



19.6.2014

MINUTES OF THE MEETING OF THE BEAC AD HOC WORKING GROUP ON FINANCIAL MECHANISM STUDY

DATE: 29.4.2014, 13.00–17.00

LOCATION: Ministry for Foreign Affairs of Finland, Helsinki

1. Opening of the meeting and adoption of the agenda

Chair Birgit Autere welcomed the new members of the BEAC Ad Hoc Working Group on Financial Mechanism Study (AHWG): Marina Naumova from the Ministry for Foreign Affairs of Russia, Elena Usacheva from the Ministry of Finance of the Arkhangelsk Region, Pål Erik Holte from the Ministry of Local Government and Modernisation of Norway, Harry Ekestam from the Ministry of Employment and the Economy of Finland, Marko Mäntylä and Zuzanna Bieniuk from the EU External Action Service.

Decision:

Chair stated that the minutes of the previous meeting on 18 February, 2014 have been approved and sent to the members of the AHWG. The meeting agenda was approved without any changes.

2. Review of the steps taken to date

Questionnaires have been sent according to the work programme.

Barents Working Groups: Altogether 8 working groups out of 16 have submitted their answers and more answers are expected to come. The response rate was satisfactory, taking into account the number of dormant working groups.

Barents Regional Committee: Altogether 10 out of 14 members have submitted their answers.

Inquiry on national funding has been sent to the members of the AHWG (Finland, Sweden, Norway, Russia). All the members have submitted their answers. The Chair of the AHWG is likely to come up with more specific questions vis-à-vis national funding.

Inquiry on EU funding has been sent to the EU representative of the AHWG.

Decision:

A summary of the answers deriving from the questionnaires of the Barents Working Groups and the Barents Regional Committee will be submitted to the members of the AHWG by mid-June. The original questionnaire answers will be available upon request.

3. Next steps

-According to the Chair's proposal, the next meeting will be held on 9 September, 2014 in Helsinki. The meeting will be devoted to the presentations of regional cooperation structures, such as Council of the

Baltic Sea States, Arctic Council, Nordic Council of Ministers, and Northern Dimension Partnerships: Northern Dimension Environmental Partnership, Northern Dimension Partnership for Transportation and Logistics, Northern Dimension Partnership in Public Health and Social Well-being, Northern Dimension Partnership on Culture, with the condition that the representatives will be available at that date.

-An additional session devoted to EU funding programmes will be held in November 2014. This session will include Kolarctic CBC, Karelia CBC, The European Union's Baltic Sea Region Programme, The Northern Periphery and Arctic Programme and Interreg North.

-A draft outline for the final report will be sent for comments to the members of the AHWG by the end of May.

4. Round-Table Discussions on the Financing of Barents Cooperation

European Bank for Reconstruction and Development (EBRD)

Arvid Tuerkner, Director for Regional Development in Russia, stated that in 2013 Russia accounted for 21% of the bank's total business volume, making it the largest country of operations. The EBRD invested altogether EUR 1.8 billion in 56 projects in Russia in 2013. The EBRD is one of the largest international financial investors in Russia. One of its key strengths is that the bank is able to provide financing in RUB, which cannot be matched by any other financial institution in Russia at this stage.

The EBRD's key priorities in Russia are diversification, modernization and innovation, privatization and private sector development and regional development. However, in the Barents region (Murmansk oblast, Arkhangelsk oblast, Nenets Autonomous area, Komi and Karelia Republics), the EBRD's portfolio is relatively small: EUR 172 million. 53% of the Barents region projects are in Komi Republic. The Syktyvkar Municipal Water and Wastewater Services is one of the most successful projects in the region.

The EBRD manages the Northern Dimension Environmental Partnership (NDEP) Fund. Tuerkner noted that the NDEP Fund is an effective instrument for financing concrete investment projects in the Baltic and Barents Sea regions. NDEP is a multi-donor fund with contributions totaling up to EUR 347 million. This sum is split into two windows of activities: EUR 167 million for nuclear safety projects and EUR 180 million for environmental projects in the municipal infrastructure sector. NDEP grants are available for municipal companies to support loans from the IFIs (EBRD, EIB, NIB, NEFCO, KfW). At present there is EUR 55 million available for new projects in the Fund. Russia has asked to extend the Fund beyond 2017 at the ND Senior Officials meeting in April 2014 in Oslo. The average structure of an NDEP project budget consists of 50% IFI loan, 25% NDEP grant, 20% Russian funds and 5% other grants.

According to Tuerkner, the Barents region is partially in depressed economic condition or requires large investments. Moreover, the budgets of regional governments are in deficit and do not allow for investments. Industrial emission and black carbon might be areas which the bank could focus on in the future. In general, in Russia there is a lack of projects matching with the bank's mandate. It is difficult to find private sector projects from companies with enough business volume and experience of work.

A loan worth of 5–6 million dollars is a minimum. Otherwise the project will not be profitable for small companies, because of the necessary feasibility studies that also generate expenses. In the Barents region the bank's mandate covers only Russia.

Expanding the successful NDEP structure was also discussed.

Hegelund pointed out that it is not possible to finance privately-owned companies through the NDEP Fund, because it would distort competition.

European Investment Bank (EIB)

Virgil Nae, Head of the EIB's Representative Office in the Russian Federation, noted that the EIB is a bank of the European Union. The main mission of the EIB is to support sound investments that underpin EU policy objectives. The EIB and the European Commission are in the process of finalizing the bank's 2014–2020 mandate, which streamlines the objectives of EIB lending outside the EU.

The EIB supports the Strategic Partnership between the EU and Russia, as well as regional initiatives, in particular the Northern Dimension Partnerships. The EIB's strategic objectives for the lending activities in Russia are private sector development, in particular SME support, development of social and economic infrastructure and climate change mitigation and adaptation. EIB has lent altogether EUR 3.85 billion in Russia in the period of 2007–2013. The current portfolio for Russia consists of 14 operations worth EUR 1.62 million.

The EIB works in close cooperation with other IFIs in Russia, the NDEP Fund serving as a prime example. The EIB operates both with public and private sector projects, which marks a difference to EBRD and its focus on the private sector.

According to Nae, there is a big financial gap between what needs financing and what is actually being financed. The problem is the bankability of projects: how can those "weaker" projects be turned eligible for financing? Projects financed by the EIB must be economically justified, technically viable, financially self-supporting and environmentally sound. Additionally, appropriate procurement procedures are required.

Nordic Investment Bank (NIB)

Harro Pitkänen, Senior Director of Business Development and Control Deputy Head of Lending, stated that NIB's main business areas are energy and environment, infrastructure, transportation and telecom, industries and services, financial institutions and SMEs. NIB has to be "lean and mean": EUR 10 million is the absolute minimum loan, out of which 50% has to be self-financing by the client.

Pitkänen stated that the Barents area is a challenging setting for national and cross-border activities. The key areas on which to focus are the natural resources (oil and gas, metals and minerals, forestry), infrastructure and the local industry. Responsible safeguard policies will have to be applied to mitigate environmental threats when utilizing the region's potential. Moreover, substantial capital resources will have to be mobilized.

In order for NIB to lend, the bank needs willing and able borrowers and feasible projects. The borrower has to be prepared to take a loan at prevailing interest rates and creditworthy enough to be able to service the loan. In finding good quality projects, project preparation is essential: adequate studies are required. Pitkänen envisaged that perhaps the Barents Euro-Arctic Council could act as a framework in which feasible projects could be identified through technical assistance. It is essential to have thorough project preparation, but there is only a limited amount of grants available to support this.

NIB's focus is on Northwest Russia. In the coming years the NIB will be looking more towards the Arctic. NIB sees energy efficiency as a key target. However, the awareness of energy efficiency is generally

weak in Russia. A reform of tariff structures is a prerequisite for sustainable public sector projects. Other special challenges in working in the Barents region are the regulatory and institutional constraints complicating the identification of borrowers and the municipalities' limited experience and resources to develop projects.

Pitkänen noted that trust funds are used for financing of feasibility studies and loans are meant for investments.

Ekestam pointed out that the future bankability of the EU funded projects should be taken into account. EU funding could be utilized to carry out the preparatory phase of the project, followed by financing from the IFIs.

Nordic Environment Finance Corporation (NEFCO)

Magnus Rystedt, Managing Director, stated that NEFCO finances middle and medium-sized projects up to EUR 5 million with a Nordic relevance or a Nordic interest. Thus, NEFCO complements other IFIs by assisting in projects' preparatory phases. The geographic mandate covers Russia, Ukraine, Estonia, Latvia, Lithuania, Moldova and Belarus.

In Russia the main areas of operation are Northwest Russia and the Barents region and the focus is on public sector projects. NEFCO's current project pipeline lists over 150 projects in Russia. So far, 75 projects have been implemented and closed. The largest sectors are energy efficiency, renewable energy, wastewater treatment, waste management and cleaner production. Examples of successfully implemented projects in Russia are the Renewable energy project in Archangel and Energy efficiency projects in Gurievsk and Novodvinsk.

NEFCO has several instruments for projects in the Barents area. The Barents Hot Spots Facility (BHSF) is targeted at developing the 42 identified Barents region hot spots defined by NEFCO in collaboration with the Arctic Monitoring and Assessment Programme in 2003. This facility reports to the BEAC Working Group on Environment. So far 68 feasibility studies and pre-project measures have received BHSF financing within waste, wastewater, industry and energy sectors. Projects are being actively developed in the Barents region, especially in the field of energy efficiency in Komi and Karelia. The challenges of the facility are the definition of hot spots, the increased engagement from the Russian authorities and successful project management from pre-study to implementation.

NEFCO hosts the Arctic Council Project Support instrument, which is expected to become operational during 2014. The instrument is set up for project preparation, development and demonstration purposes, primarily in the context of the Arctic Council Action Plan. Priority is given to projects related to pollution prevention, abatement and elimination. The size of the instrument is EUR 16 million.

NEFCO cooperates with the EBRD, EIB and NIB within the implementation of the NDEP. NEFCO finances mainly municipal projects in Northwest Russia. The focus is on waste, wastewater and district heating. There are altogether 29 investment projects in the Baltic and Barents Sea areas.

The State Corporation Bank for Development and Foreign Economic Affairs (Vnesheconombank ,VEB)

Alexey Ternavskiy, Deputy Head of SME Support Department, stated that VEB is a Russian state corporation established in 1922. It receives funds directly from the state budget and is used to support

and develop the Russian economy and to manage Russian state debts and pension funds. The minimum loan amount is EUR 20 million.

VEB is primarily a Russian development bank. This differentiates it from the other IFIs at the Round-Table. VEB prioritizes investment projects the implementation of which does not entail competition from commercial financial institutions. The bank gives preference to projects that are being carried out on a public-private partnership basis. The bank actively cooperates with foreign development institutions in the field of SME support. Ternavskiy noted that Russian small and medium-sized enterprises are less willing to take loans in comparison to Western companies. Instead, they prefer to utilize their own, internal financing.

VEB cooperates both with NIB and NEFCO. Additionally, VEB together with KfW established the Council of the Baltic Sea States Pilot Financial Initiative (PFI) in 2012. The PFI offers financing for projects of SME enterprises, as well as public-private partnership in environmental protection, innovation, modernization and energy efficiency.

Discussion on the need for a new financing mechanism for Barents cooperation

Nae stated that we should think how to make better use of the existing instruments, such as the NDEP, and how the NDEP mandate could be extended to cover the Barents region. Should there be a guarantee scheme in favor of projects in this area?

Rystedt noted that NEFCO has benefitted from hosting various trust funds for feasibility studies. However, many countries, such as Russia, are reducing their contributions, which leads to a gradual depletion of the funds.

Tuerkner pointed out that technical assistance funds would be helpful for Barents cooperation.

According to Pitkänen, capital investment funds are already available. There is no lack of money; there is a lack of good projects. A feasible option would be to put money into technical assistance resources. A technical assistance fund for projects in the Barents region would mobilize investments as well.

Ternavskiy pointed out that all the projects that have received funding from the CBSS Project Support Facility (PSF) are in Leningrad oblast or St. Petersburg. No other area has applied for funding from the instrument. Therefore, the economic potential of the Barents region should be thoroughly investigated prior to establishing a new financing instrument for the region. Moreover, in the Barents area there already exist several well-functioning financing instruments, the potential of which could be utilized even better. The potential added value from the BEAC Ad Hoc Working Group could be to give political support for specific projects that are considered important. Additionally, information support in the scope of BEAC would be useful in gaining more precise and up-to date information about the existing funding sources.

Hegelund concluded that obviously there already is a lot of financing available. The problem is to find and develop bankable projects. Thus, funding for technical cooperation is the key. Governments from various countries donate funds for technical cooperation, but these contributions have their own terms on the usage of the money. In general, with regard to projects in Russia, the challenge seems to be not only in the lack of resources for technical assistance or feasibility studies, but in the local municipalities' regulatory and institutional restraints.

5. Other Issues:

Ekestam noted that the financing for the ENI CBC programmes 2014–2020 is still open due to the current political situation. If the AHWG wants to have an impact on these programmes, the initiative has to be taken now. The programming work for the EU transnational programmes and interregional programme 2014–2020 is nearly completed. The successor programme of the Northern Periphery will be the Northern Periphery and Arctic Programme.

Ekestam also noted the Bodø process, launched by the Norwegian Government in 2013 to explore the prospects for enhanced collaboration between the territorial cooperation programmes in the Arctic. The previous meetings held in Bodø (March 2013) and Brussels (September 2013) discussed the possibility to establish a collaboration mechanism among the countries and programmes involved. This mechanism would facilitate the sharing of information and expertise across programme boundaries on Arctic-related issues. According to Sirén, the potential results of the Bodø process are still very vague.