



**ENVIRONMENT DIRECTORATE
ENVIRONMENT POLICY COMMITTEE
TASK FORCE FOR THE IMPLEMENTATION OF THE ENVIRONMENTAL ACTION
PROGRAMME FOR CENTRAL AND EASTERN EUROPE, CAUCASUS AND CENTRAL ASIA**

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PPC REVIEW SYNTHESIS REPORT

Fifth joint meeting of the Task Force for the Implementation of the Environmental Action Programme for Central and Eastern Europe (EAP Task Force) and the Project Preparation Committee (PPC)

15-16 March, Brussels

Agenda Item 11

ACTION REQUIRED: EAP Task Force/PPC delegates are invited to:

- endorse the synthesised findings of the 2006 PPC review*
- provide guidance on their incorporation into the PPC's Category II report to the Belgrade Ministerial Conference*

Please contact Mr. Craig Davies, PPC Secretariat, + 44 207 338 6661, e-mail: daviesc@ebrd.com

English - Or. English

PPC REVIEW SYNTHESIS REPORT

1. This document sets out the key findings and recommendations of the 2006 PPC review, taking into account further feedback received from PPC stakeholders. Subject to the Bureau's views, these recommendations will be reflected in the PPC's Category II report to the Belgrade Ministerial Conference. The central issue to be addressed is how the PPC can continue to bring environmental benefits to the countries of EECCA and SEE by working with IFIs and donors to support the financing of environmental investment projects. This report sets out two possible scenarios under which the PPC could meet these needs. The first scenario proposes a future PPC that works with a wider range of IFIs supported by its own multi-donor fund. The second proposes a future PPC which is more closely integrated into the EBRD and which is aligned with existing EBRD multi-donor funding arrangements such as the Early Transition Countries Initiative (ETCI). PPC and EAP Task Force stakeholders are invited to consider these proposals and provide guidance on how these options should be presented in the PPC's Category II report to the Belgrade Ministerial Conference in October 2007.

Introduction

2. The PPC was created in 1993 under the 'Environment for Europe' process to support the financing of environmentally-related investment projects in Central and Eastern Europe and the countries of the former Soviet Union. The mandate of the PPC was renewed most recently at the EfE Ministerial Conference in Kiev in 2003, where the PPC was asked to continue its work in the region but to strengthen its focus on the countries of EECCA and SEE. The PPC strategy adopted after Kiev was built on three pillars: i) project identification, preparation and financing, ii) coordination, matchmaking and networking, and iii) good practice and capacity building. The PPC has made a significant contribution to the financing of environmental projects in the region. Since 2003 it has facilitated 20 projects that have been Board approved by IFIs at a total project value of €435 million. It has also supported a further 45 projects that are still under development or exploratory, with an estimated potential total project value of more than €944 million¹. At the next EfE Ministerial Conference in Belgrade in 2007, a decision will be taken on whether to extend the mandate of the PPC beyond 2007. In order to prepare for this decision a review of the PPC was carried out during summer 2006. The review involved broad consultation with a wide range of PPC stakeholders, including donor agencies, IFIs and partner countries. An external consultant was contracted to provide analytical input and prepare a final report.

The evolving context for support for environmental investments

3. Since the PPC's mandate was last renewed the context in which it operates has evolved considerably. In 2004 the expansion of the EU shifted the focus of international environmental assistance further east and south towards the countries of EECCA and SEE. The climate for environmental investments is less favourable in many of these countries, especially in the Caucasus and Central Asia. Several of these countries are low-income, their populations have limited ability to pay for environmental services, levels of project preparation capacity and expertise are generally lower (especially at the municipal level) and, in some cases, there is limited fiscal space for external borrowing. Most of these countries also lack the strong EU accession incentive, coupled with large amounts of pre-accession aid, which helped Central European countries to raise environmental standards in the 1990s. In order to address

¹ Figures compiled from data available at June 2006

the severe environmental challenges in these countries coordinated donor and IFI action will be needed to ensure adequate financing of environmental improvements.

4. There will continue to be a clear need for official development assistance to support the financing of environmental improvements, especially in lower-income countries. Domestic expenditure in these areas has not been sufficiently prioritised in national budgets, and some countries are simply too poor to be able to allocate sufficient funding. Private sector involvement is still weak and local capital markets are insufficiently developed to contribute significantly to these financing challenges. IFIs themselves have limited grants for technical assistance and their ability to lend is constrained by limited fiscal space in some of the heavily-indebted countries in the region. Furthermore, the mandates of some IFIs limit the amount of non-lending support that they can provide. For example, EBRD's commitment to sound banking principles prevents it from financing projects that are not commercially viable and from subsidising its clients by providing grants for technical assistance or capital expenditure. Moreover, bilateral aid for environmental improvements is gradually declining. The EC is assuming a more prominent role as the leading provider of environmental assistance in the region. Its position will be strengthened further in 2007 when it launches a series of new aid instruments. Furthermore, in recent years the EC has launched a number of initiatives specifically intended to facilitate IFI investments in environmental improvements. These include a number of Investment Support Facilities designed to provide technical assistance in support of new environmental investment activities and dedicated co-financing facilities. These include the Water Investment Support Facility (WISF), the Danube Investment Support Facility (DISF) and the Environmental Project Preparation Facility (EPPF) in the Western Balkans.

5. A number of different IFIs operate in the region, with different mandates and operational approaches. EBRD has made a conscious decision to shift its focus further south and east, gradually exiting from Central Europe and focusing more on the countries of EECCA and SEE, in line with the realities of current needs. EIB is in the process of extending its activities further east into some EECCA countries. The World Bank is complementing its traditional lending activities with new approaches such as carbon financing and is preparing sub-national lending instruments through the joint WB/IFC Municipal Fund. ADB has had a significant presence in Central Asia for some time and is now extending its operations into some Caucasus countries. As IFIs shift their focus further east and south they will need external assistance for project preparation and investment co-financing in order to maintain acceptable levels of environmental investments in these more challenging countries.

6. Donors and IFIs have now been working together in the region for more than fifteen years and they have evolved a range of formal and informal mechanisms for coordination, information sharing and co-financing that did not exist when the PPC was first created. Consequently, international assistance to the region is being delivered in more coordinated and strategic ways. A number of multi-donor and even multi-IFI initiatives have been set up, some with an explicit environmental focus. These tend to be organised on a thematic or sub-regional basis, such as the Northern Dimension Environmental Partnership (NDEP), Danube & Black Sea Task Force (DABLAS), Early Transition Countries Initiative (ETCI) and the Western Balkans Initiative (WBI). The PPC is already working in partnership with some of these initiatives. Furthermore, international consensus on aid effectiveness has progressed significantly in recent years. The Paris Declaration on Aid Effectiveness, agreed in March 2005, recommended that aid should be increasingly aligned with partner countries' priorities, systems and procedures and that greater attention should be given to strengthening partner countries' capacity to manage aid. It also stressed the need to eliminate the duplication of efforts and rationalise donor activities to maximise cost-effectiveness.

Implications of the evolving context for the PPC

7. The need for assistance for environmental project preparation and co-financing assistance in EECCA and SEE is likely to continue after 2007, especially in lower-income countries. It will be more difficult to identify and develop good environmental investment projects in these countries, and IFIs will need to invest more time, effort and money in upstream project development. Country partners themselves will need more support to prioritise their environmental investment needs and develop project proposals

that can be taken up by IFIs. Capacity building will be key. A shift in focus towards the lower-income countries of the Caucasus, Central Asia and Western Balkans implies a need for a more development-oriented approach which will require increased levels of grant financing. Donor grants will be required in order to finance projects in countries where cost recovery is more difficult and where there is a need to work on smaller and more difficult projects, especially in rural areas, that might otherwise fall below IFI financing thresholds. This will require more effort to find creative ways of financing projects with greater development impact but which may require significant grant financing.

8. Different project proponents in EECCA and SEE countries have different needs with respect to support for project preparation – there is no ‘one size fits all’ solution. Different IFIs have different mandates and operational approaches and consequently have different needs for assistance with the preparation of environmental projects. The EBRD (and possibly EIB) may continue to require assistance with the identification and preparation of viable investment projects. Conversely, the World Bank may require assistance to help its country clients develop high-quality projects identified through its Country Assistance Strategy processes, and may also require project preparation support for the new lending window created by the Municipal Fund. The ADB may require assistance to help address the low levels of capacity in-country to identify and prepare projects. Partner countries will require assistance to implement their environmental investments plans and take forward priority investment projects. Flexible and pragmatic project preparation support, able to accommodate these different needs, will be needed. Existing donor and IFI efforts to support environmental investments in EECCA and SEE meet some of these demands but not all of them. IFI environmental investment activities still lack sufficient support for early stage project development. The EC’s Investment Support Facilities have been an important recent development but they are restricted to specific thematic and geographical areas and do not enjoy the full buy-in of all of the IFIs. Furthermore, they only mobilise resources for feasibility studies for projects that have already been identified and do not cover pre-feasibility studies to scope out new projects.

Demand for a renewed PPC beyond 2007

9. There is therefore a need for continued external support to IFIs for the preparation of environmental investment projects. In the future it is possible that this may be delivered through an integrated structure similar to the Joint Assistance in Supporting Projects in European Regions (JASPERS) programme that the EC has agreed with the EBRD and EIB in Central Europe or the EC Joint Environment Programme II (JEP II) that supported WB, EBRD and NEFCO projects until 2005. However, recipient countries have made it clear that they would not like to see the existing project preparation support mechanisms dismantled before a viable alternative has been put in place, and at the moment there is no immediate alternative to the PPC. A renewed PPC could therefore continue to play an important role in providing support for the preparation of environmental investment projects beyond 2007 by providing a transitory structure bridging to a more structured EC/IFI arrangement in the future. The PPC could help to fill the gaps in existing donor/IFI support for environmental investments by facilitating technical assistance and investment co-financing to help prepare environmental investment projects. It could also encourage a more development-oriented approach towards the preparation of environmental investment projects. In particular, the PPC could add most value by focusing its efforts on the poorer countries and regions of EECCA and SEE, for example those countries that are eligible for official development assistance (i.e. the Caucasus and Central Asia) together with the poorer regions of Russia and Ukraine. Specifically, a refocused PPC could focus on the following:

- a broad range of programmes, including environmental infrastructure, energy efficiency and biodiversity projects;
- targeting countries and sub-regions that are in the greatest need of assistance and which risk ‘falling between the cracks’;
- supporting pre-feasibility work to assist with the early stages of project scoping;

- ensuring broad ownership and participation by a wide range of IFIs;
- reflecting countries' national environment/finance plans as well as IFI requirements;
- providing a forum for coordinating the co-financing of IFI projects with donor grants, with a particular focus on lower-income countries to lower the upfront costs of borrowing from IFIs.

Proposed PPC activities and organisation after 2007

10. During the consultation phase of the review some stakeholders recommended that the PPC should move away from the traditional donor staffing subsidy to IFIs, specifically EBRD. They felt that the justification for funding additional IFI/EBRD staff is now much weaker than it was when the PPC was originally established, as EBRD is now a mature institution making significant profits. This makes it difficult for donors to justify allocating funds out of their finite (and in some cases shrinking) budgets to fund staff positions within EBRD. However, from EBRD's perspective there continues to be a need for external donor funding for project preparation as its mandate prevents it from subsidising its clients, which makes it difficult for EBRD to allocate staff time and resources on upstream work that cannot be attributed to specific investment projects. Stakeholders also recommended a shift towards project preparation support that is better targeted towards the needs of client countries and more accountable to donors, and greater flexibility to be able to respond to the different approaches and needs of the different IFIs and their clients in EECCA and SEE. For the PPC to contribute most effectively to supporting the preparation of environmental investment projects, stakeholders indicated that it would need to:

- facilitate a wider range of project preparation assistance services, going beyond the traditional model of donor-funded PPC Officers seconded inside IFI banking teams;
- work with a wider range of IFIs including, for example, the World Bank and Asian Development Bank;
- adopt a clearer and more coherent organisational structure with well defined governance and accountability arrangements.

Activities

11. The PPC could continue to focus on the project concept stage of project development, covering a range of environmental sub-sectors including, for example, environmental infrastructure, energy efficiency and biodiversity. It could provide an interface between upstream policy work on financial planning in environment-related sectors and the specific investment-related activities of the IFIs. This would imply continued close collaboration with the EAP Task Force and donor agencies involved in supporting environmental financial planning. This could also facilitate better coordination between national environmental and developmental priorities and investment projects. It could also provide a forum for donor co-financing of IFI investment projects, especially for low-income countries where there is a more pressing need for grants that can be blended with IFI loans to make them more affordable.

12. To meet the stakeholder demands expressed during the review the PPC would need to facilitate a flexible range of project preparation assistance services, which could include the following:

- PPC technical assistance facility: a technical assistance facility could be created for the flexible provision of a range of services to IFIs and their clients in support of environmental investments. These services could include project preparation consultants who, subject to demand from IFIs and their clients, could be deployed to work alongside IFI banking teams and country counterparts on upstream project identification, pre-feasibility studies and the identification of capacity-

building needs. It could provide sector experts with expertise in areas including, for example, water and sanitation, district heating, and energy efficiency, to provide support for the development of specific investment projects. It could also provide feasibility and pre-feasibility studies and capacity building activities. These consultancy services could be provided under a series of call-off consultancy framework contracts, managed by the PPC Secretariat, with procurement and selection procedures agreed by the participating donors and IFIs. Some stakeholders felt that the existing PPC Officer positions have become indistinguishable from regular EBRD banking positions. The technical assistance facility could address this problem by providing resources to do the things that the PPC was originally intended to do, such as upstream exploratory work to prepare the ground for investments.

- Investment co-financing facility: subject to sufficient support from donors, a facility could be created to provide grants to cover a portion of the investment costs of eligible environmental projects financed by IFI loans in low-income countries.
- PPC Officers: an option would remain open for interested donors to continue to fund PPC Officers, subject to demand from IFIs. These Officers would work inside IFI banking teams on project identification and preparation.

Organisation and funding

13. During the consultation phase of the review a number of PPC stakeholders recommended that the PPC should find ways of working with a wider range of IFIs, as opposed to the current situation in which the PPC only works with EBRD. At the same time, some stakeholders expressed the view that the PPC should make use of existing multi-donor funds that have been established in the EECCA and SEE regions, such as the Early Transition Countries Initiative, the Western Balkans Initiative and the Sustainable Energy Initiative (SEI). This implies that the PPC would act as a kind of ‘enabling agent’ that would access these existing funds and use them to implement the activities described in paragraph 12. This would be consistent with the more coordinated and strategic approach to donor/IFI cooperation that is emerging in the region, as described in paragraph 6. In practice, it would be difficult to reconcile these different demands. If the PPC were to work with a number of different IFIs it would not be able to rely solely on established multi-donor funds such as the ETC Fund, as these funds are managed by EBRD and therefore could not be used to support the activities of other IFIs.

14. In order to present options for reconciling the competing stakeholder demands that were identified during the review, two different scenarios were considered by the Bureau of the EAP Task Force and PPC in December 2006. The Bureau identified i) their preferred scenario and ii) an alternative fall-back scenario for the future of the PPC beyond Belgrade.

Preferred scenario: PPC working with a wider range of IFIs supported by a new multi-donor fund

15. Under this scenario the PPC would work with a wider range of IFIs, adopting a flexible approach with different windows to meet the different needs of the participating IFIs. For example, the EBRD still has a demand for traditional PPC Officers and project preparation consultants, whereas the World Bank does not share this need but may be interested in accessing technical assistance and investment co-finance through the PPC. In order for the PPC to provide support to a wider range of IFIs new funding arrangements would be necessary. One option would be the creation of a new untied multi-donor fund that could be used to support project preparation activities and investment co-financing across a number of IFIs. This fund could operate along similar lines to the NDEP Support Fund. Pooled funding would enable the PPC to operate more strategically and cost-effectively. It would also enable donors to make contributions according to their available budgets. The viability of this option depends on whether donors have an appetite for establishing a new separate multi-donor fund. The procurement of consultancy services would have to be arranged separately for each of the IFIs. For example, it would not be possible

for a consultant to work on a World Bank project under an EBRD contract. Therefore each participating IFI would need to make separate arrangements for contracting PPC-funded consultants and for managing PPC co-financing grants. It might therefore be necessary for separate donor funds to be created inside each of the respective IFIs. Alongside the new multi-donor fund the PPC could also access other sources of funding for specific activities. For example, it could access EBRD-managed multi-donor funds such as the ETC Fund for its EBRD-related activities, alongside the new multi-donor fund. It could also access other sources of finance such as the GEF. This would involve a mix of different funding and procurement arrangements for each of the IFIs. This scenario would allow an option for interested donors to continue to fund PPC Officers within IFI banking teams, alongside PPC activities funded by the multi-donor fund.

Alternative scenario: PPC mainstreamed into EBRD and supported by existing multi-donor funds

16. The Bureau acknowledged that it is not clear whether donors have an appetite for setting up a new multi-donor trust fund specifically to support the PPC, especially when many of them are already contributing towards closely related initiatives such as the ETCI and NDEP, for example. Furthermore, it is not entirely clear whether other IFIs, other than EBRD, have a strong demand for kinds of services that the PPC could realistically provide. Therefore, an alternative scenario was identified in which the PPC would be effectively mainstreamed into EBRD's operations, working on the assumption that EBRD is the only IFI with a strong demand for support from the PPC. Under this scenario the PPC would access existing EBRD multi-donor funds (e.g. ETC Fund, WBI, SEI) to finance the activities set out in paragraph 12. There would also be scope for further donor contributions to fund activities in sectors and countries not covered by these funds, such as Russia and Ukraine. However all these funds would be managed by EBRD and therefore could not be used to support other IFIs' activities. This scenario implies that the PPC would be effectively mainstreamed into EBRD, with all PPC-related funds managed by EBRD. All PPC staff would be contracted to EBRD and all consultancy contracts (i.e. for PPC Consultants and technical assistance services) would be issued by EBRD. This scenario would also allow an option for interested donors to continue to fund PPC Officers inside EBRD banking teams.

Governance arrangements

17. Under both of these scenarios the PPC Secretariat would continue to provide overall coordination of activities and manage the delivery of consultancy services. In order to assume a wider range of responsibilities, including the technical assistance facility and its associated funding arrangements, a stronger Secretariat with additional staff resources may be required. The Secretariat should be supported by a senior level official within EBRD, who would act as a 'champion' for the PPC within the organisation. A PPC Chair, ideally a senior level official from a donor or IFI, would continue to provide strategic guidance and senior-level representation. The PPC would ultimately report to a Steering Committee including representatives of the participating donors and IFIs. This could be linked in some way with the joint Bureau of the EAP Task Force which would help to ensure better coordination of policy, institutional and investment issues. The Steering Committee would agree a work programme, including logframe, setting out the use of the technical assistance facility. If a multi-donor fund were to be created (as set out in Scenario II), it would be controlled by donors through an Assembly of Contributors that would approve funding decisions.

Next steps

18. Following the conclusion of the review the PPC Secretariat will continue to seek the views of donor members of the PPC network on the future options for the organisation and funding of the PPC. The willingness of donors to provide funding will be a critical factor in any decisions on the future of the PPC and its activities. Pending the endorsement of PPC stakeholders at the Joint Meeting of the EAP Task Force and PPC in Brussels in March, the PPC Secretariat will feed in the final recommendations of the review into the PPC's Category II report for the Belgrade conference. In the meantime, it is anticipated that

the positions of key players, including donors and IFIs, on the future of the EfE process and the PPC will be clarified in the coming months. A final decision on the PPC's future mandate will then be taken by Ministers at Belgrade in October.