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# The Investment Policy of the European Development Fund

By Jacques Ferrandi, Brussels

The European Development Fund (EDF) is playing a fruitful role in bringing eighteen independent African States and Madagascar, plus various dependent areas overseas, into association with the European Economic Community. Over five years (from mid-1964 to mid-1969) the EEC is making available 800 million accounting units (i.e. dollars) to promote the economic development of these States and territories, 70 million of this through the European Investment Bank. Now that two years of this second EDF have gone by (this second EDF has followed upon the first EDF which also ran for five years and had about 580 millions to dispose of), it is time to draw attention to certain guide-lines and experiences—particularly since any third Fund will have to be prepared during the last phase of the second one.

"Politics", wrote Max Weber, "is like hard drilling through thick boards." This is certainly so of development policy. But can we even say that the European Development Fund has a policy?

The evidence indicates that we cannot do so. Surely the European Development Fund is merely the administration of a fund composed of contributions from EEC countries? Obviously, however, "administration" is an understatement! The origin, aims and instruments of the European Development Fund smack of politics. The Common Market has taken upon itself the political task of assisting those developing countries which, because of their colonial past, have connections with EEC countries, so that after obtaining political independence they may also achieve economic independence and become efficient partners in a world economy based on division of labour.

This task is performed by the European Development Fund. Its administration makes political demands. This is evident from the choice and preparation of projects which are given support from the Fund.

## **Influence of the Fund upon the Choice and Preparation of Projects**

The first necessity for a project is that it should be "born", i.e. that a stage be reached where a decision can be taken about its acceptance or rejection. This is where the problems begin.

According to Article 21 of the Association Agreement, the initiative lies with the Governments of Associate States. These compile the documentation and submit it to the Commission. But in many cases, because they lack suitable personnel, the Associate States are not

really competent to undertake this function. So that even in this preliminary stage the Administration of the Fund has an important function in assisting projects to "develop". In many cases, the Administration has to make a preliminary selection amongst projects to be considered, many of which are only national. The Administration decides which projects are worthy of more detailed examination; if the evidence submitted is insufficient but the project has good chances of success, the Administration, where necessary, organises and finances the sending of European experts to carry out studies.

If the documentation has been received officially by the Commission, it is examined by the Administration of the Fund and completed, if necessary, with the help of Associate States and other experts. Only then is a project ripe for decision. It is first considered by the "Committee of the European Development Fund", which is composed of representatives of the six EEC Member States, presided over by an official of the Commission, the Director General for Overseas Development. This Committee, which hitherto has, with few exceptions, reported favourably on the projects submitted to it, passes its views to the Commission. It does not decide in a summary fashion, but from case to case. If the Commission does not agree with the views of the Committee, it has to submit the proceedings to the Council of Ministers with whom the final decision rests; in the only case where this has yet happened, the Council of Ministers concurred with the vote of the Commission.

This means that the Administration of the Fund carries considerable weight in selecting projects. What is its policy? What lines does it follow?

## **The Aim of Assistance from the Fund under the Yaoundé Agreement**

The Agreement of Association signed in Yaoundé tells us relatively little about the policy behind assistance given by the EDF. The aim of such assistance is to promote the economic and social development of the Associate States of their own responsibility for such matters and steps taken by the Fund are only intended to supplement their own endeavours. Spheres of intervention and conditions of financing are only outlined in a general way (Articles 17 to 19 and 24, also Protocol No.5). The exception is assistance for production and diversification, for which amounts totalling 230 million accounting units are set aside, split up according to recipient States.

The Agreement does not state any concrete policy of intervention, leaving it only to be carried out. On the contrary, it passes "the general implementation of financial and technical co-operation" to an organ of the Association, the Council of the Association, which is composed of representatives of the EEC countries, the Commission and the Associate States. The work of this Council is based upon an Annual Report which has to be submitted by the Administration of the Fund (Article 27).

#### The General Direction of Assistance by the Council of the Association

How has the Council of the Association decided the policy of the EDF? First, it must be said that it was only in May of this year (i.e. almost two years after inception of the Association) at its meeting in Tananarive (Madagascar), that the Council made any statement about the general direction of assistance. Thus, in many respects its decisions appear to be a "definition a posteriori". As required under Article 27, these are more of a general than of a specific nature, but place certain emphasis upon the aims laid down in the Association Agreement.

Some important points: The directives emphasise the harmonious development of productive forces in the Associate States, primarily the encouragement of directly productive investments and, in particular, of projects connected with the diversification of economies. Stress is laid upon industrialisation opportunities, especially industrial diversification. Investments whose yield will allow Associate States to promote development from their own resources are particularly recommended. A warning is given about squandering efforts. The Council has also emphasised that implementation of projects should be speeded up, continuous maintenance of completed projects ensured and the training of experts encouraged. These decisions clearly mirror the efforts of the Associate States to play a larger role in the preparation and implementation of projects.

As the following table shows, measures taken hitherto by the Administration of the Fund largely coincide with the allocation outlined by the Council. There is a considerable growth of investment in directly productive sectors and, by comparison with the first Fund, infrastructural projects have been emphasised less. Diversification measures, particularly those connected with agriculture, are receiving special attention. On the other hand, the scope for industrial projects is still limited. The reason for this is evident: in many cases the markets of Associate States are too small (both as to purchasing power and population size) to justify industrial production; on the other hand, studies continue to point up how difficult it is for products from Associate States to compete on export markets as regards price and quality.

As this glance at the project selection procedure shows, the Association Agreement and the Association Council only lay down general directives for the

EDF. In practice, the Administration of the Fund has considerable discretion. On what criteria does it select projects?

#### European Development Fund Commitments (end-July 1966)

Sphere of Intervention	Second EDF		First EDF
	Million Units	%	
Development of production	125.7	43	23
Agriculture			
Improvement of structure	24.3		
Diversification	50.0		
Other measures	45.9		
Industry and Services	5.5		
Modernisation of infrastructure	91.5	31	44
Social development	74.8	25	31
Other measures	2.2	1	2
Total *	294.2	100	100

\* Taking into account the price maintenance measures for agricultural products, advances to stabilisation funds, etc., the overall commitments of the Fund at end-July 1966 were equivalent to total 325.4 million accounting units (1 accounting unit = US-\$ 1.00).

#### Policy of Good Projects

The policy of the Fund can only be described as a "policy of good projects". There are good projects and there are bad projects; the good ones need to be promoted, the bad ones—wherever possible—should be weeded out. The main criteria for selecting projects are their "general usefulness", and an optimum contribution to economic and social development. In the Commission's decree laying down how the EDF shall work (Article 8) there is a whole list of criteria for examining applications for a project to be financed. This catalogue asks—inter alia—how the project fits in with the overall development programme of the State in question, how it affects the adjoining regional and economic areas, what contribution it makes to raising the standard of living, how it will influence the trade balance and the balance of payments, whether it is suited to the economic and social conditions of the country.

In practice, certain types of projects are excluded from being financed by the Fund. Among these are military installations and administrative and prestige buildings. Neither does the Fund finance any maintenance expenses. This ban is laid down in the Association Treaty (Article 24, II), but only applies to maintenance expenses for "established" projects. Technical assistance may be given in the initial stages of running installations financed by the Fund. It is not always easy to define the frontier between old and new projects. Thus the "reconstruction" of a completely ruined road is really considered as retroactive financing of maintenance costs; however, the Commission has always approved such applications if a sufficient case can be made as to its "usefulness" and future maintenance of the road appears to be ensured both financially and organisationally, particularly where it is an extension to take account of increased traffic demands.

These remarks about the principles of project selection by the Fund point up that what scientists often call "intuition" is given relatively more weight. The literature dealing with investment criteria may contain useful hints on questions of detail; but so far no one has been able to formulate a general standard which would, for instance, be practicable both for the infrastructure and for directly productive projects.

Quite correctly, there have been repeated refusals to consider profitability as a general criterion. Apart from the political question of whether profitability is a sufficient reason for giving priority to a project (each Associate State has to decide this question for itself), it is extremely difficult, if not impossible, to make a complete calculation of the economic yield from each project. This is particularly true of infrastructural and social projects, where—characteristically—there is often mention of "diffuse profitability". The development banks (for instance, the World Bank) find it easier because they limit themselves to financing "calculable" projects; they take into consideration the chances of a loan being repaid in foreign currency, as well as the profitability potential. EDF cannot do this since its investments are spread over a far wider area.

Hitherto it has been extremely difficult to find "lending projects" in Associate States which fulfilled these requirements. This difficulty is pointed up by the fact that use has never been made of the possibility envisaged in the Association Agreement that financing may be by loan carrying special conditions as stipulated by the Fund. The reason for this is not only a lack of projects with a minimum "concrete" level of profitability, but also the problem of foreign exchange. Doubtless more use would be made of this type of financing if a loan from the Fund were repayable in domestic currency. However, such a modification would be more akin to the US Marshall Plan Aid to Europe (i.e. an advance which does not require to be repaid) than to a true loan. All the same, it does seem worthwhile considering this possibility because it would mean that available resources could be better exploited and could act as an additional stimulus to the economic development of Associate States.

#### **Division of Labour Between Associate States?**

The formula of a "policy of good projects" needs further definition. The principle of the best use of resources means that the Administration of the Fund must choose the best of the "good" projects. However, such a selection is made only within an individual Associate State. Thus the significance of comparing projects from different States is relatively slight. The comparison of similar projects in various Associate States does, of course, give the Administration of the Fund valuable indications when examining projects from a management and technical aspect. But in practice such comparisons do not lead to conclusions anything like the free trade concept of division of labour where each country concentrates on whatever it can manufacture at the most reasonable prices and

obtains other products from its neighbours in exchange. It is difficult for the Associate States to follow such a policy if only because of the great distance and high costs of transport, although it would be possible to find "partial solutions". For example, neighbouring Associate States might consider an arrangement whereby one of them undertook to manufacture one product and another a different one to supply their joint demand. Unfortunately such solutions are still mainly (paper-wasting) theory. In the "development" world of facts, what is lacking is not only suitable projects; the autarchic type of thinking often found in Associate States is extremely limiting.

#### **Allocation of the Funds Resources Among Associate States**

The above considerations lead to the problem of how individual Associate States should share in the Fund. The Association Agreement establishes certain sums per recipient country, but only for manufacturing and diversification assistance. Otherwise there is no further breakdown of resources (we are not considering dependent territories here). If the principle of "general usefulness" is universally accepted, the best would have to be selected among all the projects submitted by Associate States. This procedure would be politically unacceptable; also it would not be in accordance with the spirit of the Association Agreement. In practice, this would mean that the more advanced States, or the States with the best administrations, would be the sole beneficiaries. For this reason the Fund makes its selection from the lists of projects submitted to it by individual States.

Thus, although the question of how the Funds' resources should be allocated among the individual Associate States remains an open one, it is becoming increasingly important now that the second Fund has been running for two years. The commitment of funds differs greatly from State to State, even if amounts are calculated per head of population. Even considered objectively, the problem of distribution is an extremely difficult one. What should the criterion be? Size of population? Size of territory? Or the difference between the current per capita income and an ideal average income for all Associate States? A combination of several factors? Even more serious political difficulties would be encountered if definite amounts were fixed for each State. This has already been established in negotiations on production and diversification assistance.

These are the reasons why the Administration of the Fund has to act pragmatically. The Administration encourages the backward States to submit projects and gives them every support to do so. At the same time some restraint has to be put upon better placed States, without discouraging them from working out and submitting "good" projects. The Administration of the Fund has to play as objective and fair a role as possible; such an "optimum" expenditure of funds is not only a requirement of economic but also of political common-sense.