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Infrastructure Steering Group Meeting – March 2, 2005 Office for South East Europe, Brussels

Minutes

Background

The Infrastructure Steering Group (ISG) met at working level for the eighth time on March 2, 2005 at the European Commission/World Bank Joint Office for South East Europe. The meeting was chaired by Mr. Michel Peretti from the European Commission (DG Enlargement). All members were represented: the World Bank, the Council of Europe Development Bank, the European Bank for Reconstruction and Development, the European Investment Bank, the European Commission and the Stability Pact.

The minutes of the seventh working level ISG meeting (May 13, 2004) were presented by the Chair for comments and were adopted.

Substantial discussion covered: EU Assistance in support of infrastructure development and environment; public investment and indebtedness capacity of the countries of the region; transport, energy and environment (water).

1. Work Program 2005-2006

The new chair of the ISG, Mr. Michel Peretti (DG Enlargement) outlined some of the key findings of consultations that he held with members of the group during November and December 2004. These consultations had focused on what members felt had worked well over the last three years of operation. In general, members agreed that:

- Informal nature of the group is appreciated
- Core business of the group is regional infrastructure
- ISG is most effective when it takes a pragmatic approach to cooperation
- ISG translates coordination into action, especially through support to Project Preparation
- ISG remains a useful mechanism, especially for information exchange

On the basis of these consultations, as well as the discussions during the meeting, a program of work for the next 18 months is in the process of being elaborated.

In the discussions which followed, the World Bank raised the issue of geographic coverage of the ISG and whether it should be extended to Bulgaria, Romania and Turkey. In this context, the Commission pointed out, and other ISG members concurred, that a number of regional initiatives, including DABLAS and the Energy Community of SEE, already incorporate these countries as key partners and should therefore be considered by the ISG. The Stability Pact recalled that the work of the ISG should take due consideration to Moldova, as it is a member of the Stability Pact, to the extent that it is part of a relevant regional initiative.

The Stability Pact informed participants that the next Working Table II meeting, to be held in Sofia on May 17, 2005, will focus primarily on Infrastructure.

Operational Conclusion

- *As a first step in planning future work, the chair distributed to members a draft rolling agenda. This agenda will be transformed into a precise work program for the next 18 months by the Joint Office – a draft is attached.*
- *The next ISG meeting will be held on April 29 will be used to prepare for the Stability Pact WT II meeting. A draft agenda will be prepared and distributed by the Joint Office by early April.*
- *The discussions on environment and transport (see below) led the meeting to consider the opportunity to focus a next ISG meeting on Project Preparation Facilities, in order to have a global picture of ongoing operations and discuss experiences. Interested bilateral donors will be invited to participate. Such a meeting is scheduled for July.*

2. EU Assistance in support of infrastructure development 2005-2006

The European Commission (DG Enlargement) informed the ISG members that under the CARDS programme, the EC had prepared, in the last quarter of 2004, Multiannual Indicative programs (MIP) for Albania, BiH, fYRoM, Serbia and Montenegro, Kosovo plus one regional program for the period 2005/2006. As of the beginning of 2005, Croatia no longer benefits from CARDS assistance and is instead eligible for the pre-accession instruments (PHARE and ISPA programming). A table of planned assistance 2005-2006 to the Western Balkan countries in the infrastructure and environment sectors was distributed to participants (attached). The total envelope of funding under CARDS for these sectors amounts to €117.8 to €135.8 million, with a further €60 million programmed for Croatia under ISPA financing.

Under 'Infrastructure Development', the CARDS Regional Programme shall further intensify support to investment project preparation / implementations facilities (PPF). The Commission will be earmarking between €15 to €19 million for a Project Preparation Facility to cover the Transport, Environment and Energy sectors¹. A tentative breakdown of this budget line is as follows: Transport (45%), Environment (35%) and Energy (20%). The new regional PPF will be in implementation phase by the first semester of 2006; Environmental Impact Assessments will not be considered for financing under the facility. Support to infrastructure investment will also be granted under the national programs

The CARDS regional MIP proves that regional cooperation remains at the heart of EU policy and ISG members were reminded that they will be key counterparts for co-financing viable projects that emerge from the PPF.

4. Environment

This is a complex area, covering several sub-sectors and different regional initiatives and strategies. The chair pointed out that Joint Office had previously prepared a useful document on existing initiatives. The group should be selective in what it would like to achieve. The aim of this part of the meeting was to provide background on the state of play and to see what practical actions could be undertaken jointly in 2005. Several presentations were made, covering three regional programmes. In the discussion which followed, the key focus was on how the group could help move forward PPFs in this sector.

4a) The Regional Environmental Center (REC) - Priority Environmental Investment Programme for SEE

¹ The budget for 2005 will be around €6 million (tbs), this will be contracted in the first semester of 2006. The remaining budget will be contracted in 2007.

The Executive Director of REC provided an overview of the work program of the center, which acts as secretariat for the Regional Environmental Reconstruction Program for South-East Europe (REReP)². In particular, the REC has been responsible, together with SEE national environmental authorities, for implementing a CARDS regional project on the 'Priority Environmental Investment Programme for SEE' (PEIP). This project supports national environmental investment planning in SEE, through institutional strengthening and capacity building. The first phase of the project (2002-3) focused on assessment and prioritisation of environmental and investment needs of the region; resulting in a long list of environmental hot spots (144 locations) and a compilation of 79 priority environmental investment projects (PEIP).

The project, now in its second phase (2003-2005), is currently geared towards providing guidance material for implementation of the PEIP. An important output for this phase will be the formulation of 33 project concepts in water, air and waste sectors that are in line with key investment-heavy EU Directives, and to assist the 33 pilot hot spots in acquiring donor finance. Another task is to update list of priority environmental investment projects based on PEIP 2003 projects.

The key principle underlying the PEIP is support for EU integration and eventual EU accession, and the aim is to enable a long term process of compliance with the *EU aquis*. The REC stressed in particular that there is a strong need for knowledge in the countries of the region on how to secure financing for projects; with a pronounced gap in understanding about the procedures and requirements of IFIs. For this reason, closer collaboration with the ISG was tabled:

- ISG involvement in the planning stage,
- Participation of ISG members in PEIP events,
- Strategic advice and input to PEIP products,
- More frequent meetings between ISG and PEIP

ISG members expressed some concern about the number of priority projects emerging from the exercise and that key impediment to investment pipelines was often due to weak capacity / enforcement of legislation and weak environmental monitoring. The EBRD also highlighted the need for enhancing the self financing of projects. In response, the REC pointed out that the number of projects is not so high considering that they cover three sectors (water, waste, air) and all countries.

4b. DABLAS

The European Commission (DG Environment) provided an update on the work of DABLAS Task Force³. For the DABLAS project pipeline, six category I projects have received full approval for financing and have now been removed from the pipeline. The focus of work is now on fifteen projects, mainly located around the Black Sea, which have, however, not yet moved forward. These projects will be supported by the TACIS Black Sea Investment Facility (BSIF). The DABLAS secretariat have included some ReREP projects onto the list (only those water projects related to the Danube catchment area). The next Task Force meeting is scheduled for May 2005. As regards the Danube basin projects located in the Western Balkans, the Danube Investment Support Facility (€3.6 million) will carry out feasibility studies of future investment projects proposed by partner IFIs. Initially, € 3 M will be allocated in equal parts of € 1 M between the World Bank, the EBRD and the EIB. The remainder will constitute a reserve available for studies relating to high priority projects proposed, notably by other IFI's.

² REReP brings together the countries in Central, Eastern and South East Europe with the International Financial Institutions (IFIs: EBRD, EIB, World Bank), the European Commission, the Stability Pact, interested EU Member States and other bilateral donors. It provides a platform for regional cooperation, donor coordination and peer review. The main focus is on assisting the administrative reforms. It supports activities in the area of capacity building and institutional strengthening to develop and implement environmental legislation

³ DABLAS brings together the Black Sea and Danube countries with the International Commission for the Protection of the Danube River (ICPDR), the Black Sea Commission, the IFIs (EBRD, EIB, World Bank), the European Commission, the Stability Pact, interested EU Member States and other bilateral donors to facilitate communication and coordination and result in a more focused approach to the protection of water and project featuring. DG Environment of the European Commission holds the secretariat of the Task Force.

4c. Coastal Management Issues

The World Bank provided an overview of the GEF Strategic Partnership for the 'Mediterranean Sea Large Marine Ecosystem' which aims to assist countries in implementing policy reforms and priority investments focused on pollution remediation (water management and wastewater) and biodiversity. The Partnership will support capital investments, implementation of policy reforms, strengthening of public institutions and public participation through two elements: a regional technical assistance project, implemented by UNEP and an Investment Fund, implemented by the World Bank. The Investment Fund will be supported by the GEF with US\$ 85 million grant financing over multiple tranches. It is hoped to leverage three times this amount in co-financing through other donor contributions.

The World Bank also referred to a new Integrated Coastal Zone Management and Clean-up Program which is designed as an Adaptable Program Lending (APL) mechanism to be implemented over 7 years. The total program is expected to cost US\$54.3 million. The project, in its first phase (from Sep-2005 to Aug-2009), will focus on the operational strategies, normative and institutional capacity strengthening, basic environmental infrastructure and rehabilitation.

During discussion, the European Commission (DG AIDCO) announced that a new Environment Project Preparation Facility (EPPF) will be implemented over the next thirty months. The EPPF, which has a budget of €1.8 million, will be a sister project of the DISF but will focus more on FYR Macedonia and Albania, which are not covered by the DISF, and should result in a number of feasibility studies, which should lead to related investment financing, including from IFIs.

Operational Conclusion

- *It was concluded that a separate ISG meeting will be held on April 25 on Environmental projects in order to determine an agreed list of priorities and to ascertain linkages with the Project Preparation Facility. A morning session will be devoted to screening/prioritisation of REC projects and an afternoon session focused on financing issues and domestic capacity building.*
- *The Joint Office was also tasked to compile a synthesis (on the basis of input from Members of the Group and the REC) of 'Capacity /Institution Building' measures which are seen as being most required for the sector.*

5. Public Investment and Indebtedness Capacity of the countries in the Balkans

The World Bank made a presentation on key issues that countries in the subregion as well as funding agencies should consider when evaluating proposed borrowing and investments. While the macroeconomic situation in the Western Balkans has been improving slowly, there remain a number of key vulnerabilities, especially those relating to high or very high debt to GDP ratios (except FYR Macedonia), current account deficits and external financing needs, government expenditures relative to GDP (except Albania), and external debt to GDP (Serbia and Montenegro). It was made clear that the amount of 'fiscal space' – the amount of budgetary room that a government has to provide resources for a desired purpose without prejudice to the sustainability of its financial position – is becoming more limited in the Western Balkans. Although the findings of the Bank are illustrative and may not address all related issues, they strongly suggest a need to carefully consider macro/fiscal constraints when planning/proposing new investments. Key conclusions were:

- For proposed new infrastructure investments to have the desired growth impacts, they must be subjected to rigorous cost/benefit analysis and other evaluation, and supported by strong reforms/ regulatory framework, and enhanced cross-country cooperation.
- These considerations become more important with the currently very limited fiscal space as any foreign financing will need to fit into such limits and domestic budgetary resources will need to finance an increasing share of public investments.

Operational Conclusion

Members of the ISG took careful note of these findings. It was agreed that the Public Investment and Indebtedness Capacity of the countries in the Balkans is a very important issue. It needs to be addressed by the European Commission and IFIs; the European Commission (DG ECFIN) will table the issue at a future meeting with IFIs. While the problems are much wider than just regional infrastructure, the ISG does need to be regularly informed about the issue and will when appropriate refer to the question of overall macroeconomic issues.

6. Information Communication Technology

A presentation was made by the European Commission (DG INFOSO) on regional aspects of electronic communications in the Western Balkan countries. The European Union has developed a regulatory framework for electronic communications, to ensure fair competition in the sector. This framework is now being implemented in the EU25. In addition, under the Lisbon agenda, EU economic policies have recognised the importance of migration towards a “knowledge based economy”; success here requires the full liberalisation of electronic communications.

To date, the EU has provided very little assistance to Western Balkan countries in the Information Society field. It is currently in the process of defining an approach, which will most likely be based on the model followed by the Energy Community of South East Europe (ECSEE). The overall aim will be to establish collective ways of dealing with all the Western Balkan countries in several areas of electronic communications, primarily on harmonisation with EU regulatory practices and transfer of know-how on key regulatory aspects, on ICT policy issues, and on contribution to the ICT research strategy.

Members took note of this new component of regional cooperation, which is likely to play an important role in the economic development of the region.

7. Transport

7a) High Level Group – extension of Trans European Axes

The European Commission (DG TREN) provided an overview of the work of the group. The aim is to establish proposals on how best to connect the newly enlarged European Union (25 Member States) with its neighbours by 2020. Final recommendations will be submitted to the European Commission by the end of 2005. Two main areas are being considered:

- Main axes and priority projects
- A number of horizontal issues (for SEE: Air Traffic Management, Rail Interoperability, Road Safety)

Several members of the ISG wondered about the complementarity of this exercise to the Memorandum of Understanding on the Core Network and that partner countries may be equally confused. It was explained, however, that compared to the extensive work already done in South East Europe, this additional exercise is not about reopening the past discussions on the Core Transport Network, but rather that it is expected to add a further degree of prioritisation within this network, from the standpoint of the EU-27 (ie, including Bulgaria and Romania) Transport Trans-European Network (as defined by the EU in April 2004). Furthermore the mandate of the High Level Group is far from being only about transport axes and projects: it is also about identifying and making proposals on horizontal priorities – non-physical barriers, intermodality, interoperability, satellite navigation systems etc. The Core network, on the other hand, which also includes a comprehensive ‘intra-regional’ network, will remain unaffected.

7b) Follow-up on the MoU on the Core Transport Network (establishment of SEETO)

The European Commission (DG TREN) gave an update of work that has been carried out by the consultant responsible for the establishment of the South East Europe Transport Observatory (SEETO)⁴. Participants learnt that office space for SEETO has been provided by the Serbian government and that the legalisation of SEETO is expected to be signed by the MoU signatories by

⁴ The consultant could not attend the meeting due to illness.

the end of March. Members of the ISG were also provided, in December 2004, with a draft inception report, for which comments were received and incorporated into the final version of the document. SEETO national coordinators have also been appointed, and nominations for members of the Steering Committee were received in January 2005.

The first full Steering Committee meeting is scheduled for April 26-27, 2005 and will be held in Tirana.

The Stability Pact informed the group that they had received a letter from the European Transport Workers Federation, pointing out the importance of dialogue with civil society, as enshrined in paragraph six of the MoU. They have requested the establishment of a forum to discuss the development of the core network.

Operational Conclusions

- *On SEETO, it was confirmed that the core mandate is to assist in implementing the Memorandum of Understanding on the regional transport network to ensure that the signatories co-operate on the development of the main and ancillary infrastructure on the Network and enhance policies in this area which facilitate such development. This will involve in particular networking of transport authorities, strategic overview of the realization of the core network, institution building and support to sector policies; and, maintaining an information database.*
- *The Commission will prepare and circulate a note defining the distinction and interrelation between the TEN2 High Level Group and the Steering Committee / Core Network*

7c. Transport Project Preparation Facility

A report on lessons learnt from the TPPF was presented to the ISG by the consultant (Scott/Wilson). 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. It was explained that the project had leveraged approximately €250 million for some ten projects; this form of consultancy has therefore proved to be very efficient for IFIs and beneficiaries. For lessons learnt, the consultant stressed that it was better to develop a full corridor investment programme rather than one based on a project by project analysis. It was also felt that there was a need for more policy dialogue on a regional basis. In this context, the ISG was encouraged to consider its own role as well as that of SEETO and the Steering Committee.

7d. Air Traffic Management

Members of the group were informed by the European Commission (DG TREN) that they have developed a comprehensive approach to aviation and air traffic management in the region. The Single European Sky initiative offers the opportunity to give priority to the operational requirements of air transport development, in particular by implementing the Functional Airspace Block concept which is based on a more integrated cooperation in between air traffic control service providers in managing traffic flows regardless national boundaries. One of the current gaps in this system is the Balkans, especially Kosovo and it has been proposed that Western Balkan countries negotiate a comprehensive aviation agreement to eradicate this fragmentation. Full details are available in the note attached to the minutes.

Members, some of which like the World Bank do not intervene in this area, expressed support for this approach, which will facilitate investments in the sector.

8. Energy

8a) Progress Report on establishment of the Energy Community

The European Commission (DG TREN) provided an update on the state of play. There have been important developments for the Energy Community over the last few months. A successful Donors group meeting was held on February 4, and members were informed that the Treaty establishing the Energy Community will be initialled on March 22, although there have been some reservations from Turkey. It is expected that the Treaty will be officially signed by the Summer of this year and will

come into force by January 2006. An Energy Community secretariat is also being established in Vienna.

Of particular concern to the Commission is the recent decision of Serbia to impose new fees and taxes on cross-border transactions. This threatens the viability of the entire Energy Community and urgent negotiations to correct this situation with the authorities will be undertaken.

8b. Update on the Electric Power Adaptable Program Loan of the World Bank

The World Bank program aims to help the countries in the region to effectively participate in and further develop the Energy Community by implementing priority investments supporting electricity market and power system operations, technical assistance for system development, and project preparation and implementation. The first constituent loan under the ECSEE APL facility, was approved by the World Bank's Board on January 27 through a €66 million (US\$84.3 million equivalent) loan to the Romanian hydropower generator Hidroelectrica S.A. The total ECSEE APL facility will provide US\$ 1 billion of investments. It is expected that Turkey, Albania, and Serbia and Montenegro will be the next candidates to receive support under the facility within the next six months. Other financial institutions and bilateral donors supporting the Energy Community include the European Bank for Reconstruction and Development (EBRD), the European Investment Bank (EIB), the German Development Bank (KfW), the United States Agency for International Development (USAID), the Canadian Agency for International Development (CIDA), and the governments of France, Greece, Italy, and Switzerland.

A note on developments was distributed to participants (attached).

8c. Update on the Generation and Investment Study (GIS) by the World Bank

Participants heard that the Study is progressing well and is close to completion. The final report will be published no later than April 30, 2005 and will be discussed at the next Athens Forum (June 2005). Draft results for the GIS have already been presented at the Tirana energy seminar (Feb 10-11, 2005) and the main results show that the region will need to invest about US\$15 billion over the next 15 years in the rehabilitation of 11,574 MW of existing power plants and the construction of about 11,000 MW in new power plants. This does not include associated investments in transmission and distribution which are probably of the same magnitude (i.e. no less than US\$10 billion).

A note on developments was distributed to participants (attached)

Operational Conclusions

- *It was noted that the GIS will be crucial in determining the planning of investments and will provide a common reference for all stakeholders and investors*
- *The European Commission (DG TREN) was requested to put together a short note explaining the difficulties posed by SaM's unilateral adoption of fees/taxes on cross-border energy transactions. This will be circulated to members of the ISG.*

9. Regional Infrastructure Program

The Joint Office provided an update on the current status of implementation of the regional infrastructure projects being monitored by the ISG. There has been considerable progress over the last two years, with 33 projects or €3.06 billion of investments under implementation, and eleven projects worth €430 million having been completed. There have been delays in implementation, however, primarily caused by:

- Technical standards being altered, resulting in increased cost not covered by existing financial commitments
- Land acquisition – high compensation prices / legal disputes
- Geological problems
- Design issues
- Tendering issues

The ISG also discussed whether the current list is as valuable as it once was and whether it should be reviewed to focus more on monitoring the output of regional initiatives / strategies in the transport, energy and environment sectors.

Operational Conclusions

- *The Joint Office was tasked with reorganising the output of the database to demonstrate more clearly how the projects relate to regional initiatives and to illustrate where the major implementation difficulties lie.*