

## The European External Investment Plan in the Southern Neighbourhood: how to make it work

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The EU is putting an increasing emphasis on blended finance for development. However, analysis suggests that its use should not be seen as a panacea, but as part of a coordinated effort to implement a broader reform agenda. The EU's External Investment Plan (EIP), aimed at boosting investment in Africa and the EU neighbourhood, is now fully operational.<sup>1</sup> The key areas for the plan's implementation (investment windows) have been approved and potential projects presented.<sup>2</sup> While mostly aiming to contribute to achieving the Sustainable Development Goals (SDGs), the EIP was also developed to tackle the 'root causes' of the growing migration flows to the EU. The objective is to create jobs and stimulate growth in target regions, with the presumption that this would reduce migration flows in the short to medium term.

The EIP is innovatively designed, with a single framework that includes three mutually reinforcing pillars: the European Fund for Sustainable Development (EFSD), technical assistance and political dialogue to foster reforms and improve the investment climate. The risk mitigation mechanism provided by the EFSD guarantee should help encourage investment in the fragile context of Africa and the EU Southern Neighbourhood, where investment is usually deemed risky. The EIP aims to bring coherence to and complement previous blending instruments. The plan has the potential to raise significant additional funds for development. The envisaged financial leverage is high, especially compared to previous blending exercises. The European Commission expects its initial contribution of €4.1 billion to raise at least €44 billion from development finance institutions, and institutional and private financiers by 2020. This figure would increase to €88 billion if EU member states decide to contribute. Therefore, in principle, there are prospects for an effective implementation of the plan and a tangible added value.

At the same time, the plan has some weaknesses. First, there is a discrepancy between the short-term goal of limiting migration and the much longer timeframe required to promote sustainable development and address the identified root causes of migration. Second, it is not entirely clear what the impact is of economic growth on migration flows from countries with very low levels of income. Some studies have even suggested that economic growth (and thus higher wages) can lead to more migration.<sup>3</sup> And third, migration itself has proven to be an important factor of development and financial income, mainly through remittances, for countries of origin.

In addition to these challenges, the increasing reliance on blended finance to fund the SDGs has come under growing criticism. Several reports have noted that it is difficult to measure the impact of blending instruments on achieving development priorities.<sup>4</sup> There is also the issue of how to align the interests of business and the public interest.

<sup>1</sup> Regulation (EU) 2017/1601 of the European Parliament and of the Council of 26 September 2017 establishing the European Fund for Sustainable Development (EFSD), the EFSD Guarantee and the EFSD Guarantee Fund.

<sup>2</sup> Five areas are considered to be essential: Sustainable Energy and Sustainable Connectivity; Micro, Small and Medium Enterprises (MSMEs) Financing; Sustainable Agriculture, Rural Entrepreneurs and Agroindustry; Sustainable Cities; Digitalisation for Sustainable Development.

<sup>3</sup> For instance: Clemens, Michael A. (2014), 'Does Development Reduce Migration?', IZA Discussion Paper No. 8592.

<sup>4</sup> See in particular: UN Economic and Social Council 2016 report, E/2016/65 and Griffith et al., 2014, Financing for Development post-2015: Improving the Contribution of Private Finance, European Parliament.

This does not mean that businesses should not be engaged in development. The private sector already plays an important role and blended finance helps reconcile profit-making with social and environmental responsibility. However, it will be important to accurately monitor corruption, prevent the misappropriation of funds, and address issues of (social and environmental) accountability in the implementation of the EIP. As EU policymakers have been stressing, it is essential that the reform agenda attached to the third pillar of the plan, aimed at creating a better investment environment, not only benefits businesses, but society in general. Blended finance should therefore complement a wider spectrum of development and budget support initiatives and should not be treated as a silver bullet to solve all problems. In the EU's Southern Neighbourhood in particular, connecting the implementation of the EIP with a wider reform agenda coordinated at EU level will be key.

The countries in the region share some common traits that challenge the effective implementation of development strategies. First of all, the apparent collusion between the business sector and political institutions undermine the benefits of business development. Widespread corruption and cronyism are particularly costly for societies and are directly linked to high levels of inequality and many of the other 'root causes' of migration that are identified in the EFSD regulation. That is why the reform of the rule of law and governance are absolute priorities. So far, the countries in the region have failed to address these issues effectively. Even though the countries themselves and the EU acknowledge the problems, there is a lack of leverage and of a clear reform strategy. The EIP's launch opens the door to a more effective coordination of EU policies, linking in particular the activities covered in the EIP's third pillar with those foreseen under the partnership priorities in the implementation of the European Neighbourhood Policy's (ENP).

The role of the informal sector in the economy is another challenge. According to the European Bank for Reconstruction and Development (EBRD), the European Investment Bank (EIB) and the World Bank, the informal sector's size in the region is estimated to be an average of 33% of GDP and accounts for even higher percentages of employment in some sectors.

At the same time, a lack of regional integration continues to hamper development. Cross-border activities related to smuggling and criminal networks are thriving. For the EIP to be effective, the reform agenda needs to include measures that facilitate the creation of formal legal frameworks by introducing simpler procedures for business registration, addressing border tariffs and starting up dialogues to standardise regulations at regional level.

In order to address these reform priorities, the implementation of the EIP will have to be accompanied by strong political and diplomatic engagement from the EU. Close coordination with other instruments, most importantly budget support through the ENP, will be vital to make sure that the EIP benefits the partner countries' societies, and not just the business sector or political elites. Ensuring complementarity with existing efforts, such as the EIB resilience initiative, and constant dialogue with non-state actors (civil society and grassroots organisations) will also be critical to the success of the new plan. It is in the strategic interest of the EU to contribute to prosperous stability in this region. With that objective in mind, the EU should not fall into the old trap of being a payer and not a player. The financial firepower of the EIP has great potential but needs to be carefully directed if the EU is to avoid business as usual.

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