

The EBRD's use of subsidies – Phase 1



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The EBRD's use of subsidies in projects has increased substantially over the past decade, on par with the overall increase of Bank business volume. Key drivers of growth include the financial crisis and the Bank's expansion into new areas including climate change, clean energy and resource efficiency. The role of subsidies is likely to increase further under the Bank's current strategic direction. Phase 1 of this EvD study maps subsidies approved between 2010 to 2014 by type, sector, geography and donor, and their consistency with Bank policies.

About subsidies

The four main types of subsidies used at the EBRD are:

1. **Investment grants** from donors or the EBRD's Shareholder Special Fund (SSF) representing part of the cost of projects and accompanying EBRD and other finance.
2. **Concessional loans** with terms (such as interest rate, grace period or repayment schedule) more favourable than available commercial loans.
3. **Incentives** - either *performance fees paid to partner financial institutions* as they extend loans to sub-borrowers, or *rebates for sub borrowers* when their use of loans for specified purposes is validated.
4. **Risk-sharing facilities** designed to encourage financial institutions to make intended kinds of loans, by reducing their risks of credit or exchange rate losses by the Bank's assumption of some of those risks.

Subsidies reviewed in this study are not used for technical cooperation purposes (technical cooperation involves assistance to clients lacking know-how, technical skills or expertise).

Study approach

Phase 1 of this study maps subsidy usage and extent of fit with EBRD policies through description and analysis, providing foundation. A later Phase 2 will involve evaluation of the results of subsidy use.

It includes: a review of EBRD policies and operational practices; interviews with EBRD staff in HQ and resident offices; analysis of 60 investment projects and facilities using all types of subsidies; and, builds on findings from recent EvD studies.

Findings

Wide usage across sectors and countries: Investment grants are mainly used by public sector clients; concessional loans balanced are across private and public clients, including partner financial institutions (PFIs); while incentives and risk sharing are offered to PFIs and individual sub-borrowers.

Uneven growth in use across types: Substantial increases were observed in *concessional loans* (large contributions from the Global Environment Facility and Climate Investment Funds), and *risk sharing*, with low growth in investment grants and incentive payments.

Donor priorities differ markedly despite some synergies. There were some gaps in countries and sectors filled by the SSF. Subsidy amounts are usually determined by the EBRD although donors drive some decisions (particularly for large grants from the European Structural and Investment Funds in infrastructure and transport).

Principles for use: These require clarity and coherence with some flexibility; they have been widely road-tested operationally and substantial experience exists. Approvals for subsidies in projects usually follow these principles.

Uneven application of policy principle "temporariness": Subsidies are often scaled down or ended in follow-up facilities, but there have been instances of repeated use. This warrants review.

Subsidies most often used as an incentive to clients (and sometimes sub-borrowers) to enable Bank operations, without separate objectives from the project.

Difficulty in measuring effectiveness without objectives: this requires judging whether the operation could have been successful with less or no subsidy. Only a minority of cases can be easily assessed due to presence of specific separate objectives.



Issues for consideration

Focus on distinctive objectives

Because of the difficulty in many cases of assessing the effectiveness of subsidies, even as the volume and range of subsidies to support new strategic and operational objectives are likely to grow, greater attention should be given to those aspects of the use of subsidies where relatively clear evidence may be available. These aspects include bridging gaps in the affordability for householders of municipal services, encouraging sector reforms, expanding PFI's lending of designated kinds, and achieving economies in energy use by sub borrowers.

Defining purpose

Work already underway in the Bank to strengthen results frameworks provides an opportunity to better isolate the use and intended purposes of subsidies where possible. Examples include: the effects on demand for municipal services of combinations of tariff increases and service improvements; the effects of tariff increases and public service contracts on the financial sustainability of municipal utilities; sustainability and demonstration effects of subsidised lending by PFI's after Bank credit lines have been repaid.



Case studies comparing subsidised and non-subsidised projects

Case studies of comparator projects in the same sector could usefully explore differences between subsidised and non-subsidised structures, their effects and sustainability. Approved projects that remained unfunded through a shortage of needed subsidies for longer than, say, one year, could also provide insights.

Review practices at other international financial institutions

There would be value in examining the practices – both design and assessed performance – of other providers of subsidy-enhanced operations in the specific sectors and countries of operation to identify opportunities to improve EBRD methods and practices. Comparison with other IFIs in similar context might be included in one of the cases for evaluation of results.

Read the full report at www.ebrd.com/evaluation.

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