolian Fault are significantly at risk. Given Istanbul's predominant role in the country's economic fabric, any devastation from a major earthquake would have far reaching repercussions on the country's economy. Turkey has set up a dedicated investment programme with the aim of strengthening Istanbul's resilience to a major earthquake. The Bank developed a first *earthquake risk mitigation* facility in close co-operation with the World Bank in 2008 to support these investments. A widening of the investment programme should be considered for the years ahead.

In order to reinforce the country's *human capital potential*, the Bank should consider projects in support of the health and educational sector. Turkey is setting-up a significant investment programme in the health sector to strengthen the quality and efficiency of the healthcare system and enhance access to healthcare facilities. In this context, Turkey is undertaking an ambitious construction programme on a PPP basis of integrated health campuses across a wide range of cities. Given its extensive experience in the field of PPP financing, the Bank should consider making a significant contribution, thereby attracting other funding sources to this capital intensive sector.

Climate change mitigation and adaptation

Turkey is one of the most erosion-prone countries in the world, due to its topography, climate, vulnerability of soil type and the tendency towards overexploitation of rangelands and forests. Turkey's National Climate Change Strategy 2010-2020 identifies areas of key importance such as protection and improvement of natural forests, afforestation and measures to prevent forest fires and to reduce flooding risks as part of climate change mitigation and adaptation. In 2011, the Bank has provided a first dedicated Climate Change Facility to Turkey under the Climate Change Mandate in favour of the afforestation, erosion control, rangeland rehabilitation and forest fire fighting investments carried out by the Ministry of Environment and Forestry. More funding should be considered in the years ahead in support of the country's efforts in this respect.

In Turkey, floods rank the second among the natural disasters after earthquakes in terms of economic and human losses. The Bank should pursue its discussions with the relevant national agency to support its investments in the field of flood prevention. The project would aim at financing defined and prioritised flood prevention investments in areas of Turkey that have been exposed or expected to be exposed to substantial flood damage due to insufficient protection.

Turkey is in the initial stages of setting-up an ambitious investment programme to upgrade the energy efficiency standards of its public buildings, including schools, hospitals, etc. Currently, a study is being prepared to take a stock of the public buildings standards. Given the current state of the public sector buildings, a significant investment programme will be required to improve energy standards. The Bank should seek to support the investments in energy efficiency following the required decisions and prioritisation at the level of the Turkish authorities.

2) Operational focus in the Western Balkans

Local private sector development, in particular support to SMEs

The Bank should continue to support SME investments in the region through its lending operations, which remains a priority, both via public sector development banks and commercial banks.

In the context of the WBIF, the EIB Group will support the implementation of EDIF to enhance access to finance for innovative SMEs, start-ups and other high growth SMEs difficult to reach with ordinary SME loans. The instrument will offer equity and quasi-equity, as well as guarantee instruments, which will complement ordinary SME loan financing from

EIB and EBRD. In addition, a reform-oriented technical assistance package completes the offer of this innovative platform.

Development of social and economic infrastructure

The Bank should continue its support to the development of social and economic infrastructure in line with the priorities agreed between each country and the European Union as well as at the level of regional organisations (such as SEETO, ECS, etc.). This support should concentrate first and foremost on projects in transport and environmental infrastructure, however, health and education will also continue to be supported by the Bank. Where appropriate, these projects could benefit from technical assistance and grant financing from the WBIF. Priority should be given to the most mature projects (approved and signed projects) to improve the link between signatures and disbursements.

In light of the accession perspective of countries in the Western Balkans, it will be important to promote synergies between the WBIF and the support provided by the EU Commission and the IFIs through JASPERS, which prepares EU structural and cohesions funds projects post enlargement.

Climate change mitigation and adaptation

With climate change financing only representing 1% of EIB financing under the mandate in the Western Balkans in 2010-2011, the Bank is expected to gradually step-up its activity in this sector. This should be facilitated by the materialisation of climate change projects for which EIB is lead IFI under the WBIF.

In the Western Balkans, recent floods resulted in major human and economic losses and required urgent remedial action. The Bank will pursue its discussions with the authorities to support its investments in the field of flood prevention with the support of WBIF resources, based on its long standing experience in the sector, notably in the Czech Republic and other New Member States, and in line with what it is doing in Turkey.

Upgrading the energy efficiency standards of public buildings, including schools, hospitals, etc. will make a key contribution towards reduction of CO_2 emissions in each country of the Western Balkans. The Bank is expecting to continue to promote its energy efficiency products in the region, focusing in particular on the public sector. The Bank will identify with the relevant national authorities in close cooperation with other financing institutions (including Green for Growth Fund) specific investment programmes. Project preparation and implementation could be supported where necessary by WBIF resources.

Many climate action investments will cover more than one objective; for example sustainable transport (both climate mitigation and infrastructure) improved coastal protection against rising sea levels and floods (both climate adaptation and infrastructure) and energy efficiency in industrial context (both climate mitigation and private sector). The added aspect of climate action will support the sustainability of the other underlying objectives, reducing running costs and maintenance costs as well as greenhouse gas emissions.

3. EIB Financing in EU Neighbourhood and Russia

3.1 General context

The European Neighbourhood Policy (ENP), launched in 2004, was subject to a substantial revision in 2011 to adapt its goals and tools to recent political and social evolutions occurred in the EU's partner countries. Towards the Southern Mediterranean countries, the EU sent a clear message of solidarity and support to the peoples struggling for democracy, dignity, prosperity and security. Building on the achievements of the Eastern Partnership, the new policy was also a response to the call of the EU's Eastern European partners for closer political association and deeper economic integration with the EU.

The progress in the delivery of the new European Neighbourhood Policy was presented in the joint Communication of the Commission and the HRVP of 15 May 2012[9]. The reviewed European Neighbourhood Policy is based on new features, including a "more for more" approach. Only those partners willing to embark on political reforms and to respect the shared universal values of human rights, democracy and the rule of law have been offered the most rewarding aspects of the EU policy, notably economic integration (based on the establishment of Deep and Comprehensive Free Trade Areas - DCFTAs), mobility of people (mobility partnerships), as well as greater EU financial assistance.

It highlights the importance of mutual accountability between the EU and its partners, the need for partnerships not only with governments but also with civil society (e.g. NGOs, businesses, academia, media, unions, and religious groups) and recognition of the special role of women in reshaping both politics and society.

The new ENP approach also recognises the importance of differentiation and tailors relations to the level of ambitions of partners. It is therefore based on the respect for every partner's specificities and their own reform path. The new policy has enshrined greater flexibility and set out a framework for tailored responses, matching the specific requirements of the countries, their progress in undertaking reforms, and the nature of the partnership they seek with the EU.

The Commission has put forward "umbrella" financial programmes (SPRING[10] for the South and EaPIC[11] for the East) to make available more rapidly the additional funds announced in 2011, in order to support democratic transformation, institutional-building and further growth in the partner countries.

In light of the challenging economic outlook in Europe, the High Representative and the Commission have taken bold steps to mobilise financial assistance for transition in the Neighbourhood from outside the traditional community budget. This has included an increase in the lending ceilings of EUR 1.15bn to partner countries from the EIB, and an extension of the mandate of the EBRD to cover the countries of the Southern and Eastern Mediterranean.

A Civil Society Facility covering the entire neighbourhood was launched in September with an initial budget of EUR 26m for 2011 and similar amounts planned for 2012.

The **Southern Mediterranean region** is of strategic importance to the EU, in both economic (trade, energy, migration) and political (security, stability) terms. The events which took place in early 2011 (Arab Spring) are of historic proportion and they reflect a profound

[9] Delivering on a new European Neighbourhood Policy, JOIN(2012)14, 15 May 2012.
[10] Support to Partnership, Reform and Inclusive Growth.
[11] Eastern Partnership Integration and Cooperation.

transformation process with lasting consequences not only for the people and countries of the region but also for the rest of the world and the EU in particular. Regional problems call for regional solutions, and the Arab Spring reactivated desires to increase links with neighbours, which already had concrete consequences, e.g. in the Maghreb. This is a unique opportunity, and the EIB should support such revitalization through projects aiming at increasing South-South links.

The radically changed political landscape in the Southern Mediterranean determined a change in the EU's approach to the region. The EU response to the changes in the region was outlined in the two documents issued in March and April 2011: the Communication on a *Partnership for Democracy and Shared Prosperity in the Southern Mediterranean* [12] and the Communication *A new response to a changing Neighbourhood*[13]. The three main directions along which the EU intends to further develop its relations with its Mediterranean partners are: democratic transformation and institution building; a stronger partnership with the people; and sustainable and inclusive economic development.

The EU's **Eastern neighbourhood** is a region which is strategically important for the EU, for example in terms of security of gas, oil supplies from and through some of the countries as well as trade, but also in political terms. After deep changes following the fall of the Soviet Union, most countries of the region are undergoing transition towards democracy and market-based economy. On one side of the spectrum are countries (such as Ukraine, Republic of Moldova and Georgia) with clear European ambitions. On the other side is Belarus, with little prospect of change in the near future. Diverging foreign policy orientations, protracted conflicts, and a growing but still low level of inter-state cooperation further fragment and polarise the region. Russian claims for a dominant position in the post-Soviet area hamper EU's capacity to respond adequately to the challenges emanating from the Eastern neighbourhood. In 2009 the EU and Eastern Partners[14] launched the Eastern Partnership (EaP) as a specific dimension of the ENP to support partner countries' sustainable reform processes with a view to accelerating their political association and deep economic integration with the EU. The EaP Warsaw Summit (29-30 September 2011) decided to further strengthen the implementation of the EaP and called on the High Representative and the Commission to develop a Roadmap of the EaP[15].

The pace of reforms varies from country to country. In order to accelerate reform process, the EU will apply more regularly the principle of conditionality as proposed in the framework of the ENP Review and agreed at the EaP Summit in Warsaw.

Decision 1080/2011/EU has (temporarily and exceptionally) increased the regional ceiling for lending under the Mandate by EUR 148mn for the EU Eastern Neighbourhood and Russia and by EUR 1bn for the EU Southern Neighbourhood. The Decision specifies that EIB financing operations ensuing from this increase should respond to the political reforms undertaken by individual partner countries as assessed by the Commission with the involvement of the European External Action Service (EEAS) taking into account European Parliament resolutions and Council decisions and conclusions. The review of the ENP and the renewed emphasis on differentiation should also be reflected in that assessment.

Russia is the EU's third biggest trade partner, with Russian supplies of oil and gas making up a large percentage of Russia's exports to Europe. The EU-Russia strategic partnership's on-

[12] COM (2011)200

[13] COM (2011)303

[14] Armenia, Azerbaijan, Georgia, Republic of Moldova, Ukraine, and Belarus.

[15] Eastern Partnership: A Roadmap to the autumn 2013 Summit, JOIN(2012)13, 15 May 2012.

going cooperation is based on 4 specific policy areas or “common spaces”: common economic space; common space for freedom, security, and justice; common space for external security; and common space for education, research and culture. The Partnership for Modernisation launched in 2010 reinforces mutually beneficial cooperation in the common spaces and provides a framework for joint activities for societal, judicial and economic modernisation. Russia was not interested in being part of the ENP but wanted a relationship between equals with the EU, reflecting its size and importance.

The EU and Russia cooperate on dealing with a number of challenges, both at international level, as well as in our common neighbourhood. These include climate change, sustainable energy, drug and human trafficking, organised crime, crisis management cooperation, North Africa and the Middle East Peace Process, and Iran. Russia can no longer be considered a receiver of development-oriented EU assistance. Consequently, programme implementation such as for example in the case of Cross-Border-Cooperation is based on equality and partnership. Equality means an approach whereby programmes are jointly designed and managed.

A series of trade related questions prevented the European Commission from providing a favourable opinion to EIB support to projects in a number of sectors in Russia. The acceptance of Russia to the WTO was agreed in the WTO Ministerial meeting on 16 December 2011. Russia will be legally bound to the commitments undertaken in their WTO agreement once it has ratified the Accession treaty. Russia’s observance of WTO rules and commitments related to WTO membership will be closely followed. The European Commission will continue to look at projects on a case-by-case basis while the EIB should focus its activity on sectors without problematic trade issues, particularly on priorities of the Partnership for Modernisation (P4M).

The cooperation with Libya

Following the conflict in Libya and the establishment of an Interim Authority, Libya now faces major challenges stabilising the country and taking forward a process of democratic transition. Although rich in resources, Libya which has been made eligible by Decision 1080/2011/EU, could benefit from financing in particular as regards efforts to diversify the economy and to restore infrastructure in priority areas for the EU. Following the recent elections on 7 July, the EIB is waiting for the newly elected General National Congress to replace the National Transitional Council and to appoint a prime minister which will form a new Government. Once the new Government is in place, the EIB will be able to start discussing the framework arrangement with the country.

The cooperation with Syria

The Council and the European Parliament have already explicitly invited the EIB not to approve new financing operations in Syria for the time being respectively in the Council Conclusions of 23 May 2011 and in the European Parliament Resolution of 7 July 2011. Thereafter, the Council adopted a further series of restrictive measures against Syria, including the prohibition of disbursements by the EIB in connection with existing loan agreements between Syria and the EIB. In this context, the Commission, in accordance with Article 4(2) of Decision 1080/2011/EU, has issued a delegated act[16] to remove Syria from Annex III of Decision 1080/2011/EU for the time being.

[16] COM(2012)615

The cooperation with Belarus

For the time being, Belarus is not eligible to EIB financing under Decision 1080/2011/EU.

3.2 Regional macroeconomic situation / business climate situation

1) Macroeconomic situation/ business climate in Southern Neighbourhood

Although the South Mediterranean countries weathered the global financial crisis relatively well, partly on account of the economies' low financial and trade integration and in some cases (e.g. Morocco and Tunisia) reflecting their room for counter-cyclical fiscal policies, the social and political turmoil of 2011 has damaged growth prospects throughout much of the region and has taken some of the momentum out of the recovery which started in 2010. Exports have been hit, particularly tourism; remittances have been affected, notably in the Maghreb region due to the conflict in Libya; and the gradual revival in foreign investment, which was already at low levels due to the global economic crisis, is set to be more drawn out. On the domestic side, strikes and demonstrations have disrupted activity, unemployment pressures have intensified and consumer confidence has been shaken. Libya and Syria have been most severely affected due to the long-lasting civil conflict and neighbouring economies, notably Tunisia, Egypt, Lebanon and, to a lower extent, Jordan have suffered a significant slowdown. In sharp contrast, growth has held up in countries where social tensions have not boiled over, such as in Morocco and Israel. Excluding Libya, real GDP growth in the region is estimated to have grown by nearly 2% on average in 2011. Regional instability has also weighed on financial market conditions, raising the cost of external financing. Stock indices have overall fallen since the outbreak of the Arab Spring, including in countries less affected by the social unrest, such as Jordan and Morocco. On the other hand, exchange rate pressures have been in most cases moderate and banking sectors, which dominate the region's financial system, have on the whole remained stable, although the rate of non-performing loans has started to increase, notably in Egypt. Public finances have also been under strain due to higher borrowing costs, reduced revenues and the adoption of fiscal measures (including increases in outlays for food and energy subsidies and in public sector wages) aimed at assuaging social tensions. In light of these developments, the IMF has estimated that MENA oil-importing countries will face external and fiscal financing needs of more than USD 200 bn in total during 2012-2013 and, with capital markets providing only a small part of these funds and at a higher cost, official financial support would be essential.

Despite the direct economic impact of the political unrest, the investment climate has overall improved throughout the region according to the World Bank's Doing Business Report and even the most severely affected countries, such as Egypt and Tunisia, have managed to retain their previous rankings. This improvement has been the outcome of reforms, including strengthening investor protection, simplifying paying taxes, and facilitating business start-up and access to credit. At the same time, persisting political instability in some countries raises concerns about their business environment.

The outlook for 2012 and 2013 is equally challenging with downside risks mainly related to domestic political uncertainty, the global economic dynamics, the trend in international commodity prices and the potential impact of the euro zone sovereign debt crisis. Within this context, economic recovery will be slow with average GDP growth broadly remaining at the 2% level in 2012, before picking up to around 3.5% in 2013 (again excluding Libya), while employment will at best stabilize at high levels. To deal with these challenges, South Mediterranean countries need to advance with structural reforms aimed at promoting sustainable and inclusive growth and at fighting unemployment. Replacing generalised energy and food subsidy systems with targeted social transfers; reforming energy labour markets; strengthening educational systems; fostering the role of the private sector; improving economic governance; and deepening international and regional trade integration are key policy challenges of the region.

2) Macroeconomic situation/ business climate in Eastern Neighbourhood and Russia

The EU's **Eastern neighbours** have embarked on a recovery that gradually solidified during 2010 and 2011, after having been hit hard by the crisis (with the exception of Azerbaijan). Macroeconomic, financial and balance-of-payments vulnerabilities have been reduced, often supported by external assistance from institutions such as the IMF and the EU. Crucially, private capital flows to the region started to recover in tandem with a general improvement in investor attitudes towards emerging markets. Real GDP advanced by about 4.8% on average in the region in 2011. Growth was supported by strong commodity prices and the economic recovery of Russia, a main destination for the region's exports and migrant worker flows. Top economic performer in 2011 was Georgia with real growth of 7%, followed by Moldova at about 6.4%. In Armenia and Ukraine, the economic recovery accelerated with annual real GDP growth of 4.6% and 5.2% respectively. An exception to this trend is Azerbaijan which originally managed to avoid a recession during the global crisis, cushioned by the buffer oil fund built up in previous years. However, growth in Azerbaijan almost stagnated in 2011 as production in the oil and gas sector was halted due to maintenance works. Belarus is clearly out of step with the economic cycle in the rest of the Eastern neighbourhood and is expected to experience a sharp slowdown from the second half of 2011 as it underwent a currency crisis and serious macroeconomic instability. For 2012, however, downside risks to growth have increased for the entire Eastern neighbourhood region, due to the global economic slowdown and the potential impact of the euro zone sovereign debt crisis. However, the still robust economic performance of Russia is expected to cushion the deceleration in 2012.

As access to external financing may become again more difficult given the renewed international financial turmoil, the still prevalent pre-crisis growth model of the region, characterised by an over-reliance on external financing and insufficient channelling of this financing into productive capital formation raises some concerns. There is a potential for macroeconomic imbalances and vulnerabilities to re-emerge, unless the EU's Eastern neighbours implement policy measures to diversify and re-balance their growth model. The current account deficits of the oil importers declined during the crisis and its aftermath, showing less reliance on foreign savings. But they remain high at about 10% of GDP (with the exception of Ukraine, where the current account deficit is at around 6% of GDP) and have recently widened again in some countries. A major contributor to the external adjustment was the ambitious fiscal consolidation process taking place in Armenia, Georgia, and Moldova. Exports have also rebounded strongly in most of the economies in the region but they are facing a more challenging global environment now. Finally, the financial sectors remain fragile due to high shares of non-performing loans and are still vulnerable to spillovers from the rest of the world and capital outflows, as it happened during the global financial crisis. Average inflation has remained in 2011 at a level below but close to 10% in most of the Eastern neighbours and exceeded 50% in Belarus. A number of countries responded by tightening their monetary policy, but this stance may be challenged by the fallout from the worsening external environment.

The investment climate has gradually improved in 2011 and most Eastern neighbours (except for Ukraine) advanced in the World Bank's Doing Business Report and now rank in the first half of the country ranking. Main reforms were related to strengthening investor protection, simplifying paying taxes, improving the legislation for enforcing contracts and resolving insolvency and facilitating starting a business and getting credit. At the same time, the overall global competitiveness of these economies is less favourable due to factors that only indirectly affect the ease of doing business, such as political instability, inefficient public sectors and relatively high levels of corruption. Key policy challenges for the Eastern neighbours relate to improving public and corporate governance; strengthen financial systems, including through improved banking regulation and supervision; reforming the energy sectors, via privatisation, unbundling of large state-owned monopolies and aligning domestic energy prices to costs; and pursuing trade liberalisation, including by negotiating DCFTAs with the EU.

Russia's growth outlook is still strongly dependent on international commodity prices, and a considerable amount of non-performing loans continues to inhibit credit growth. Economic growth is expected to decelerate slightly from 3.9% in 2011 to 3.8% in 2012 and to edge up to 4.0% in 2013. With expected GDP growth of around 4% a year, growth will remain below the rates achieved before the crisis. Exports accelerated in 2010, but the sluggish expansion in the oil and gas sector (where some existing fields are almost depleted), combined with the negative demand effects of the euro-area sovereign debt crisis, are likely to limit export volume growth in 2011 and 2012. In the second half of 2011 higher agricultural output could partially boost exports. Imports increased strongly in 2011 due to the strengthening of domestic demand. Growth in consumer spending and investment activity increased in 2011. Overall, the current-account surplus is expected to decrease to 4% of GDP in 2012 and to 3.8% of GDP in 2013, mainly due to assumed lower oil prices. Inflation picked up to almost 10% by January 2011 mostly due to higher food prices following widespread damage to crops caused by forest fires in August 2010. CPI moderated to 7.4% on average in the second half of 2011, slowing down from 9.5% on average in H1 2011. CPI continued moderating in the first months of 2012, amounting to 4.2% in January, 3.7% in February and March. This downward trend was largely driven by lower food prices, following a very good harvest in summer 2011.

The Central Bank of Russia (CBR) increased the refinancing rate to 8.25% on 3 May 2011, while cutting it to 8% on 26 December 2011. The CBR manages the rouble against a USD/EUR basket made up of 55 cents of a USD and 45 cents of a EUR. The rouble appreciated in the first half of 2011 as a result of surging oil prices. Starting in August 2011, Russia experienced a significant weakening of its currency in reaction to the uncertain global outlook. However, in the first quarter of 2012 the rouble appreciated again by 7.2% versus the dual-currency basket.

3.3 Brief overview of EIB activity to-date

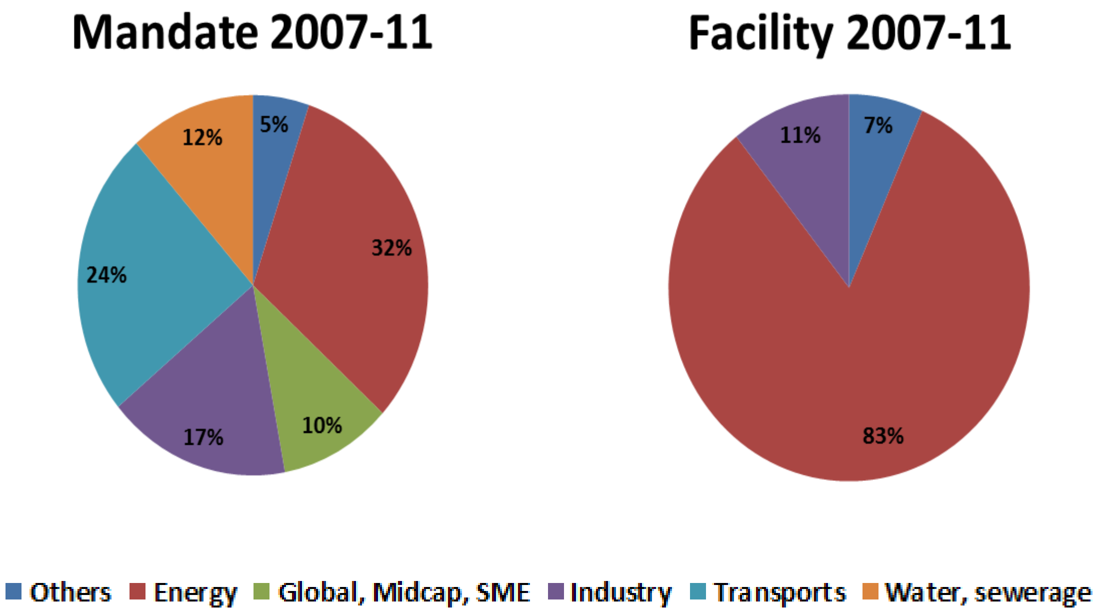
The EIB lends in the EU Neighbouring region primarily on the basis of the External Mandate, which has a ceiling of EUR 13.548bn over the period 2007-13, broken down into indicative sub-ceilings of EUR 9.7bn for the southern and 3.848bn for the Eastern neighbours and Russia. The Climate Change Mandate is providing an extra envelope of up to maximum of EUR 1bn for climate change operations in this region.

Secondly, the EIB carries out own risk operations under the Mediterranean Partnership Facility II (authorized amount EUR 2bn for 2007-2013) and the Eastern Partners Facility (authorized amount 1.5bn for 2010-13).

In the Mediterranean region, the EIB also manages EU budgetary resources for technical assistance and risk capital activities as well as the FEMIP (Facility for Euro-Mediterranean Investment and Partnership) trust fund. The figures for these activities are not covered in the tables below, however, the FEMIP risk capital envelopes totalled around EUR 120mn between 2007-11 (‘08: EUR 62mn; ‘09: EUR 27mn; ‘10: EUR 21.5mn; ‘11: EUR 10mn).

1) ***EIB activity in Southern Neighbourhood***

Sector (2007-11 in EUR mn)	**Mandate**	**%**	**Facility**	**%**	**Total**	**%**
Others	355	*5%*	55	*7%*	**410**	*5%*
Energy	2,160	*32%*	685	*83%*	**2,845**	*37%*
Global, Midcap, SME	707	*10%*	-	*0%*	**707**	*9%*
Industry	1,157	*17%*	89	*11%*	**1,247**	*16%*
Transports	1,673	*24%*	-	*0%*	**1,673**	*22%*
Water, sewerage	793	*12%*	-	*0%*	**793**	*10%*
Grand Total	**6,845**	***100%***	**829**	***100%***	**7,674**	***100%***
	Mandate	***89%***	**Facility**	***11%***		



EIB has been providing finance in the Mediterranean region for 33 years as part of the long-term partnership between the EU and its Mediterranean neighbours. It has built up this activity over time and now operates within the framework of the FEMIP, which has become the leading source of external financing for modernising and opening-up of these countries’ economies, through infrastructure and private sector investments.

Since its inception in October 2002, the FEMIP combines EIB loans and loan guarantees with EU and Member States budgetary resources, which are used by the EIB for technical assistance and risk capital. The Facility was reviewed in 2006 by the ECOFIN Council, which decided to further reinforce it.

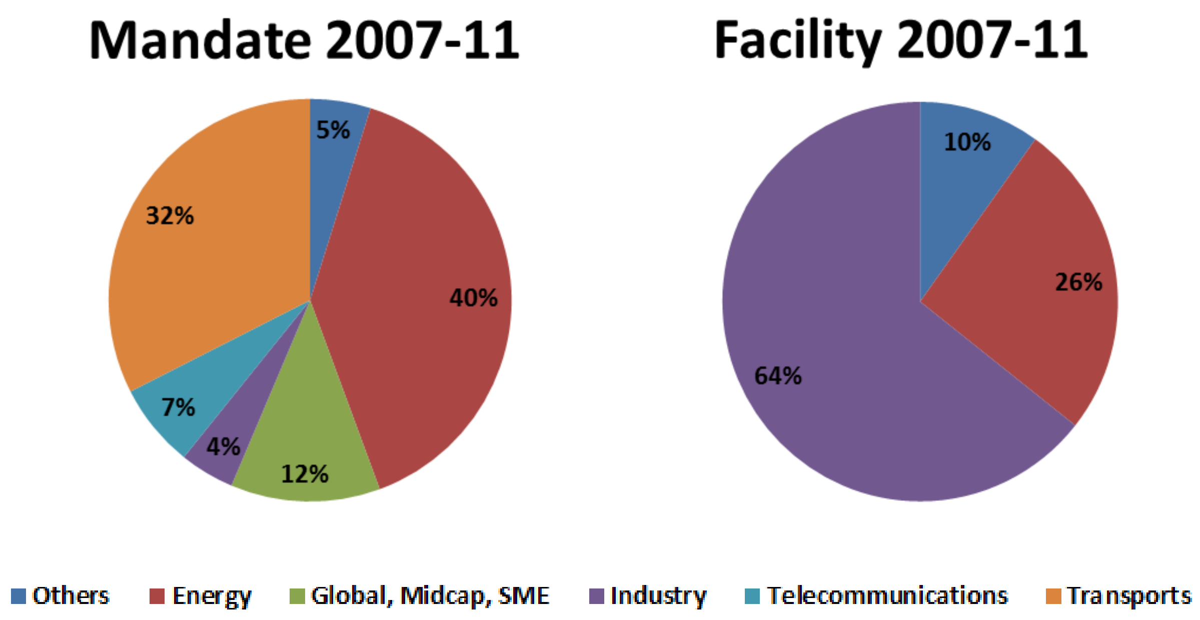
Over the period 2002 – 2011, FEMIP deepened its activity year by year, reaching EUR 13bn of investments since 2002 and mobilising roughly EUR 35bn of additional capital.. In 2011, the EIB invested around EUR 1bn in the region under FEMIP: 51.6% of FEMIP financing was implemented in the Maghreb, 43.4% in the Near East and the remaining on a regional basis. The bulk of the investments were realised in the energy (mainly gas power, gas and power transmission lines and renewables), transport (mainly motorways, roads, urban railways and seaports), industry (mainly fertilizers and refined petroleum products, and some chemicals, cement, motor vehicles) and water *sectors*. The main recipients of loans under the current Mandate are Morocco, Tunisia and Egypt (together 64%).

Sustainable employment creation always remained a top priority for the EIB in the Mediterranean. Since its creation in 2002, FEMIP has provided its support to over 2,400 SMEs creating an estimated 30,000 new jobs. In addition, through its direct lending operations, over the period 2007 – 2011, the EIB created nearly 13,000 permanent jobs and some 28,000 temporary ones in the partner countries.

For the period 2010-2011, *Climate Action* lending (mitigation and adaptation) was 18 % of EIB lending for Southern Neighbourhood.

2) EIB activity in Eastern Neighbourhood and Russia

Sector (2007-11 in EUR mn)	Mandate	%	Facility	%	Total	%
Others	83	*5%*	10	*10%*	**93**	*5%*
Energy	675	*40%*	26	*26%*	**701**	*39%*
Global, Midcap, SME	205	*12%*	-	*0%*	**205**	*11%*
Industry	75	*4%*	65	*64%*	**140**	*8%*
Telecommunications	115	*7%*	-	*0%*	**115**	*6%*
Transports	555	*32%*	-	*0%*	**555**	*31%*
Grand Total	**1,708**	***100%***	**101**	***100%***	**1,809**	***100%***
	Mandate	***94%***	**Facility**	***6%***		



The mandate governing EIB activity in Eastern Neighbourhood countries has broadened in size and scope since 2001, when the first EUR 100mn mandate for Russia alone was introduced. A further EUR 500mn was made available for the period 2005 - 2007 and covered Russia, Moldova and Ukraine.

The current mandate runs from 2007 - 2013 and covers Ukraine, Moldova, Armenia, Azerbaijan, Georgia and Russia. To date, the Bank has extended financing in the four Eastern Partnership (EaP) countries that signed a Framework Agreement for Financial Cooperation with the Bank (Armenia, Georgia, Moldova and Ukraine) and in Russia; Azerbaijan is expected to sign its Framework Agreement with the Bank in 2012.

As of mid-2009, as a follow up to the priorities established under the Eastern Partnership, the EIB started providing loans for SMEs via banks in Eastern Partnership countries. The scope of the mandate in the region was significantly broadened by Decision N° 1080/2011/EU of 25 October 2011. Understandably, the operational implications of this sectoral broadening have not yet materialised in loan signatures.

Since 2007, EIB financing in the Eastern Neighbourhood and Russia under the Mandate totalled EUR 1.7bn, supporting 23 projects in all five countries which signed a Framework Agreement with the Bank (with Ukraine having a share of over 50%, followed by Russia with 22%). EIB financing in this region increased significantly in 2010-2011, totalling EUR 1.4bn.

The overall sectorial distribution at end-2011 still reflects the former focus of the Mandate in the region, i.e. projects of significant interest to the EU in transport and energy (accounting for 72% of the Bank lending in Eastern Neighbourhood and Russia), telecommunications and environmental infrastructure. However, from 2010 onwards a sectoral diversification has started to take place, a trend which is likely to become more eminent, also due to the broadening of the sectoral remit resulting from the revision of the mandate. The strengthened Bank’s activity in Eastern Neighbourhood countries and Russia represents a visible contribution to the EIB’s enhanced support to the EU Neighbourhood policy. For the period 2010-2011, Climate Action lending (mitigation and adaptation) was 11 % of EIB lending for Eastern Neighbourhood and Russia.

3.4 EIB contribution to EU regional policy framework, including cooperation with the COM, the EEAS and with other IFIs

Cooperation with the Commission

Cooperation with the **European Commission** is instrumental for the Bank's activities with the EU’s Southern and Eastern neighbours. Synergies and complementarities between EIB financing and EU funds from the European Neighbourhood Policy Instrument (ENPI), both at regional and country level, to support EU policies have been exploited via several avenues. Some of them have been institutionalised, as in the case of the FEMIP Committee, where the Commission is represented, or the **Neighbourhood Investment Facility** (NIF), in which the EIB is an active player.

NIF is an innovative financial mechanism – complementary to FEMIP in the Southern Neighbourhood - aimed at mobilising additional funding to cover the investment needs of the Neighbouring region. The NIF has been designed to finance capital-intensive energy and transport infrastructure, address common environmental challenges and to support smart, sustainable and inclusive growth, in particular through support for SMEs, in neighbouring partner countries. The Facility brings together grants from the European Commission and the EU Member States with loans from European public Finance Institutions, in particular the EIB. By pooling different resources, the NIF plays a key role in donor coordination and increasing aid effectiveness in accordance with the Paris Declaration and the Accra Agenda for Action. EIB is a key active player in the Facility and at the same time administers the NIF Trust Fund, which complements the Commission’s NIF resources.

The EIB manages in the context of FEMIP and on behalf of the EU a budgetary envelope for risk capital and technical assistance (EUR 32mn per annum for 2007-13) in order to support the private sector and create an investment-friendly environment in the EU Southern Neighbourhood.

Another avenue of cooperation is the "Charter for Enterprise", an initiative supported by the EC and adopted by the Euro-Mediterranean Industry Ministers in 2004. This represents a platform for Euro-Mediterranean cooperation, to which the EIB is contributing through its “access to finance” thematic area, which covers the credit environment and financial facilities for enterprises.

Synergies with EC have also been created in many areas related to horizontal activities such as Horizon 2020, the Maritime and Land Highways and the Mediterranean Solar Plan, all priority areas of the Union for the Mediterranean (UfM). In the maritime field, the EC, the International Maritime Organisation (IMO) and FEMIP are cooperating through the elaboration of a study which builds upon the experience of the three institutions. The EIB also plays a crucial role in depollution of the Mediterranean, inter alia through direct contribution to the MeHSIP[17] programme. As regards to the Mediterranean Solar Plan (MSP), the Bank and the EC support the elaboration of the MSP Master Plan led by the Secretariat of the UfM and will actively participate in the working group on the MSP financial implementation, paving the way for the financing of concrete renewable energy projects through different financial mechanisms.

In line with the Memorandum of Understanding signed in January 2011, the EIB and the **Secretariat of Union for the Mediterranean (UfMS)** cooperate with a view to implement UfM priority projects, notably: the Depollution of the Mediterranean Sea, the Mediterranean Solar Plan, the Land and Sea motorways, and the Mediterranean Business Development Initiative and the urban dimension (Urban Development Platform Financial Initiative UDPFI). This collaboration in association with the EC and other financial institutions aims at facilitating the set-up of specific financial and non-financial instruments that would accelerate the development of bankable project in the UfM priority areas.

Regarding **Russia**, the EIB has maintained a continuous dialogue with the EC and EEAS with a view to identifying how the EIB could support the Strategic Partnership between the EU and Russia, in particular the Partnership for Modernisation between the EU and Russia. This dialogue will be pursued, taking into account the recent accession of Russia to the WTO, which is likely to help to address some of the sectoral issues that have prevented the EC from supporting EIB financing in Russia in certain sectors. To lay the basis for such cooperation over the medium term, the EIB signed a MoU with the Russian VEB in June 2011, in the context of the Summit between the EU and Russia.

Cooperation with other IFIs

EIB closely cooperates with the **other International Financial Institutions (IFIs)** and is taking new steps towards more solid and sustainable partnerships: with EU neighbours, which share common values; the EBRD who expanded its geographical scope to the Mediterranean; the UfMS, which complements the Euro-Mediterranean institutional architecture; and European financial institutions to ensure complementarity, coherence and effectiveness. On top of informal coordination already on-going within the Luxembourg Group (WB/IFC, IMF, EIB, EBRD, EC/EEAS), the EIB will seek systematic cooperation for co-financing with other International Financial Institutions (especially under the G8 Deauville Partnership).

[17] Mediterranean Hot Spot Investment Programme

In the **Southern Neighbourhood**, cooperation with other IFIs, Governmental organisations and NGOs is considered important. EIB already co-financed 63% of its activities in 2011 with other public financial institutions, in particular KfW and AFD. In this context, the Mutual Reliance Initiative (MRI) between the EIB, AFD and KfW should be mentioned. Its aim is to promote efficient project co-financing by various financing institutions through the mutual recognition of procedures. The objectives are to simplify project appraisal and monitoring, reduce transaction costs and develop “best practice” for the division of labour, which could be extended to other partners and donors. In 2010, the cooperation with AFD and KfW was reinforced through the signature of the Tripartite Agreement on Mutual Reliance. To date, nine pilot projects have been selected for the FEMIP region, all of them stemming from the commonly established NIF project pipeline. In 2011, seven projects were co-financed with AFD and/or KfW. Moreover, the Bank is actively exploring the potential for cooperation with KfW and AFD where relevant in Eastern Neighbourhood countries. In addition, coordination meetings have been and will continue to be held on a regular basis, both at operational and senior management levels between the Bank and its peers.

In addition, in the spirit of the Deauville Partnership that calls on international financing institutions to deliver coordinated support to the EU Southern Neighbourhood, the European Commission, the EBRD and the EIB Group are working on an extension of the existing tripartite MoU to the southern Mediterranean region and are coordinating in Technical Assistance initiatives in the fields of Energy and PPPs.

In the **Eastern Neighbourhood**, the EIB and EBRD have a long tradition of cooperation since the 1990s, as demonstrated by the high percentage of Bank operations structured as co-financing with EBRD: 83% of the EIB lending activities in Eastern Neighbourhood Countries and Russia to date are co-financed with the EBRD (17 operations out of 27).

Following the signature of the new Tripartite MoU on 1st March 2011 between the EC, the EIB Group and the EBRD, a new framework for cooperation in particular in the Eastern neighbourhood[18] has been established in order to better organise the co-operation between the EIB and the EBRD, focusing on complementarity, additionally, and efficient use of their respective resources with the view to enhance the combined impact of the two Banks’ respective operations, in the interest of beneficiary countries and of the respective Banks’ shareholders. The new framework of cooperation is based on distinct and complementary mandates and business model of each Bank, and areas of cooperation were clearly identified on that basis.

Mutual reliance based on mutual recognition of procedures and standards and – to the extent possible, in particular for Pre-accession and Neighbourhood countries – harmonisation of standards (including on procurement and environment) will be pursued and developed to provide the building blocks for intensified cooperation, which both Banks recognise as an important element to enhance the efficiency and impact of joint operations. The two Banks will also investigate further the possibilities for cooperation in lending in local currency in cooperation with the beneficiary countries.

The EIB also aims at deepening its cooperation with the other IFIs active in the Eastern Neighbourhood Countries and Russia, in particular the World Bank group, the Asian Development Bank (in Southern Caucasus countries) and the Nordic Investment Bank.

[18] As mentioned, the new MoU has also been extended to cover Pre-Accession region.

3.5 Operational focus for the remainder of the mandate period

1) Operational focus in the Southern Neighbourhood

Local private sector development, in particular support to SMEs

The Mediterranean economies are characterised by high levels of unemployment and an unequal distribution of wealth. Supporting inclusive sustainable economic and social development is one of the objectives of the renewed approach of the ENP as outlined in the recent Communications. It should be instrumental in supporting the democratisation of the economy, in a context where SMEs constitute the key driver for economic and social progress and have a critical role to play in job creation. The combination of this with the envisaged strengthening of trade ties with willing and able partners should provide a powerful stimulation of economic growth and competitiveness and hence a significant support to economic recovery.

In the current context in the region, the EIB should continue *supporting the SMEs and private sector* employment growth companies and creating an enabling environment for them in the Mediterranean region as one of the main priorities for the future. In particular, as stated in the Decision 1080/2011/EU, EIB should continue to actively cooperate with local financial intermediary institutions in the Mediterranean countries, in order to ensure an effective transmission of the financial benefits to their clients and to provide value added compared to other sources of finance. In this context, the financial intermediaries' activities in support of SMEs should be fully transparent and be reported regularly to the EIB. Moreover, where appropriate, through its cooperation agreements with those intermediary institutions, the EIB should request that clients' projects are checked against agreed criteria in line with its development indicators so as to provide added value. Finally, EIB should facilitate the creation of new financial products (e.g. to facilitate local currency lending), a step that is necessary to unlock the potential of the smallest SMEs to grow.

These operations should complement FEMIP private equity operations carried out with budgetary and FEMIP Trust Fund roles which aim both at financing Micro, Small and Medium-sized Enterprises (MSMEs) and improving the financial practices implemented in the Mediterranean partner countries. Risk capital resources should be deployed through a combination of direct investments, co-investments with pre-selected local intermediaries and investments in microfinance institutions, in order to target small operations with high value added. Microfinance operations are expected to lead to the creation of new, well-governed microfinance institutions or help existing ones to grow responsibly and fully integrate into their local financial sector.

Development of social and economic infrastructure

Energy and transport, together with environmental (mainly water) infrastructure remain a high priority of the operations in the region, complemented by investments promoting the communication, health and education sector.

A necessary condition for the sustainable economic development of the Mediterranean region is setting up of integrated, safe and efficient *transport* networks between the two shores of the Mediterranean. As part of its goal to improve the economic environment of the partner countries, EIB should help to set up an integrated and effective Euro-Mediterranean transport system, with specific focus on the improvement of the extension of trans-European transport networks (TEN-T) interconnections, including at sub-regional level (e.g. in Maghreb). This would also be part of the "Maritime and Land Highways" initiative, identified as an UfM priority project in the Joint Declaration of the Paris Summit in July 2008. The Bank should also further support rails and road interconnection development in the region which are key elements of further regional integration.

As regards urban development projects, the creation of new towns to address problems of housing stress, seen as a solution by many governments in the region, has important environmental and social implications that need to be given adequate attention. In this context, EIB should ensure that the supported projects comply with international standards and regulations and that the promoter display adequate technical capacity or governance skills in order to ensure both proper project implementation and good quality in monitoring/reporting tasks. Moreover, these projects should be in line with the UfM rehabilitation of historic urban centres programme ("Medinas 2030"), supported by EIB. Urban transport projects should be supported to address growing mobility and congestion problems.

With regards to the *energy sector*, the security of energy supplies, renewable energy, energy efficiency as well as coordinating the financing of the MSP – one of the UfM's priority - projects should remain a priority for EIB. As energy demand is expanding fast in most of the Mediterranean countries, there is a need to invest substantially to develop energy infrastructure, including the development of gas and electricity distribution infrastructure. Southern Mediterranean is strategically important for the EU in terms of security of gas and oil supplies from some of the countries but also more broadly in terms of transit from the region and beyond. The EU intends to build an EU-Mediterranean partnership in the production and management of renewables, in particular solar and wind *energy*, and to have a joined-up approach to ensuring energy security notably in support of the MSP. In the mid to long term, this process would contribute to establishing a form of 'EU-Southern Mediterranean Energy Community'.

Decision 1080/2011/EU specifically mentions water and sanitation as an important area of *environmental infrastructure* in which EIB should operate. This is all the more valid for the Mediterranean region, where, on its Southern and Eastern shores, 60% of urban areas with a population of more than 100 000 still discharge their wastewater into the sea. Moreover, one of the leading projects supported by the UfM is the "de-pollution of the Mediterranean Sea".

In the water and solid waste sectors, the Bank should follow three main strategic axes: (i) the de-pollution of the Mediterranean, (ii) improved water security and resources management, including treated effluent reuse and climate action adaptation through the implementation of the Union for the Mediterranean's Strategy for Water in the Mediterranean ("SWM") and (iii) climate action (with a special focus on adaptation to water-related climate impacts and reduction of greenhouse gas emissions from landfills). In addition to these three main strategic axes and building on the UNEP-MAP EIB joint Horizon 2020 Initiative and cooperation with Blue Plan, the Bank should follow the implementation of priority projects in the water and solid waste sectors.. In the solid waste sector efforts should aim at reducing the adverse environmental and health impact from improper disposal of waste through construction of new regional sanitary landfills and improving efficiency in waste transports through transfer stations. Efforts to increase the level of material and energy recovery from the waste stream should be considered where feasible and appropriate.

The use of electronic *communications* technologies was at the heart of the wave of upheavals in the Mediterranean countries. Any further development in the Information and Communications Technology area will imply additional regulatory reforms to exploit the full growth and productivity potentialities of the sector. Mediterranean partner countries, with few exceptions, can be characterised as having moderate mobile and low fixed line penetration, very low broadband availability, unclear telecommunications regulation and limited competition, as well as low diffusion of e-government services. To address the shortcomings of the current ICT infrastructure, EIB should mainly focus on: (i) bridging the digital divide by supporting network expansion in rural and poorly served areas; and (ii) promoting open competition between mobile and fixed line services operators to increase the efficiency of markets and bring down the end-consumer prices.

Tackling high levels of illiteracy is key to promoting democracy and ensuring a qualified workforce to help modernise the Southern Mediterranean economies through adequate education infrastructure. Demographic trends indicate a rapidly growing youth that needs appropriate education and training facilities for achieving employment goals. Improving the health systems in the region should also be a crucial factor in social cohesion and in the improvement of the citizens' quality of life. The Bank should therefore continue to finance, through direct loans, projects in the field of *education and health* in the Mediterranean countries. In the education sector, the Bank should support national school-building programmes, with the emphasis on rural areas. In the health sector in particular, the primary objective should be to optimise the allocation and use of scarce healthcare resources to improve the health of the population of a particular region or country, whilst ensuring access to safe, appropriate and effective healthcare interventions.

In order to develop appropriate instruments to address challenges faced when financing larger infrastructure projects, the Investment Security in the Mediterranean (ISMED) initiative was created, where the EIB is actively participating in the Working Group set up under ISMED. The EIB has proposed two projects under NIF (for guarantees and PPPs in the Southern and Eastern Mediterranean) which could support ISMED priorities.

Climate change mitigation and adaptation

The Mediterranean region, in particular its Southern and Eastern rims, is expected to be one of the regions most affected by climate change. A recent FEMIP study evaluated the costs of on human development of not taking action on climate change, specifically in relation to agriculture, tourism, infrastructure, and urbanised coastal areas, where 80% of the population will be concentrated by 2030. Considering the high costs of not taking action, the study showed that investing today in this field could generate economic benefits of about EUR 22bn by 2015.

As far as EIB financing climate action in the region is concerned, key focus areas should include: renewable energy (including efforts for the implementation of the MSP); energy efficiency; research and innovation; sustainable transport; urban infrastructure; water; agriculture; forestry (including national parks, but also afforestation), water basin management coupled with erosion control and biodiversity, adaptation and carbon markets. EIB will systematically screen projects in these areas for their climate action potential, and implement project including through the Mediterranean Climate Change Initiative (MCCI).

2) Operational focus in the Eastern Neighbourhood

Local private sector development, in particular SMEs

Most Eastern Neighbourhood countries have weak and poorly diversified economies that remain vulnerable to external shocks. They are characterised by high levels of unemployment and an unequal distribution of wealth. SMEs are relatively under-developed and have been confronted by a lack of funding due to under-developed capital markets and a financial sector still in transition. As highlighted in the above section on the MED region, supporting inclusive sustainable economic and social development, including through support to SMEs, is one of the objectives of the renewed approach of the ENP.

The EIB should extend its support to the SMEs sector in the Eastern Neighbourhood region as one of the main priorities for the future. Operations might also be dedicated to specific areas like the promotion of a green economy, e.g. by encouraging investments in more sustainable and resource efficient production processes in industry, constructions, agriculture and food processing. To effectively reach out to SMEs, the EIB intends to cooperate with local financial intermediaries, including subsidiaries of foreign banks and locally-owned financial institutions, both public and private. The EIB should ensure an effective transmission of the financial benefits to their clients and provide value added compared to other sources of finance. In this context, the financial intermediaries' activities in support of SMEs should be fully transparent and be reported regularly to the EIB. Moreover, where appropriate, through its cooperation agreements with those intermediary institutions, the EIB should request that clients' projects are checked against agreed criteria in line with EU development goals so as to provide added value.

In addition to intermediated financing support, the EIB could also support, on a case by case basis, investment projects carried out by the local private sector in Eastern Neighbourhood countries (including local subsidiaries of EU companies, locally-owned companies as well as local Midcaps) through direct loans and loan guarantees. This would include projects that contribute to economic integration among between EaP countries and the Union, as well as projects that have a strong potential to achieve sustainable economic growth and job creation.

Development of social and economic infrastructure

Faster, cheaper and more efficient *transport* connections between the EU and the EN region is a necessary condition for its effective integration with EU markets and the sustainable economic development of the region. Such integration requires the ENCs to move closer towards the EU standards in such areas as safety, security and environmental protection. In this context, EIB should focus its activities in the following areas:

i) The Bank should support major transport connection projects which are key elements of further regional integration and trade facilitation. This should take place notably in the context of the envisaged extension of the trans-European transport networks (TEN-T) to neighbouring partner countries.

ii) The Bank should support investments linked to the upgrade of infrastructure connections or transport equipment in a view to making transport more effective and sustainable, notably to support environmentally and climate friendly modes of transport and equipment.

iii) The Bank should promote port modernisation, the motorways of the Sea and the development of inland waterway transport.

iv) The development and the rehabilitation of local or regional transport networks with important socio-economic impact.

v) Particular attention should also be paid to cooperation in the field of safety and security for maritime, air and land transport modes.

The EN region is strategically important for the EU in terms of security of gas and oil supplies from some of the EN countries but also more broadly in terms of transit from the region and beyond. It is relevant for the EIB to support the development of a pan-European *Energy* Community, providing for a better integration of the energy markets, including those of neighbouring countries, and the development of new energy import and source routes to the EU.

Another important objective is to support the development of low carbon energy projects (notably energy efficiency and renewable energy projects). And a priority objective of the Bank's activities outside the EU remains to contribute to their economic and social development, for which energy sector is a key area.

In this context, EIB should focus its activities in the following areas:

i) Rehabilitation and development of energy infrastructure, in order to diversify and secure energy supplies to the EU, to promote the regional integration of energy markets between themselves and with the EU and to support the increase of efficient and reliable production and transportation of energy.

ii) Development of a low carbon economy, notably through development and grid integration of renewable production and by promoting energy efficiency projects, as well as Joint Implementation and Clean Development mechanism projects.

iii) Support to projects improving the performance, safety and security of energy infrastructure.

iv) Improved and reliable access to energy sources, including the development and the rehabilitation of the gas and electricity distribution infrastructure.

Decision N° 1080/2011/EU specifically mentions water and sanitation as an important area of *environmental* infrastructure in which EIB should operate.

Within the framework of the EIB mandate, the focus should be on environmental infrastructure projects that fall within the scope of either the European Neighbourhood Policy documents[19] or documents that set out sectoral priorities bearing an impact on the ENPI Eastern Region[20].

In this context, EIB should focus its activities in the following areas:

i) Public sector wastewater and waste management projects, including development of integrated solid waste management systems and upgrades of solid waste treatment and disposal facilities, and the cleaning up of legacy pollution and other hazardous waste, in particular - but not exclusively - those having an impact on the coastal waters of the Baltic Sea, the Barents Sea, the Black Sea and the Caspian Sea, including projects located on the coast itself or on river basins flowing into the coastal waters, taking into account the strategies of HELCOM and the Baltic Sea Strategy.

ii) Water management projects, to improve water quality, supply and sanitation, taking into consideration EU projects on environmental monitoring.

iii) Environmental infrastructure projects supporting nature protection, biodiversity conservation and land degradation, as well as the forestry sector.

iv) Infrastructure projects reducing air and noise pollution.

v) Other environmental infrastructure projects under the Northern Dimension and in the Black sea region or more generally benefiting from EU grant assistance.

[19] These Neighbourhood Policy documents, such as Strategies, Action Plans or Road Maps, provide a framework for the relations with partner countries in the ENPI Eastern Region.

[20] The EU is also interested in industrial projects, e.g. aiming at the reduction of air pollution or industrial waste, which falls within the usual remit of EBRD financing in the regions covered by the Commission-EIB-EBRD MoU.

Development of modern *information and communication technologies and infrastructure* is a particular importance for the development of democratic societies and market economies. Several countries in the Eastern Neighbourhood region are characterised by a moderate mobile and fixed line penetration and low broadband internet availability. However, the telecom sector has proven a very challenging sector in the Eastern Neighbourhood region considering the market structure and players and a deficient regulatory framework.

The EIB should primarily focus its activities in the following areas:

i) Projects of investments in broadband infrastructure for fixed and mobile (3G and 4G) telecommunications.

ii) Investments in telecommunications infrastructure linked to stimulation of market liberalisation and competitiveness.

iii) Investments in transmission networks (notably, cable ducts alongside railroads or pipelines or satellite links).

iv) Projects favouring investments to further strengthen global partnerships (notably, to support science, technology and education networks).

Reform and modernisation of the *education sector* is key to combating poverty, to promoting convergence with EU standards and practice, and supporting ENC's sustainable economic growth potential. The EIB is exploring the potential to support investments related to the education infrastructure (including in the context of regional initiatives) under the general mandate, provided that EIB financing of such projects has a clear added value, and if such projects meet the EIB's requirements. A similar approach is applied for the *health sector*.

Climate change mitigation and adaptation

With climate change financing only representing 11% of EIB financing under the mandate in the Eastern Neighbourhood and Russia in 2010-2011, the Bank is expected to gradually step-up its activity in this sector for the remaining of the mandate period.

As far as EIB financing climate action in the region is concerned, it should actively support national climate change strategies (mitigation and adaptation) of the respective countries, and should seek cooperation with other international organisations active in this field, such as the EC and the EBRD. Key focus areas should include: energy efficiency; renewable energy; research and innovation; sustainable transport; urban infrastructure; water; landfill upgrade projects with landfill gas capture; protection and improvement of natural forests; adaptation measures and carbon markets. Among those, energy efficiency; renewable energy; sustainable transport; urban infrastructure, and water are viewed as high priorities by the ENCs.

Activities should also aim at supporting the establishment of the enabling conditions to invest in more sustainable and resource efficient production processes in industry, constructions, agriculture and food processing, which is often involving the private sector. Companies are aware of the necessity of improving the environmental performance of their operations and production processes but many of them cite the lack of financial resources for environmental investments and overall regulatory and policy uncertainty as a primary constraints for adopting more sustainable production methods. Access to affordable financing and appropriate technology and management systems are then needed to start a virtuous cycle of sustainable production investments, while overall policy and fiscal frameworks can provide the enabling conditions to encourage green private investment.

At the same time, afforestation, prevention of forest fires and water basin management coupled with erosion control and biodiversity will gain in importance also within the climate change debate. EIB should support projects implemented in these areas.

3) Operational focus in Russia

The Bank's operational remit in Russia is the same as in the EN countries. The operational focus in Russia will therefore be largely aligned to the areas presented above for the Eastern Neighbourhood, but also supporting the priorities of EU Strategic Partnership with Russia. To that effect, priority should be given to areas defined under the EU-Russia P4M, comprising energy security, sustainability, research and innovation and technology co-operation, cross border cooperation, as well as to projects developed in the context of the relevant Northern Dimension initiatives (NDEP and NDPTL) and to climate action projects.

The Bank should pay a particular attention to avoid engaging in projects that are not in line with Russia's WTO obligations or the bilateral agreements signed between EU and Russia at the occasion of Russia's closure of WTO negotiations or where Russia continues protectionist and trade-distorting measures.

4. EIB Financing in Asia and Latin America

4.1 General context

1) General context in Asia

Asia comprises high-income industrialised partners and dynamic emerging economies but is also home to two thirds of the world's poor. Development cooperation therefore remains high on the EU's agenda with Asia, and more than EUR 5bn have been allocated to Asia for the period 2007-2013 as reflected in the EU Regional Strategy 2007-2013 (reviewed in 2010)[21]. Policies are being put in place jointly to address common challenges, such as climate change, sustainable development, water resource management, security and stability, governance and human rights, as well as the prevention of, and response to natural and human disasters.

The EU is stepping up its support to regional integration through the Asia-Europe Meeting (ASEM), and intensifying cooperation with the Association of South-East Asia Nations (ASEAN), the ASEAN Regional Forum (ARF) and the South Asian Association for Regional Cooperation (SAARC).

2) General context in Central Asia

The political system in Central Asia stays stable in spite of political events in the Middle East. The EU has strengthened its relationship with the Central Asian countries since the adoption of “The EU and Central Asia: Strategy for a New Partnership”[22] by the European Council in June 2007 (Central Asian countries: Kazakhstan, Kyrgyz Republic, Tajikistan, Turkmenistan, Uzbekistan). The strategy strengthens relations in all areas of cooperation, including through the reinforcement of EU-Central Asia political dialogue with regular meetings of EU and Central Asian Foreign Ministers, reinforcement of dialogue on human rights, cooperation in the areas of education, rule of law, energy and transport, environment and water, common threats and challenges (including border management and combating drug trafficking), and trade and economic relations. The strategy is supported by a significant increase in EU assistance.

The EU and Central Asian countries have since confirmed their commitment to the strategy, and it is well under way. The EU most recently reviewed the state of implementation of the Central Asia Strategy in a Progress Report in June 2012[23]. The Delegations of the European Commission to Kazakhstan, Kyrgyz Republic and Tajikistan are the three official representative offices of the European Commission to these three central Asian states.

3) General context in Latin America

The European Union and Latin America have enjoyed a Strategic Partnership since the first bi-regional Summit in Rio de Janeiro (Brazil) in 1999. They are natural allies linked by strong historical, cultural and economic ties. They co-operate closely at international level and maintain an intensive political dialogue at all levels - regional, sub regional (Central America, Andean Community and Mercosur) and also more and more at bilateral level.

[21] http://eeas.europa.eu/asia/rsp/07_13_mtr_annex_en.pdf
[22] http://eeas.europa.eu/central_asia/docs/2010_strategy_eu_centralasia_en.pdf
[23] Council conclusions on Central Asia. Foreign Affairs Council meeting of 25 June 2012

EU policy priorities towards Latin America are defined in the Communication "EU-Latin America: Global players in Partnership"[24] that updates the Communication on a "Stronger Partnership between the European Union and Latin America" [25] . Issues such as macroeconomic and financial matters; environment, climate change and energy; science, research and technology; migration; and, finally, employment and social affairs; figure prominently in bi-regional dialogues.

The regional strategy paper 2007-2013 defines the specific areas for regional development cooperation programmes while country and sub-regional strategy papers identify the areas for bilateral and sub-regional cooperation. For the 2007-2013 period, overall EU assistance amounts to around EUR 3bn, while for the same period the EIB is authorised to lend up to EUR 2.8bn.

The EU is the leading investor in the region and the second trading partner of Latin America.

4.2 Regional macroeconomic situation / business climate situation

1) Macroeconomic situation/ business climate in Asia

Global uncertainty has cast a shadow over Asian economies with deterioration in business and consumer sentiments and a negative reaction in the financial market. Growth in Asia has been revised down in 2011to 5.9% mainly due to weaker external demand and it is projected at 6% in 2012 before gradually recovering to 6.5% in 2013. Domestic demand has been generally resilient and overheating pressures have remained elevated in certain economies, with credit growth still robust and inflation rates relatively high. Risks for Asia are tilted to a further downturn in Europe. Asia is one of the world's most trade-dependent regions and it is expected only a relatively soft demand for its exports. Besides, recent stresses in several regional financial markets have suggested that financial channels of contagion also pose a risk. Events in the euro zone in late 2011 have created a global aversion to risk and a corresponding sharp decline in Asian stock markets. Further financial turmoil in the euro zone would likely have an impact on Asia by reducing access to credit. Eurozone banks are an important source of funding for many Asian banking systems and play a crucial role in providing trade credit. But Asian banks are generally in good financial health and many large Asian banks have sufficient capacity to step in as Eurozone banks deleverage.

The downside risks to growth amid persistent overheating pressures confront Asian policymakers with a difficult dilemma, as they need to guard against risks to growth but also limit the adverse impact of continued easy financial conditions on inflation and balance sheet in certain economies.

There is room for manoeuvre but less than at the outset of the global financial crisis in some countries. Some economies have already started monetary easing. Fiscal policy consolidation could be appropriately delayed if external demand were to collapse, especially where low levels of public debt afford space for measures. Asian economies can also use a set of additional measures, as many did in response to the global crisis in 2008. For example, in order to maintain critical flows of credit, liquidity guarantees may be needed for certain banking systems. Moreover, the region has large accumulated foreign exchange reserves, which could be drawn down to smooth the impact on economic activity. Structural reforms are needed to sustain Asia's economic dynamism and reduce vulnerabilities to external shocks. The challenges vary widely across countries. In China, further actions are needed for a

[24] COM(2009) 495/3

[25] Com (2005) 636 final

sustained rebalancing of growth away from investment and exports toward private consumption. These include reform and liberalization of the financial system, fiscal support to household consumption, and a further expansion of the social safety net. In Korea, productivity gains in the service sector should be targeted, and many countries within the Association of Southeast Asian Nations should focus on infrastructure investment to boost potential growth. Besides, structural reforms are also needed to make growth more inclusive. Despite notable progress in reducing poverty, income inequality has increased in most of Asia over the last two decades.

2) Macroeconomic situation/ business climate in Central Asia

The recovery continued across the Central Asian region in 2011 supported by robust commodity exports and remittance inflows. The growth outlook is largely positive but subject to downside risks. For the oil and gas exporters (Kazakhstan, Turkmenistan, Uzbekistan), IMF forecasts growth of 6-7% for 2012-13, supported by high oil and gas prices. For the oil and gas importers (Kyrgyz Republic, Tajikistan), the IMF estimation for 2012 growth is at 5-6%, supported by a continued growth in Russia. A downside risk to this forecast relates to the uncertainties over the global environment. The growth prospects of Central Asia oil and gas importers are particularly vulnerable to growth deterioration in Russia which would be adversely impact on their economies through reduced trade and remittance flows.

With the uncertain global environment, Central Asian oil and gas importers should aim at restoring fiscal buffers and strengthening fiscal sustainability against future shocks. Oil exporters could use a positive momentum for improving the quality and efficiency of public spending. Preserving flexible exchange rates and continuing with structural reforms would improve the competitiveness and limit external vulnerabilities of Central Asian economies. Uzbekistan needs to follow prudent monetary policy as double-digit inflation rates constitute a threat to its macroeconomic stability. Kazakhstan, Kyrgyz Republic and Tajikistan should address the issues of nonperforming loans which impair bank lending and limit the growth of domestic demand.

Job creation and achieving of inclusive and sustainable growth are the main challenges for Central Asia over the medium term. The reform agenda should support policies that improve the business environment and transparency; guarantee equal access to public services; enhance governance and institutional quality; support regional trade integration; and tackle skill mismatches. Business environment varies across the region with the Kyrgyz Republic and Kazakhstan being more advanced while the other three countries, notably Turkmenistan, rank at the bottom in terms of the World Bank Doing Business indicator. The common problems relate to the state dominance in the economy, dependency on several commodities and remittances, underdeveloped banking system and low level of financial intermediation. Further reform-efforts are needed to modernise public infrastructure, notably energy sector, reinvigorate trade and private investment which would contribute to the diversification of their sources of growth.

3) Macroeconomic situation/ business climate in Latin America

Latin America has surpassed expectations after the crisis and GDP is projected to have grown by 4.4% in 2011. Market expectations are for relatively solid economic growth of 3.6% in 2012. The growth performance has been supported by strong domestic demand, capital inflows and prices of raw material remaining at elevated levels. In 2012, economic growth is expected to moderate on slower global growth and spill-overs from advanced economies. Latin America is expected to grow by 3½ % in 2012. Still, the on-going integration in the world economy by itself and the domestic structural changes are supportive of economic growth. Softening exports to advanced economies are expected to be partly offset by continued demand for commodities from emerging economies, a more accommodative domestic policy stance and domestic demand. Local financial conditions are likely to be supported by a generally improving assessment of creditworthiness as evidenced in the improving credit ratings. Still, the economic woes of advanced economies weigh on the economic outlook mainly through increasing global risk aversion.

The more positive data from the US and dissipating fears of another recession bode well for the whole region in particular for Mexico and Central America, which are more closely linked to the US business cycle. Domestic demand is expected to wane from the surprisingly good performance in 2011. The limited growth of consumer credit in Mexico and the inching down of consumer confidence are part of the reason for this relatively timid development of domestic demand in comparison to other Latin American economies.

Policy tightening in the first half of 2011 combined with a weakening global momentum slowed down the Brazilian economy in the second half of 2011. However, the drivers of growth over the past two years - foreign demand for its commodities as well as robust domestic private demand - are expected to ensure the GDP expansion of just above 3% in 2012. Going further into 2012 and 2013, growth will receive additional stimulus from renewed expansionary fiscal policy (presidential elections, world soccer championship) and investment (development of new oil fields). Import growth is expected to exceed export growth as a consequence of relatively strong domestic demand developments.

The growth of the Argentine economy in 2011 has been revised upwards to 7.5%, backed by expansionary fiscal and monetary policies especially in the third quarter of the year. Growth is estimated to decelerate to around 4% in 2012 and 2013 due to higher interest rates, a deterioration of the global environment, a slowdown of the Brazilian economy and less expansionary fiscal and monetary policies. Official figures set consumer price inflation at 9.8% while private estimates record figures above 24%. The growth in imports outpaces growth in exports. The reserve coverage will be weakened by the Government's use of reserves to shield the peso and to repay external debt.

4.3 Brief overview of EIB activity to-date

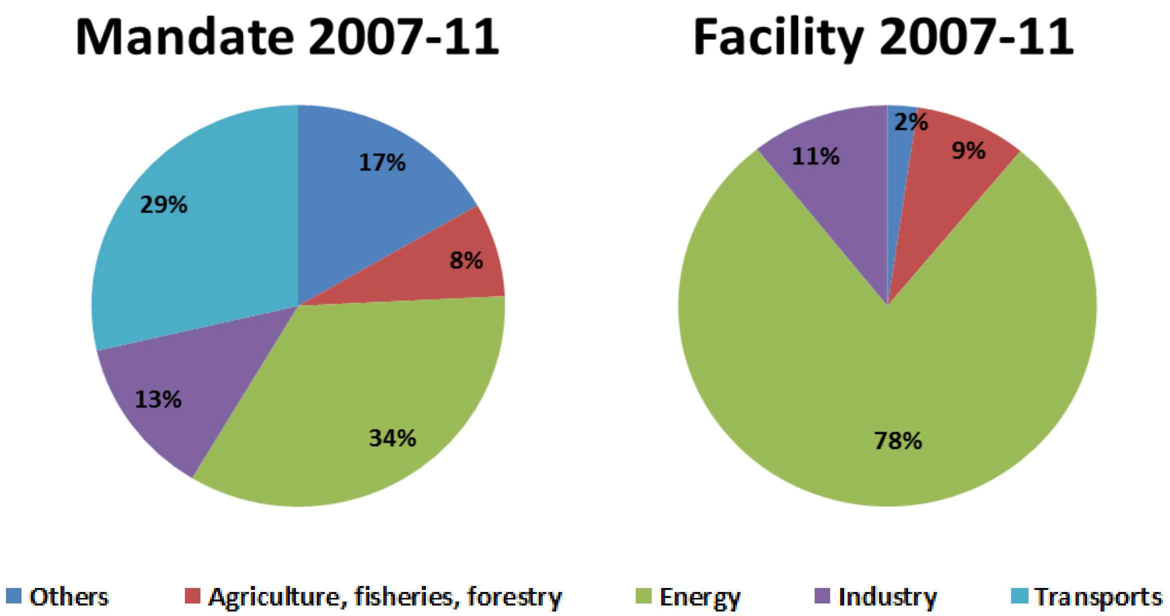
The ceilings of the general mandate, the Climate Change Mandate and the Energy Sustainability and Security of Supply Facility (ESF) are outlined in the following table.

ALA envelopes and commitments as at the end of 2011 (in EUR mn)							
	Committed			Ceiling and Utilisation			
	General Mandate	ESF*	CCM	General Mandate (Decision 1080/2011/EU)	%	ESF and CCM (as per EIB Board decision)	%
Latin America	1,991	879*	0	2,912	68%	2,050	43%
Asia (incl. Central Asia)	779	200*	0	1,040	75%	(ex-China)	10%
China	59	1,309*	0	-	-	1,500*	87%
Total ALA	2,829	2,388*	0	3,952	72%	3,550	67%

* At EIB own risk.

1) ***EIB activity in Asia***

Sector (2007-11 in EUR mn)	Mandate	%	Facility	%	Total	%
Others	130	*17%*	29	*2%*	**159**	*8%*
Agriculture, fisheries, forestry	59	*8%*	109	*9%*	**169**	*8%*
Energy	268	*34%*	986	*78%*	**1,254**	*61%*
Industry	100	*13%*	135	*11%*	**235**	*12%*
Transports	223	*29%*	-	*0%*	**223**	*11%*
Grand Total	**779**	***100%***	**1,259**	***100%***	**2,039**	***100%***
	Mandate	***38%***	**Facility**	***62%***		



The revised General Mandate for the period 2007-2013 has an envelope of EUR 1,040mn for Asia. In addition, it is estimated that up to 30% of the additional EUR 2bn for global climate action could be allocated to Asia and Latin America. Thirdly, it should be recalled that Asia can benefit from part of the EUR 4.5bn available under the Energy Sustainability and Security of Supply Facility (ESF) [26].

For the period of 2007-11 and in line with the EU high-level objectives and regional priorities, the sector focus of the Bank financing under EU guarantee in Asia has been mainly on energy and transport, and besides this, on industry, forestry and global loans. The energy sector accounted for the largest share of activities by investment value, also reflecting the strong demand for renewable energy projects. A large portion of the activities also supported EU presence through financing of Foreign Direct Investment, transfer of technology and knowhow from Europe. In the last years, there has been a drive to focus even stronger on projects which contribute to climate change mitigation and adaptation. For the period 2010-

[26] EIB internal regulations set lending ceilings of EUR 2,05bn under the Climate Change Mandate and ESF combined for the whole of the Asia and Latin America region (excluding China), plus EUR 1,5bn to China under the ESF.

2011, almost all of EIB lending in Asia was classified as Climate Action (mitigation and adaptation).

As required by Decision 1080/2011/EU, the Bank seeks to prioritize the use of resources so as gradually to increase the number of countries where investments are carried out. To achieve this, the Bank focuses the use of the EU guarantee on less prosperous countries where it is needed to make projects financially viable. Own risk operations have been carried out in investment-grade countries and/or private sector structures where the financial value added of the Political Risk Guarantee is low, in order to focus the EU guarantee on operations where its value added is higher . In terms of country distribution over the period 2007-2011, as regards EIB overall lending (including mandate and own risk operations), China accounts for the largest share of loans in Asia (45%)[27] followed by India (12%), Viet Nam (11%) and other countries (between 5%-10%:Indonesia, Philippines, Pakistan; less than 5%: Sri Lanka, Thailand, Bangladesh, Laos, Maldives). Good prospects exist for signing framework agreements with Iraq and, especially, Cambodia in the foreseeable future. As at the end of 2011, 30% of lending in Asia had benefitted the private sector and 70% the public sector.

2) ***EIB activity in Central Asia***

Central Asia became eligible for EIB operations with an EU guarantee pursuant to Council Decision of 4 November 2008 (2008/847/EC) "*on the eligibility of central Asian countries under Decision 2006/1016/EC granting a Community guarantee to the European Investment Bank against losses under loans and loan guarantees for projects outside the Community*".

The 2008 Council Decision was confirmed by the European Parliament and the Council in the decision 633/2009/EC of 13 July 2009 which stated as follows: "*In Central Asia, the EIB should focus on major energy supply and energy transport projects which also serve Community energy interests and are consistent with and support the Community policy objectives of diversification of energy sources and the Kyoto requirements, and of enhancement of environmental protection.*"

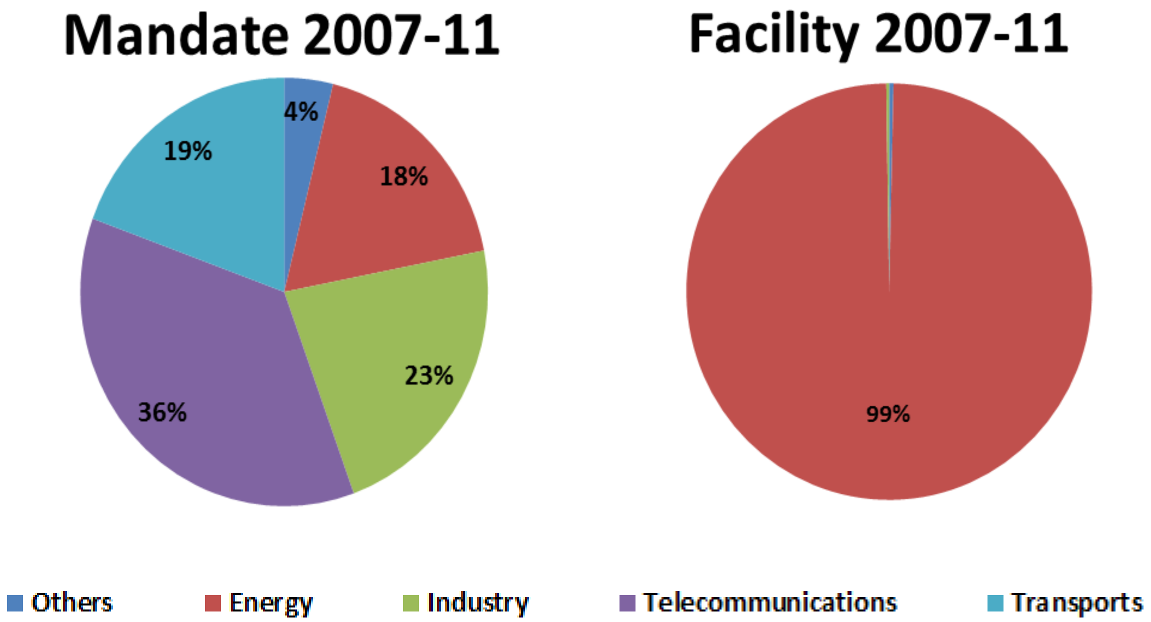
At present the EIB activity in Central Asian countries has been launched in Tajikistan and Kazakhstan, with the respective Framework Agreements signed in February 2009 (ratified in October 2009) and April 2010 (ratified in November 2010). The EIB has pursued its efforts towards setting up the institutional framework of its potential activities (i.e., the signing of the respective FWAs) in Kyrgyzstan, Turkmenistan and Uzbekistan, but the eventual outcome of these efforts will depend on the political situation and the willingness of these countries to sign.

The potential EIB lending activity in the region under the Mandate is currently limited under EIB internal rules to EUR 100mn for Central Asia out of the total EUR 1bn available for Asia under the general mandate. Central Asian countries are also eligible for EIB lending under the EUR 2bn Climate Change Mandate and the EIB's EUR 4.5bn own risk Facility for Energy Sustainability and Security of Supply (ESF). As at the end of 2011, two operations were signed in Tajikistan.

[27] 96% of lending in China has been carried out at the Bank's own risk.

3) EIB activity in Latin America

Sector (2007-11 in EUR mn)	Mandate	%	Facility	%	Total	%
Others	77	*4%*	3	*0%*	**80**	*3%*
Energy	359	*18%*	875	*99%*	**1,234**	*43%*
Industry	449	*23%*	2	*0%*	**451**	*16%*
Telecommunications	719	*36%*	-	*0%*	**719**	*25%*
Transports	387	*19%*	-	*0%*	**387**	*13%*
Grand Total	**1,991**	***100%***	**879**	***100%***	**2,870**	***100%***
	Mandate	***69%***	**Facility**	***31%***		



The revised General Mandate for the period 2007-2013 has an envelope of EUR 2,912mn for Latin America. In addition, it is estimated that up to 30% of the additional EUR 2bn for global climate action could be allocated to Asia and Latin America. Thirdly, it should be recalled that Latin America can benefit from the Energy Sustainability and Security of Supply Facility (ESF) [28].

For the period of 2007-11, the sector focus of the Bank financing under EU guarantee in Latin America has been mainly on telecommunications (predominantly in Brazil), industry, transport and energy. A large portion of the activities also supported EU presence through financing of Foreign Direct Investment, transfer of technology and knowhow from Europe. Of late there has been a drive to focus primarily on projects which contribute to climate change mitigation and adaptation, mainly in the transport and energy sectors. For the period 2010-2011, Climate Action lending (mitigation and adaptation) represented 57 % of EIB lending in Latin America.

[28] EIB internal regulations set lending ceilings of EUR 2,05bn under the Climate Change Mandate and ESF combined for the whole of the Asia and Latin America region (excluding China).

In Latin America, the Bank seeks to prioritize the use of resources so as to gradually increase the number of countries where investments are carried out. To achieve this, the Bank focuses the use of the EU guarantee on less prosperous countries where it is needed to make projects financially viable. Own risk operations have been carried out in investment-grade countries and/or private sector structures where the financial value added of the Political Risk Guarantee is low, in order to focus the EU guarantee on operations where its value added is higher.

In terms of country distribution over the period 2007-2011, as regards EIB overall lending (including mandate and own risk operations), Brazil accounts for the largest share of loans (48%)[29] in their respective regions, followed by Argentina (13%), Panama (12%), Mexico (7%) and the other countries (all less than 5%). As at end 2011, 89% of lending in Latin America had benefitted the private sector and 11% the public sector.

4.4 EIB contribution to EU regional policy framework, including cooperation with the COM, the EEAS and with other IFIs

Cooperation with the Commission

Cooperation with the European Commission is instrumental for the Bank's activities in Asia, Central Asia, and Latin America. Key countries in the region have a great relevance for the EU both from policy and economic standpoint. The EU has Association or Strategic Partnership Agreements in place with Mexico, Chile, Brazil, China and India; others are under negotiation. For Assistance to Central Asia, the EU's Regional Strategy Paper for the period 2007-2013 sets up the framework of the cooperation between the EU and the five Central Asian countries, which is complemented by the EU and Central Asia: Strategy for a New Partnership" by the European Council in June 2007 and the Progress Report of June 2012. All of the mentioned agreements and strategies are generally in line with the focus of the EIB operations as outlined in the previous section. With its drive towards an even stronger focus on climate action operations, the EIB intends to concentrate on the area with a particularly high relevance in the regional EU policy frameworks, given the fact that the region includes some of the world's largest green-house gas emitters.

Also relevant in the context of EU policy frameworks are the regional investment facilities by the EC, which provide financial contributions to support loans from EIB, EBRD and other European multilateral and national development finance institutions. The EIB is participating in the regional blending mechanisms (Investment Facility for Central Asia (IFCA), Latin America Investment Facility (LAIF) and Asia Investment Facility (AIF)).

The IFCA's main purpose is to promote additional investments and key infrastructures with a priority focus on energy, environment and climate change, transport, SMEs and social infrastructure sectors. The EC allocations for IFCA amount to EUR 20mn in 2011 and EUR 25mn in 2012. The LAIF and AIF have similar sectoral priorities as IFCA, which shows a great synergy to the focus sectors of EIB operations.

In addition, the EIB has established an excellent cooperation with EU Delegations in many of the countries covered by the mandate. This cooperation offers valuable local insights for the planning and execution of EIB lending operation in a number of countries. Close collaboration with the EC and the local EEAS delegations is a vital ingredient of the Bank's working arrangements. In addition to providing substantive and logistical support to EIB

[29] In Brazil, 34% of lending has been carried at the Bank's own risk.

missions, this promotes synergy, shared know-how, and ultimately allows the EIB to support EU objectives and achieving lending targets in a more efficient way.

Cooperation with other IFIs and BFIs

Overall, since 1993, well over a quarter of the projects approved by the EIB has seen the participation of one or more of the ***IFIs and EU bilateral*** FIs. EIB closely cooperates with the other IFIs operating in the countries covered by the mandate, in particular with EBRD in line with the Memorandum of Understanding signed between the EIB, EBRD and the Commission on 1 March 2011. It is noted that the first EIB operation in Tajikistan is co-financed with EBRD. The EIB has traditionally worked very closely with other IFIs such as the World Bank Group, the Asian Development Bank and the Inter-American Development Bank, with which it shares very similar project due diligence procedures and performance standards.

The EIB also works closely with EU bilaterals such as KfW and AFD with which it has recently signed a framework on mutual reliance. Mutual reliance is expected gradually to lead to additional investments by promoting a more efficient allocation of workload and resources among co-financiers.

4.5 Operational focus for the remainder of the mandate period

1) Operational focus in Asia

Local private sector development, in particular support to SMEs

The EIB will give priority to projects to local private sector projects (notably SMEs) which have a high relevance with regards to EU objectives, strategies and national priorities. Additional value would be derived from a ‘pro poor’ focus, increased efficiencies through the cooperation with other IFIs/Bilateral FIs, the use of blending as an innovative way of using public funds[30], or the provision of guarantees to leverage private capital.

Development of social and economic infrastructure

The EIB’s financing of social and economic infrastructure will focus primarily on energy and associated infrastructure as well as environmental infrastructure, including water and sanitation. Other sectors such as sustainable transport may be considered but must have direct climate mitigation, adaptation or environmental benefits or a particularly high relevance with regards to EU objectives, strategies and national priorities. Despite the region’s vast needs and the EU interests, volumes for economic infrastructure, especially beyond climate action operations, will be limited due to resource constraints.

Climate change mitigation and adaptation

With Asia being accountable for more than 40% of the world’s CO_2 emissions, climate action constitutes the overwhelming operational focus of the Bank in the region. The region’s Green House Gas (GHG) emissions are dominated by energy use in China (the world’s largest carbon emitter), changes in land use in Indonesia (the world’s fifth largest emitter due to massive deforestation), and the rapid industrialization of the Indian sub-continent (India is the world 3rd largest emitter of CO_2 in absolute terms). Across Asia, low per-capita emissions

[30] E.g. to facilitate local currency financing

reflect a reality of millions still with no access to electricity. A significant number of people and areas are highly vulnerable to the impacts of climate change because of their geographic exposure, low incomes, and greater reliance on climate sensitive sectors such as agriculture, forests and fisheries.

In order to successfully pursue EU objectives in the region, the Bank intends to rely on two main product lines, as follows:

- Scaled-up debt financing for the development and diffusion of low-carbon technologies with significant potential for long-term, transformational GHG emission savings.

  This product would focus on: i) renewable energy installations, fuel switch to less carbon intensive technologies, and single to combined-cycle projects in the power sector, and associated infrastructure; ii) energy efficiency in industry and buildings; iii) carbon sequestration through afforestation and reforestation; iv) urban transport projects, as well as environmentally sustainable railway infrastructure.

  The volume of operations in this segment will be conditioned not only by the availability of own EIB resources but also by the attractiveness of the terms at which the EIB will be able to lend to borrowers going forward.

- Blended products with a higher concessionality element suitable for smaller-scale projects that promote low-carbon climate-resilient growth in lower income countries or regions.

  Projects examples would include off-grid solar or biogas home systems for the rural poor; small hydro and biomass mini-grids; flood control, drainage, sanitation, and watershed management; small-scale afforestation and reforestation, etc.

2) Operational focus in Central Asia

The EIB’s sectorial guidelines and priorities in the region are aligned with the EU objectives. However, given the amounts available under the various Mandates and facilities for Central Asia, EIB lending potential is quite material for projects that contribute to climate change mitigation and adaptation under the Climate Change Mandate and the ESF (subject to compliance with creditworthiness requirements). For the other projects, the relatively small amount available for Central Asia under the general mandate requires strict prioritisation of EIB financing to the projects with the highest EU interest.

Local private sector development, in particular SMEs

This is a new general objective for the EIB’s activities in the Central Asian countries. The access to credit for SMEs remains a major hurdle for the further development of the SME sector, which would contribute to the inclusive sustainable economic and social development of the Central Asian countries.

Therefore in the current context in the region, the EIB will aim at extending its support to the SME sector as one of the main priorities for the future. The EIB intends to actively cooperate with local financial intermediary institutions (including subsidiaries of EU banks) in the Central Asian countries, and would ensure an effective transmission of the financial benefits of Bank lending to their clients and to provide value added compared to other sources of finance. In this context, the financial intermediaries' activities in support of SMEs would be fully transparent and reported regularly to the EIB. Moreover, where appropriate, through its cooperation agreements with those intermediary institutions, the EIB would request that clients' projects are checked against agreed criteria in line with EU development goals so as to provide added value.

It is expected that Kazakhstan, with its relatively developed banking sector (including subsidiary banks of EU banks and an institution dedicated to supporting the development of SMEs and the diversification of the Kazakh economy) will offer good potential for SME lending through intermediary banks.

Development of social and economic infrastructure

In the *energy* sector, where Central Asia is strategically important for the EU, the EIB will continue to explore the potential for supporting the development of new oil, gas and hydro-power resources, the upgrading of the existing energy infrastructure as well as the development of additional pipeline routes and energy transportation networks, under both the external mandate (including Climate Change Mandate) and the ESF. Another important objective is to support the development of low carbon energy projects (notably energy efficiency and renewable energy projects) which would be eligible under the Climate Change Mandate and the ESF.

In the area of *environmental infrastructure*, the EIB will aim at enhancing its cooperation with the EC to develop appropriate frameworks for facilitating the financing of water related infrastructure projects through attracting EIB's, other IFIs' and public-private partnership funds.

In the *transport* sector, EIB intends to focus its activities in the following areas in order to support progressive integration of the transport markets of Central Asian and ENPI eastern countries, the gradual approximation with the EU's legal framework and standards and effective implementation of international agreements in the transport sector, including safety and security; the improvement of rail and road safety; the improvement of air communications, aviation safety and air traffic management, and of maritime and aviation security to international standards; the improvement of inland waterway transport; and the introduction of EU inter-modal concepts.

Climate change mitigation and adaptation

As far as EIB financing climate action in the region is concerned, key focus areas include: renewable energy; energy efficiency; research and innovation; sustainable transport; urban infrastructure; water; landfill upgrade projects with landfill gas capture, adaptation investments and forestry. Among those, energy efficiency investments related to existing energy networks (electricity and gas networks) and sustainable transport (railway infrastructure and urban transport) are viewed as high priorities, also by the Central Asian countries. Also, afforestation and water basin management coupled with erosion control and biodiversity gain in importance, also within the climate change debate, and can be targeted for EIB financing.

3) Operational focus in Latin America for the remainder of the mandate period

Local private sector development, in particular support to SMEs

The EIB will give priority to local private sector projects (notably SMEs) which have a high relevance with regards to EU objectives, strategies and national priorities. Additional value would be derived from a 'pro poor' focus, increased efficiencies through the cooperation with other IFIs/Bilateral FIs, the use of blending as an innovative way of using public funds[31], or the provision of guarantees to leverage private capital.

Development of social and economic infrastructure

The EIB intends to focus its activities in social and economic infrastructure as outlined in the following section with strong focus on energy and associated infrastructure as well as environmental infrastructure. Other projects need to have direct climate mitigation or environmental benefits or a particularly high relevance with regards to EU objectives, strategies and national priorities. Projects responding to development objectives, for example in the area of social infrastructure, could also be considered. The EIB will also endeavour to strike a better balance regarding countries' participation as well as address increasingly the public sector.

Although infrastructure is one of the main areas of expertise of EIB, current organisational setup in terms of restrained resources and limited lending volumes assigned to the region will likely imply modest results in this area, especially beyond climate action operations.

Climate change mitigation and adaptation

Strong growth rate over the last years have led to increased CO_2 emissions and environmental problems and led to an increased importance of climate change mitigation measures to support the development of a low carbon economy. At the same time, a huge number of people and areas are highly vulnerable to the impacts of climate change because of their geographic exposure, low incomes, and greater reliance on climate sensitive sectors such as agriculture, forests and fisheries.

In order to successfully pursue EU objectives in the region, the Bank intends to focus in particular on operations in the following areas:

- Renewable energy: development, grid connection and back-up of renewable energy sources, both large and small-scale,
- Energy efficiency (e.g. in industry, demand-side),
- Sustainable urban transport, as well as environmentally sustainable railway infrastructure,
- Environment: water, waste-water, solid waste and forestry (including carbon sequestration through afforestation and reforestation),
- Adaptation measures.

[31] E.g. to facilitate local currency financing

5. EIB Financing in South Africa

5.1 General context

Although the largest African economy (accounting for one third of Sub-Saharan Africa's GDP), South Africa still faces many development challenges, not least in fighting AIDS, poverty and high unemployment. South Africa is the EU's 13th largest trade partner, while the EU accounts for a third of South Africa's trade balance. Two-way trade amounted to EUR 39bn in 2010.

EU-South African relations have flourished since 1994, and both sides entered in May 2007 into a Strategic Partnership, the sole concluded by the EU with an African country. The Strategic Partnership has two strands: enhanced political dialogue and cooperation on regional, African and world issues, and stronger cooperation in a number of economic, social and other areas. The EU-South Africa political dialogue, which includes annual Summits and ministerial level meetings, has recently been focusing on issues of mutual interest such as peace and security in Africa, global governance or Climate Change. The Strategic Partnership has also given new impetus to cooperation and dialogue in a broad range of areas from the environment, energy, space, transport or migration to education and research.

South Africa, the EU and its Member States have drawn up a joint country strategy paper (CSP) guiding their development cooperation over the period 2007-13. Its main objective is to reduce poverty and inequality, while promoting social stability and environmental sustainability in South Africa. Programs focus on employment creation and capacity development for service delivery and social cohesion, with a total indicative budget for the seven-year period of EUR 980m. The objectives of European Union-South Africa development cooperation remain, as in the past, firmly anchored in the view that the real value added of ODA is not the finance itself, but what comes with it, namely value added activities involving innovation, pilot programmes, capacity development, the sharing of skills and knowledge, and risk taking. This value added approach to development cooperation lays emphasis not on the "heavy lifting" that might be expected of ODA in other countries, but rather on a more focused approach which gives space to Government to identify value added activities, provides technical assistance in areas where this form of assistance is most valued, and complements these activities with support to civil society organisations.

5.2 Regional macroeconomic situation / business climate situation

Following a contraction of GDP by 1.5% in 2009, the South African economy recovered in 2010 at rate of 2.9%. Growth in the fourth quarter of 2011 was 2.9% year-on-year, down from 3.1% in the previous quarter and from 3.2% in the second quarter of 2011. The government forecasts a 3.1% growth in 2011, and 2.7% in 2012. Although economic growth is not strong enough to make an impact on the high unemployment rate (estimated to be above 24% in 2011), higher salaries will support consumers' domestic demand.

Inflation increased from 5.7% in September 2011 to 6.1% in December 2011, driven by the rise in food prices observed globally, fuel and electricity prices, and wage growth. Annual average inflation was 5.0% in 2011.

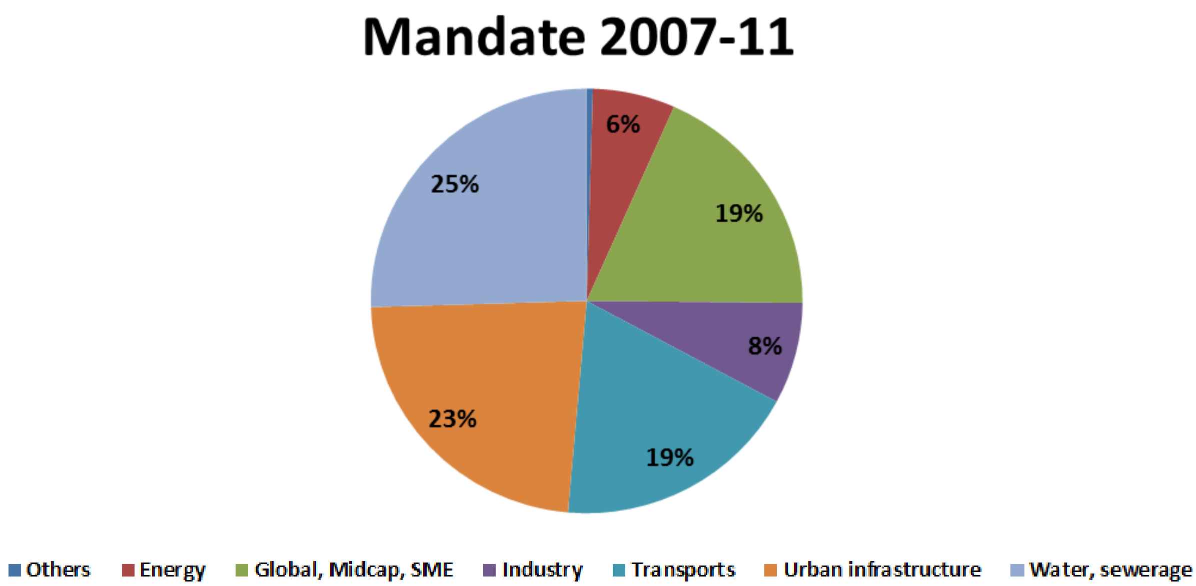
Monetary policy will remain focused on keeping annual inflation, as measured by the CPI, within the official target range of 3%-6%. The SARB (South African Reserve Bank's)'s monetary policy committee cut rates aggressively in 2009-10 and since then has kept an easy stance. The current repo rate is 5.5%, the lowest level for 40 years.

According to the new budget plans, the government deficit is expected to be 4.6% of GDP in 2012. The public debt burden will however remain below 50% of GDP.

The current account deficit reached 2.9% of GDP in 2010 and is expected to widen to 3.3% of GDP in 2011 as imports grew faster than exports. The saving ratio is one of the lowest among Emerging Market Economies (16.5%). Higher savings, channelled to investments and the creation of better business environment (in order to attract more foreign direct investments) would greatly benefit the entire economy.

5.3 Brief overview of EIB activity to-date

Sector (2007-11 in EUR mn)	**Mandate**	**%**	**Facility**	**%**	**Total**	**%**
Others	3	*0%*	-	*0%*	**3**	*0%*
Energy	40	*6%*	50	*100%*	**90**	*13%*
Global, Midcap, SME	120	*19%*	-	*0%*	**120**	*17%*
Industry	50	*8%*	-	*0%*	**50**	*7%*
Transports	120	*19%*	-	*0%*	**120**	*17%*
Urban infrastructure	150	*23%*	-	*0%*	**150**	*22%*
Water, sewerage	165	*25%*	-	*0%*	**165**	*24%*
Grand Total	**648**	***100%***	**50**	***100%***	**698**	***100%***
	Mandate	***93%***	**Facility**	***7%***		



The EIB has been active in the South Africa since the country's transition to a democratic government in 1994. Following the conclusion of the EU-South Africa Trade, Cooperation and Development Agreement, the EIB has been entrusted with four successive Mandates for a total lending volume of EUR 2.4bn (2.5bn including the additional climate action envelope). The current Mandate covers the period 2007 – 2013 and has a lending ceiling of EUR 936mn (up to EUR 1,090mn including the additional climate action envelope).

EIB's lending priorities are aligned with the overriding objectives identified in the CSP between the EU and South Africa. Implementation of the mandate in South Africa is proceeding in line with these objectives. Private Sector support plays an important role, while in the infrastructure area, the main sectors receiving support were water, urban development and transport. Energy sector projects were mainly carried out under own-risk facilities (being the only sector supported by these facilities). For the period 2010-2011, Climate Action lending (mitigation and adaptation) was 23 % of EIB lending in South Africa.

In addition to the activity under the mandate in South Africa, a EUR 50mn loan was recently approved outside the mandate envelope under EIB's Facility for Energy Sustainability and Security of Supply.

5.4 EIB contribution to EU regional policy framework, including cooperation with the COM, the EEAS and with other IFIs

With GDP per capita of around USD 7,300 (10,500 at PPP), South Africa is classified as a middle-income economy. However, apartheid gave rise to one of the most unequal and racially segregated societies in the world. In addition, 43% of the population lives on less than two dollars a day and 5.7 million people out of a 49-million population are infected with HIV/AIDS. Social and development challenges remain daunting, with unemployment at 25% of the labour force, acute income disparities and limited access to basic services for the poorest segments of the population.

In this context and in line with the CSP, priority shall be given to projects that have a significant development and social impact while contributing to increase the growth potential of the country and the region. Special regard should continue to be given to the historical disparities between different segments of the population and the need to improve the living conditions and economic empowerment of historically disadvantaged persons.

The EIB cooperates closely with the European Commission in South Africa. Regular coordination meetings on country strategy and operational issues are held between the EU Delegation in South Africa and EIB's Regional Representation

The EIB has also cooperated very successfully with the Commission on the design and implementation of the two Risk Capital Facilities for South African SMEs in the context of South Africa's Black Empowerment Strategy (RCF I and II). The EIB is currently involved in the consultations regarding the design of the envisaged blending mechanism for South Africa (Investment Programme for South Africa).

In South Africa, the EIB also works very closely with EU bilaterals such as AFD and KfW, including under the MRI. Joint documentation for the funding of a major water supply project in South Africa, a MRI pilot project under EIB lead, was signed in 2011.

Regular contacts are kept with other IFIs on the ground, like the World Bank and African Development Bank both for co-financing specific projects (i.e. Eskom Renewable projects) and for sectoral or strategic discussions.

5.5 Operational focus for the remainder of the mandate period

The Bank's South African rand (ZAR) funding programme has been very successful and the possibility of ZAR disbursements for long maturities and at currently still attractive rates adds significant value to the Bank's financing in South Africa. It is therefore expected that an important share of EIB lending in the below sectors will continue to be in ZAR.

Local private sector development, in particular support to SMEs

EIB should continue to support the local private sector in South Africa, either directly or in cooperation with local financial intermediaries (commercial banks or development finance institutions). In line with the specific lending objectives for South Africa mentioned in the Decision and the renewable energy investment programme of the Government of South Africa – which aims at increasing the share of renewable energy to 15% of electric power generation by 2020 and at the same time stimulating the local economy - the focus of EIB's activity in this area shall be support to renewable energy and energy efficiency projects (see also point 3 below).

Development of social and economic infrastructure

Particular attention should be paid to support for improved municipal infrastructure and delivery of basic services.

Furthermore the EIB should continue to focus on economic infrastructure projects in areas with a positive contribution towards climate action, like renewable energy, energy efficiency and urban infrastructure investments (see next section).

Following the successful implementation of EIB's first affordable and social housing programme in South Africa, further support to this key sector could be envisaged. Consideration should also be given to the possibility of contributing to improved health and education infrastructure.

Climate change mitigation and adaptation

As mentioned above, a significant share of EIB financing in South Africa for the period 2012-2013 should be provided for projects that support climate change mitigation and adaptation.

Respective initiatives of the South African Government include the renewable energy investment programme (IPP Procurement Programme), the SARi (South African Renewables Initiative and the GFM (Green Financing Mechanism). EIB's activity in the country should thus focus on renewable energy, energy and water efficiency and urban infrastructure investments carried out by both public and private sector developers. In addition, since South Africa is expected to experience more extreme weather impacts due to climate change in the future, adaptation measures will become increasingly important as part of the climate action portfolio.