



Office for South East Europe European Commission / The World Bank



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International Financial Institutions Advisory Group meeting March 15, 2007

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Draft Minutes

Background

The International Financial Institutions Advisory Group (IFIAG) held an inaugural meeting on March 15, 2007 at the European Commission Borchette Center. The meeting was chaired by Mr. Dirk Meganck Director Financial Instruments and Regional Programmes, DG Enlargement, European Commission. The following institutions participated: the European Commission, the World Bank, the European Investment Bank, the Council of Europe Development Bank, the European Bank for Reconstruction and Development, KfW, The Black Sea Trade and Development Bank, The Nordic Investment Bank, and the Stability Pact for SEE.

1) Discussion on Scope of Work of the IFI Advisory Group (IFIAG)

The meeting was opened by Mr. Meganck, who began by providing the group with an overview of the work of the Infrastructure Steering Group (ISG) and the rationale for upgrading its mandate. He reminded participants that the ISG had been instrumental in helping the countries of the region to develop regional approaches in transport, energy and environment sectors, while ensuring as far as possible that those regional approaches respected the criteria of economic and financial sustainability. Demonstrable progress has been made in this respect, with the countries having signed with the Commission a regional transport strategy including an agreement about a core regional transport network. The countries of the region also endorsed the Treaty establishing an Energy Community for SEE (Athens Treaty) and have actively used the Regional Environmental Center (REC) to work together on environmental issues.

Given that all the countries of SEE are, to varying degrees, clearly on the path to EU integration and considering that the EU agenda is therefore highly prominent in all countries, Mr. Meganck explained that the Commission believes that it is time to upgrade the level of the ISG so that it can:

- develop more strategic views in line with the EU integration objectives of the Instrument for Pre Accession (IPA) countries;
- extend its scope to the coordination of the development of national infrastructure
- extend participation to all actors present in the countries.

It was recognised that achieving this new mandate will rely on building upon the excellent cooperation among the financial institutions developed within the ISG. The aim will be to provide an advisory, informative and non-binding forum.

This introduction was followed by a tour de table on the draft Scope of Work of the IFIAG.

The **European Investment Bank** began by expressing appreciation for the work of the former Infrastructure Steering Group and the desire to contribute to the work of the IFIAG. Nevertheless the EIB stressed that, as an institution of the EU, it was vital for it not to be limited in its comparative advantage through the IFIAG. The EIB also pointed out, in the context of the 'geographical scope' of the IFIAG that not all actors work in the same countries. For this reason, the EIB proposed that the scope of work document incorporate the following sentence from the MoU between the EC and the IFIs¹ – "Each of these IFIs contributes to... cooperation within its scope of action and statutory geographical or sectoral remit".

The **Stability Pact** noted that the "Scope of Work" document does not place sufficient emphasis on the regional dimension, whereas one of the important functions of the ISG was to advocate for a regional approach to infrastructure development. The Stability Pact would like to see a more specific reference to cross border issues and regional projects and regional secretariats (SEETO, REC etc) being woven into the document. Against the backdrop of limited fiscal space, the Stability Pact stressed that it is indispensable, when considering specific projects, to look at different financing options in order to involve the private sector as much as possible; PPPs should therefore be part of the agenda of the IFIAG as it moves forward. Participants were also reminded that the Stability Pact is now in the process of helping to set up its successor – the Regional Cooperation Council (RCC), which will take over the role of fostering regional cooperation in SEE. The IFIAG will need to be closely linked to the RCC in order to cover the regional dimension of the work.

The **World Bank** welcomed the initiative and requested that specific new topics to be addressed by the IFIAG be agreed quickly. The World Bank proposed that the IFIAG cover 'social sectors' (eg, education, health), as the needs in this sector are very large and the path towards the EU is not easy, requiring regulatory reform and structural adjustment. The issue of fiscal space and unsolicited bids was highlighted as an area where the EU candidate and potential candidate countries continue to face challenges. Participants were reminded that the World Bank has been following this issue closely, with various presentations and papers tabled at previous ISG meetings; it was proposed that the IFIAG continue to address this topic.

Another area of concern is the limited capacity of countries of the region to prepare projects and disburse funds; procurement, an essential aspect of good governance and the fight against corruption, is seen as being particularly problematic. In the view of the World Bank, it is important that partner countries and institutions learn how to prepare projects for themselves, rather than relying on consultants to help them, so as to ensure country 'ownership' from the outset. The IFIAG could serve as a forum to discuss modalities of best using EU Project Preparation Facilities, as well as investigating alternative models to encourage greater country ownership.

¹ Amended Memorandum of Understanding between the European Commission in liaison with the European Investment Bank, EBRD, IBRD, IFC, NIB, Nordic Environment Finance Corporation, the Council of Europe Development Bank, the Black Sea Trade and Development Bank on co-operation in (i) economic development of the new EU Member States of Central and Eastern Europe, Cyprus, Malta, and (ii) accession preparation in the EU candidate and potential candidate countries signed on 11 April 2006

The World Bank concluded by proposing that targeted discussions on specific themes, covering operational priorities, should be discussed within context of individual IFIAG working groups.

The **European Bank for Reconstruction and Development** echoed appreciation for the work of the ISG, whose strength, in their view, had been in providing a neutral and informal forum in which member IFIs could review their differences in approach. The EBRD proposed that this should not be lost when upgrading to an IFIAG. Similar to the World Bank, the EBRD stressed that policy discussion within the IFIAG be coupled with separate working group discussion of regional operational priorities (eg, Kosovo Energy, PPP issues, Transport and the core network).

The **International Finance Corporation** also welcomed the initiative, but would like to operationalise the collaboration. Participants were informed that the priorities of the IFC in the region are: infrastructure and PPPs, the energy sector, housing finance and energy efficiency finance. The IFC would like the IFIAG to help them align more closely to EC and other IFIs programs on the ground, possibly with identification of joint projects.

The **Council of Europe Development Bank** proposed that the IFIAG should continue to look at environmental issues and particularly water management in its widest sense (eg, flood prevention). They also concurred with the World Bank that human development and social issues were particularly pressing in the region and should be covered by the group.

2) Principles of Co-operation with International Financial Institutions in 2007 under the Instrument for Pre-Accession Assistance

This part of the meeting examined planned related activities between the EC and IFIs under the 2007-2009 Multi Beneficiaries MIPD. Mr Meganck reminded participants that the EC has a number of old and new instruments for developing cooperation, which currently fall under several strands:

- a) **SME financing** through either (i) the EFSE (Investment Fund) or (ii) the SME Finance Facility (SMEFF), both of which aim to strengthen the capacity of financial sector institutions so as to enable economic actors gain access to finance in the long term, in particular finance for micro-enterprises and SMEs including the farming business.
- b) **Energy efficiency** finance facility (EEFF)
- c) **Project Preparation facilities** (including JASPERS)
- d) A new **Infrastructure Facility**, which will include Technical Assistance component for project preparation. Technical Assistance will be available for infrastructure projects aimed at upgrading transport networks, environmental schemes and investments improving energy efficiency and using renewable energy. It will also cover projects in other sectors such as health, education and urban redevelopment.

2a) SME financing

The **European Commission** began by introducing the SME Finance facility, a supply side instrument, which has been a successful co-operation instrument with the IFIs since 1999. It has provided a number of incentives to financial intermediaries to expand and maintain their lending to SME's, with a balanced country coverage. To date, the EU contribution to the facility has been €383 million and the amount of incentives paid out to financial intermediaries has been €143 million; the number of SMEs reached is 84,000. Participants were informed that a review of the SME Facility is currently underway and the European Commission does not envisage to put IPA funds into it in 2007, especially considering that it has a backlog of €200 million.

Kreditanstalt für Wiederaufbau (KfW) presented the European Fund for Southeast Europe (EFSE). This facility aims to foster economic development and prosperity through the sustainable provision of additional development finance, primarily to SMEs and to private households. It is a multi-donor engagement, which started operations one year ago and has already grown to be one of the largest micro-finance facilities in the world, with 44,577 borrowers and a sub loan portfolio of €195.4 million.

During a discussion that followed these two presentations, the **EBRD** pointed out that although the countries of the Western Balkans have limited financial intermediation levels, statistics for the financial sector show that liquidity is very high, especially at the local corporate level. For this reason, the EBRD suggested that the key issue for development of SMEs is the capability of local companies to become bankable, which is why EBRD has focused on 'turnaround' management through a Western Balkans Local Enterprise Facility to make direct equity investments in local companies.

The **World Bank** cautioned that there is a huge credit explosion in the Western Balkans. Despite the fact that all countries of SEE have preferential arrangements for exports to the EU, export levels have remained flat. This suggests that most credit is going towards imports/consumption. This is a disturbing development, especially considering the large current account deficits that the countries of SEE are grappling with.

The **EIB** contested that financial intermediaries do still need assistance and that the demand for investment exists. Overall, there are encouraging developments in the financial sector and commercial banks are beginning to increase their footprint in the region.

Conclusion

It was agreed that the next meeting of the IFIA, or its working groups, should look at the wider macroeconomic picture, so as to inform the development of current and future SME facilities.

2b) Energy Efficiency Facility

The EBRD made a presentation of this facility, which aims to stimulate energy efficiency investments in the industrial sector and in all types of building by making appropriate financing available to the end-borrowers, thereby resulting in energy-saving and in the reduction of CO² emissions.

During discussion, the **World Bank** pointed out that the best way of ensuring energy efficiency is to ensure that people pay for energy. A comprehensive approach is required if the IFIs are to encourage energy efficiency, with adequate resources at: country, municipal and household levels. Another challenge is to help the countries build capacity to develop a project pipeline in this sector. The World Bank recommended that IFIAG consider establishing a working group to look at energy efficiency activities by the IFIs in the region in a coordinated fashion.

2c) Project Preparation Facilities

The European Commission began with a presentation on a number of Project Preparation Facilities (PPFs) which it has made available over the last few years to address the assistance needs in the field of regional infrastructure development in the Western Balkan countries². The main areas of intervention have been:

² The importance of developing modern networks and infrastructure in the transport, energy and environmental sectors was pointed out as a priority in the Thessalonica Declaration of June 2003, the 2004 European Partnerships, as confirmed in the 2004 SAP Annual Reports, and the regional Multi-Annual Indicative Programme (MIP) for 2005-2006.

- **Transport** - To support preparation of documentation preliminary to transport investments (roads, railways, ports, airports, etc) in compliance with the standards of the IFIs concerned. A Transport Project Preparation Facility (TPPF) was undertaken in 2003 and 2004. The contract for the TPPF was signed on October 1, 2003 and reached completion on December 31, 2004. The overall budget was €2.53 million and the project leveraged approximately €250 million for some ten projects
- **Energy** - To support modern and efficient energy networks in South-East Europe, connected and compatible with the corresponding European networks (gas, oil, electricity)
- **Environment** - To improve the condition of environment and environmental infrastructure through the implementation of a functioning system of law and standards and the enforcement of existing instruments and resources. A Danube Investment Support Facility (DISF, CARDS 2002: €3.70 million) was contracted in 2004 and will end in June 2007. In addition, an Environment Project Preparation Facility (EPPF, CARDS 2003: €1.80 million) was contracted in July 2006, activities commenced in October for a period of 24 months

Two further PPFs, under CARDS 2005 (€10 million) and 2006 (€6 million) are under discussion covering primarily the energy sector and also transport and some environment infrastructure. Mr. Meganck explained that the EC is considering expanding this PPF through the creation of a new Infrastructure Facility, which will include Technical Assistance component for project preparation.

The **EIB** followed with a presentation on the JASPERS (Joint Assistance to Support Projects in European Regions) program, which is a major joint policy initiative of the EIB, European Commission (Regional Policy Directorate-General - DG Regio) and the European Bank for Reconstruction and Development (EBRD). JASPERS will assist beneficiary countries (principally the new Member States of the EU) to prepare major infrastructure projects which will be assisted by the EU Structural and Cohesion Funds over current budgetary planning period 2007-2013. All assistance will be offered free of charge. Assistance may be given to prepare individual projects or horizontal studies that cover more than one project or more than one country.

During a discussion which followed these presentations, the **World Bank** expressed encouragement that the EC is considering expansion of the PPF. In addition to the JASPERS model, the World Bank pointed to the experience that it has had with the Policy and Human Resources Development (PHRD) TA Fund. This is a Japanese facility, administered by the World Bank, in which the funds are provided directly to the client countries for project preparation, under supervision by the Bank. This results in a capacity building effect in which the countries assume full ownership for developing the project. The World Bank also stressed the need for ensuring that projects being prepared fit squarely into the government's overall public investment and expenditure program.

KfW concurred that PPFs have been very helpful to the region but they have seen that most of the investments prepared out of the PPFs have been financed by the EBRD and/or EIB. Similarly, JASPERS appears to be limited to the EIB and EBRDs. KfW encouraged the EC to ensure that future PPFs would be open to a wider array of IFIs.

The **EIB** responded by pointing out that unlike other some other banks represented the EIB, as an EU institution, only has access to grant based funds coming from the EU budget.

3. Overall Conclusion

Participants welcomed the IFIAG initiative and underlined the importance to continuous coordination among financial institutions acting in the region.

The Advisory Group should help to harmonise approaches in implementing projects and programs, including in addressing issues linked to the policy agenda and overall prioritisation of public investments by the authorities.

The Group will address issues linked to the development of infrastructure, national and regional. Attention will continue to be given to the regional initiatives, in transport, energy and environment, while new sectors will be addressed, including social sectors (health and education). Horizontal issues, such as fiscal sustainability, PPP and unsolicited bids, overall Public Investment prioritisation will also be part of the agenda.

Based on the experience of the ISG, coordination at the operational level shall continue. To this end, ad hoc working group meetings will be convened.

The Advisory Group of IFIs and/or its ad hoc working groups will provide, as necessary, input to the respective coordination groups established in the frame of the regional initiatives, avoiding duplication of efforts.

The Chair requested the Joint Office to prepare a work program for the IFIAG, including its working group(s) on the basis of the points raised during the tour de table.