

**Project Fiche: No. 5 – Amendment 2**

**IPA Multi-Beneficiary Crisis Response Package**

**1. Basic information**

- 1.1 CRIS Number:** 2009/021-373, 2010/022-471
- 1.2 Title:** IPA Multi-Beneficiary Crisis Response Package
- 1.3 ELARG Statistical code:** 02.20 – Enterprise and industrial policy
- 1.4 Location:** Western Balkans: Albania, Bosnia and Herzegovina, Croatia, the former Yugoslav Republic of Macedonia, Montenegro and Serbia as well as Kosovo under UNSCR 1244/99; Turkey

**Implementing arrangements:**

- 1.5 Contracting Authority (EC):** European Community represented by the Commission of the European Communities for and on behalf of the Beneficiaries
- 1.6 Implementing Agency:** Activity 1.1 & 1.3: European Investment Fund (EIF)
- 1.7 Beneficiary:** Micro, Small and Medium size companies (SMEs)<sup>1</sup>; large companies; households; financial institutions; ministerial units and departments; financial and banking sectors supervisors/regulators; education, training and research institutes in the Western Balkans and Turkey

**Financing:**

- 1.8 Overall cost (VAT excluded)<sup>2</sup>:** EUR 735 450 000
- 1.9 EC contribution:** EUR 125 450 000
- 1.10 Final date for contracting:** 30 November 2010
- 1.11 Final date for execution of contracts:** 30 November 2021<sup>3</sup>

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<sup>1</sup> According to the Commission Recommendation on SME definition (in particular if Community funds are involved), SME definition already includes micro enterprises. (ref. Commission Recommendation C (2003) 1422 of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises

<sup>2</sup> The total cost of the project should be net of VAT and/or other taxes. Should this not be the case, the amount of VAT and the reasons why it should be considered eligible should be clearly indicated.

<sup>3</sup> The longer execution deadline is due to the following: Activity 1.1: EFSE is based on a 10 year mandate until 2015, date by which funds will be transferred to beneficiaries based on verification of administrative capacities to assume ownership and management of funds; Activity 1.2 and 1.3: these are new funds to be set up, which will require identifying the financial intermediaries, signing loan agreements and predisposing an adequate investment monitoring system. Activities 1.4 and 1.5 are also new and the grants will be used on a revolving fund basis. As such these activities are long-term and will have a higher impact if utilised over a longer period,

**1.12 Final date for disbursements:** 30 November 2022

## **2. Overall Objective and Project Purpose**

### **2.1 Overall Objective**

To contribute to the stabilization of financial markets and economies in the Western Balkans and Turkey, thereby alleviating the impact of the global financial and economic crisis in the region.

### **2.2 Project purpose**

The purpose of the project is to provide economic actors, i.e. the financial institutions and businesses (micro, small and medium size enterprises), with the necessary financial means, human resources to offer competitive products and services and support them to face the challenges of the economic and financial crisis in the short and longer term.

### **2.3 Link with AP/NPAA / EP/ SAA<sup>4</sup>**

Strengthening the stability of the financial sector including improving prudential and supervisory standards as well as establishing effective monitoring of the financial sector are identified as priorities under the recent Accession and European Partnerships of the Western Balkans and Turkey.

For all, the Accession and European Partnerships highlight the need to implement measures to improve the competitiveness of the economies and to strengthen macro-economic stability. Actions required include (i) measures to increase labour market flexibility, (ii) efforts to promote the adaptability and the skills of the labour force, (iii) design and application of an integrated research policy and for some Beneficiaries measures are needed to (iv) boost innovation and competitiveness in small companies.

With regards to private sector development and small businesses, the European and Accession Partnerships emphasize the need to implement the SME Charter and to instigate comprehensive industrial policy strategies in key sectors of the economy. Western Balkans and Turkey are also called upon to employ measures to reduce the share of the grey economy.

In the field of energy efficiency, European and Accession Partnerships call on Western Balkans and Turkey to fulfill obligations arising from the Energy Community Treaty and to complete alignment with the *acquis* in particular in the field of energy efficiency and renewable energy sources.

### **2.4 Link with MIPD**

Co-operation with International Financial Institutions in the field of private sector development and energy efficiency is defined as a strategic priority under Article 2.3.3.2 of the IPA Multi-beneficiary Multi-Annual Indicative Planning Document (MIPD) 2009-2011<sup>5</sup>.

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and could also absorb further financing in future programming years if successful. It is therefore reasonable to allow a twelve year project implementation period for these activities. 2021 is thus the minimum executing period, even in case of short final investments (e.g. 1 year).

<sup>4</sup> AP = Accession Partnership; NPAA = National Programme for the Adoption of the Acquis (for Candidates), National Action Plan (for Potential Candidates); EP= European Partnership; SAA = Stabilisation and Association Agreement

<sup>5</sup> C(2009)5418

Raising the competitiveness of the economies is identified as a strategic priority in section 2.3.2.1. of the IPA Multi-Beneficiary MIPD 2009-2011.

## **2.5 Link with National Development Plan**

Although in different degrees and modalities, Western Balkans and Turkey are predisposing programmes in the field of competitiveness, enterprise and industrial policy, including support to SMEs. Measures are also taken to promote energy efficiency, including to progress towards alignment with the *acquis*. Most importantly, in the context of the crisis, governments are also recognising the need to accelerate the implementation of such programmes as a means to preserve economic and financial stability, as well as to ensure steady progress in the pre-accession process.

Turkey's 2009 economic programme aims at improving the investment environment for SMEs, by increasing available financial resources and introducing new financial instruments.

## **2.6 Link with national / sectoral investment plans**

Even more in the current crisis context, access to credit, adequate infrastructure and services for industry and SMEs, including networks in the transport, energy, and environment are emerging as crucial for ensuring sustained socio-economic development and stability in the region. Insufficient financial resources and lack of experience of Beneficiaries in preparing projects suitable for consideration by International Financial Institutions and other donors for financing are among the key factors in these areas. The situation obviously differs from Beneficiary to Beneficiary. Generally, though, Western Balkans and Turkey are making efforts to gear their national investment plans towards more focused measures in favour of SMEs, energy efficiency, education and competitiveness, including through upgrading infrastructures in various sectors.

One of the main objectives of Turkey's SME Strategy and Action Plan (2007 – 2009) is to improve existing financial instruments and establishing new mechanisms. The Plan identifies access to finance as one of the main problems of SMEs, which prevents their further growth and harms their competitiveness.

## **3. Description of project**

### **3.1 Background and justification**

#### **The global financial crisis**

The global financial crisis was generated by the breakdown of the US housing sector through which massive losses on financial products linked to housing were transmitted progressively from the US into the European financial sector and thereby affected the real economies. The crisis has hit the EU and its neighbours hard. A squeeze on credit, falls in house prices and tumbling stock markets are all reinforcing a slump in consumer confidence, consumption and investment.

Economic forecasts paint a bleak picture of close-to-zero growth and risks of contraction for the EU economy in 2009, with unemployment rising by some 2.7 million in the next two years, on the assumption that no corrective action is taken. Economic conditions are

deteriorating further. In particular, financial market conditions remain fragile, and are likely to be tighter for longer than expected; confidence amongst households and firms has fallen much lower than expected; the slowdown has spread to emerging economies with negative effects for European exports.

The euro area and several Member States are in recession. The risk is that this situation will worsen, with inevitable consequences on neighbouring regions. Investment and consumer purchases are put off, sparking a vicious cycle of falling demand, downsized business plans, reduced innovation, and job cuts. This could push into a deep and longer-lasting recession, further economic contraction and rising unemployment.

### **The situation in the IPA region**

The global crisis has not spared the IPA region. This came at a very critical moment for its progress towards sustained economic growth and macroeconomic stability. The economies of the IPA region outperformed other European countries in terms of growth during the last years with governments making an effort to stabilise their economies and undertake reforms. These resulted in a number of features:

1. The strong growth of imports and the lack of growth of exports contributed to rising current account deficits; a rapid and "non-productive" credit expansion took place due to consumption credits to private individuals for the purpose of financing their purchases of imported consumer goods, in particular in the Western Balkans. It contributed both to an increased indebtedness of financial institutions and to increased debts of individuals. The lack of credit expansion for productive activities i.e. loans to businesses, and persisting high unemployment rates, due to missing human capital reforms and a lack of innovation, inhibited an increase in productivity and stronger export performance.
2. FDIs and remittances facilitated the financing of current account deficits. The capital markets, in particular in the Western Balkans, stayed relatively underdeveloped and financial actors have so far limited possibilities to diversify their refinancing sources.
3. The banking sector developed into a highly concentrated market mainly dominated by large international banking groups. The four largest international banking groups (Erste Bank; Raiffeisen, Société Générale and Unicredit) alone make up a combined market share of more than one third in the Western Balkans for example. Total employment in the financial sector in the Western Balkans alone is estimated at 90,000.
4. Due to the limited access to financing from international capital markets domestic banks, in particular, developed into institutions mainly relying on customer deposits for the financing of their operations, while foreign owned banks mainly relied on re-financing via the parent company.

During October 2008, the first signs of the crisis started in the IPA region in the form of increased deposit withdrawals from banks (in Serbia and Montenegro the deposit withdrawal rate reached 10% of national deposits), increased exchange rate volatility (Serbia), increased difficulties to obtain corporate loans and considerable declines of the stock markets (25% decrease of the Serbian stock exchange in October 2008).

Governments, in particular the US, Eurozone, UK and Japan intervened in the financial markets to prevent the global banking sector from collapse. The authorities of the Western Balkans and Turkey also reacted quickly to these first signs. Croatia's Central Bank for example, lifted the reserve requirements for foreign borrowings and made cash available to banks to enable them to meet their commitments. IPA beneficiary Governments have also

undertaken measures to restore confidence of the population concerning their deposits by increasing the level of state guaranteed deposits with banks. In Croatia, for example, the bank guarantee was increased four-fold to EUR 56 000. In Serbia, the Central Bank intervened repeatedly in the foreign exchange market to prevent a strong fluctuation of the exchange rate. To reassure investors, Serbia has requested an International Monetary Fund (IMF) Programme. Also in Turkey discussions were launched with the IMF to reassure investors that access to external financing and sound domestic policies will remain in place.

The crisis had a negative impact on Turkish SME's access to finance opportunities. The SME's share in total banking sector loans decreased from 25.33% in June 2008 to 21.55% in June 2009. During the same period, the domestic currency equivalent of total banking sector loans increased from TL 343.5 billion (EUR 185.9 billion) to TL 368.6 billion (EUR 171.7 billion). However, SME's total loan portfolio decreased from TL 87 billion (EUR 47 billion) to TL 79.4 billion (EUR 37 billion), confirming that the banking sector started to have a clear preference for large scale companies in their lending activities.

The Western Balkans' vulnerability to the global financial crisis is due to the characteristics of the financial sector and the overall macro economic picture. In particular:

1. The strong and concentrated presence of international banking groups in the IPA region, mostly from EU Member States has increased the risk for local subsidiaries to be confronted with a parent company that could consider reducing its engagement in the region to allow it to focus resources to surviving on the home market.
2. A lack of trust in the banking sector and the strong reliance on short term deposits make local financial institutions vulnerable towards slumping liquidity levels. Montenegro and Serbia even experienced small bank runs in individual institutions which required the intervention of the government.

Remittances have been a major source of liquidity over the last years, but are now expected to drop significantly. Again, a sign of exogenous shocks that will impact the stability of the local economies that need remittances both as a source of income in order to maintain their purchasing power and as a source that allows creditors to continue servicing existing debt. Remittances can be considered as a main driver of spill over effects from Western Europe to Southeast Europe.

3. The economic slow down will be further aggravated and accelerated through this crisis as there is a risk that important sources of income for the region will decrease sharply over the next few years, a phenomenon which is also being experienced in Turkey. Most likely, there will be falling demand for exports, a lower amount of remittances, which remain a high source of finance (up to 20% of GDP in the former Yugoslav Republic of Macedonia for example) in particular in Western Balkans, but also fewer FDIs as investors could postpone investment decisions to the future.

## **The EU policy responses to the crisis**

In response to the European Council conclusions of 15 and 16 October 2008, the Commission adopted in November 2008 a "European Economic Recovery Plan"<sup>6</sup> (the Plan). This is based on two key pillars and on an underlying principle:

- The first pillar is a major injection of purchasing power into the economy, to boost demand and stimulate confidence.
- The second pillar rests on the need to direct short-term action to reinforce competitiveness in the long term. The Plan sets out a comprehensive programme to direct action to "smart" investment. Smart investment means investing in the right skills, including management skills, for tomorrow's needs; investing in energy efficiency to create jobs and save energy; investing in clean technologies to boost sectors like construction and automobiles in the low-carbon markets of the future; and investing in infrastructure and inter-connection to promote efficiency and innovation.
- The fundamental principle of this Plan is solidarity and social justice. In times of hardship, action must be geared to help those most in need, to protect jobs, to cut energy costs for the vulnerable through targeted energy efficiency. To address the needs of those who cannot yet use the internet as a tool to connect.

## **The IPA response to the crisis**

The Plan recognises that Europe's return to solid growth will also depend on its capacity to export and thus on the performance and well being of other regions in the world. Keeping trade links and investment opportunities open is also the best means to limit the global impact of the crisis, since global recovery will depend crucially on the sustainable economic performance of emerging and developing economies.

The specific situation of the IPA region is explicitly acknowledged in the Plan, which aims at continuing to support the economic and social consolidation of the candidate countries and potential candidates in the mutual interest of the EU and the region. The Plan refers to a special (EUR 120 million) "Crisis Response Package" that should leverage (an amount of up to EUR 500 million in) loans from International Financial Institutions (IFIs). De facto, with all related activities that are likely to be implemented under the national programmes the overall amount available for the IPA Crisis Response Package would reach €150 million

The Enlargement Strategy 2008-2009<sup>7</sup> recognises the challenges posed by the crisis to the macroeconomic stability and the unemployment situation of the region. It thus confirms the Commission readiness to assist Western Balkans and Turkey's authorities in managing the economic and financial consequences of this situation. Although IPA is not a crisis response instrument *per se*, it can help predisposing instruments and facilities to assist Western Balkans and Turkey in alleviating the impact of the crisis and leverage IFIs' efforts to ease the financial constraints of financial institutions and to keep financing available for private economic actors.

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<sup>6</sup> "A European Economic Recovery Plan", COM (2008) 800 final, 26 November 2008

<sup>7</sup> "Enlargement Strategy and Main Challenges 2008-2009", COM(2008) 674 final, 5 November 2008

## **The project rationale and justification**

In line with the pillars and principles of the Economic Recovery Plan, and with the Enlargement Strategy 2008-2009, this project will focus on critical areas where, in close cooperation with IFIs, support is needed in the short and longer term for beneficiaries to be able to respond to the crisis and progress in their financial and economic recovery, namely:

1. Ensure continued availability of finance for private and public sector operations in the short and medium term, backed with technical support to ensure the security of the financing;
  2. Reform banking sector supervision/regulation for the sake of financial stability across the region;
  3. Focus policy making on actions enhancing the competitiveness of the economies;
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1. Ensure continued availability of finance for private and public sector operations in the short and medium term

With parent banks focused on stabilising the situation in their home markets and with the threat of further customer deposits being withdrawn in deteriorating global environments, local financial institutions have increased their calls for support from governments, parent companies and international financial institutions to allow them to continue to play their role as a financial intermediary. To ensure continued growth and stability of employment levels and the financial sectors, parent companies have requested support from the European Community and local governments.

### **Micro, small and medium sized enterprises**

With more than 90% of the private sector consisting of micro, small and medium sized enterprises, it is crucial that financial institutions be in a position to meet the financing demand from micro and SMEs. Continued availability of financing for business activity will further contribute to re-establishing confidence in the financial markets and reduce the risks of further deposit withdrawals. It will also help to reassure foreign direct investors and reduce the risk of disruption of Foreign Direct Investments (FDI) flows in the financial and other sectors of the economy. Most importantly, this will allow not halting these activities, thus preventing further economic contraction and detrimental effects on employment.

In order to be competitive in the future EU Single Market, companies need to pursue the upgrading of their industrial equipment and environmental management in line with *acquis*, as meeting standards in the field of environmental protection, occupational health and safety and product quality and safety, will be a key factor when competing with others for business from the EU and globally.

### **Energy efficiency**

Rising energy consumption as well as the increasing dependence on energy supplies for the effective functioning of the economy makes continued investment in energy cost savings particularly important in times of crisis. Financial institutions should be enabled to re-enforce their supply of financial products to both the private and public sector to allow them to realise important long term energy savings that will increase the competitiveness of businesses and benefit citizens.

## 2. Reform banking sector supervision/regulation for the sake of financial stability across the region

Strengthening banking supervision, upgrading prudential regulation to international standards and preserving financial stability at large are a key policy issue in the Beneficiaries. Financial risks, stemming from the high pace of credit growth, the widespread use of foreign currencies, and the large degree of external funding, are the most relevant risk factor for financial sector stability in the region. Moreover, supervisory and prudential policies are essential to ensure sustainability and to respond to the crisis given the limited room for independent monetary policies (given fixed exchange rate regimes in most Beneficiaries) and, in some cases, fiscal policies.

As a result of the financial crisis, reform of the global and European financial market architecture has started. The major challenge of the reform will be to ensure that financial sector supervision and regulation can keep pace with financial market innovation providing a good balance between regulation and innovation. For the Western Balkans and Turkey it is crucial to follow these reforms closely and for the European Commission to be involved in the global and European reforms. It is also an opportunity to strengthen the administrative capacities of financial supervisors and regulators further and to increase cooperation between supervisors and the supervised institutions.

## 3. Focus policy making on actions that are most likely to enhance the competitiveness of the economies.

In the longer term perspective, raising the competitiveness of the economies will contribute reducing the exposure to external shocks such as the current crisis. The generation of productive investments both through FDIs and through local investments will be an important priority for the region to increase its productivity and export capacities thus keeping it on track for a future of balanced and sustainable growth.

To achieve this major structural reforms focusing on increased competitiveness of the economies are necessary:

- The most urgent reforms are required in the field of human capital development. According to the OECD and the World Bank, the economies of the Western Balkans are competitive today on a cost basis, but long term competitiveness is threatened, if the mismatch between available and required skills on the market is not addressed through substantial reforms to enhance employability of human resources in line with the skills required by the private sector. The Beneficiaries need to be in a position to offer the skills in line with market demands.
- The education and vocational training systems overall need to be better connected with the private sector and labour markets and evolve around the needs of the market. Education, vocational training and research, supported by adequate competitiveness policies, need to create stronger links with the private sector so together they can become a source of innovation and generate employment and inward investments.
- Finally, for the region to capitalize on its existing competitive advantages a fully-fledged a process of continuous policy reform per sector has to be generated, linking sector policy reform in the IPA region to European Community sector policy developments,.



### **3.2 Assessment of project impact, catalytic effect, sustainability and cross border impact**

The **project impact** will stem from its focus on three critical areas of intervention namely i) ensure access to finance to financial institutions and private companies; ii) support supervision and regulatory reforms of the financial sector; iii) promote reforms enhancing competitiveness in the longer run. This will be achieved mostly through enhancing cooperation with IFIs, thus reaching economies of scale in mobilising the necessary financial and technical expertise to ensure access to finance to private sector operators through local financial intermediaries, to support banking sector supervisors and regulators to prevent further "run-to-deposit" crisis and to work on longer-term competitiveness as a means to strengthen these economies against future similar crisis. The project will also facilitate networking and exchange of know-how among Beneficiaries, and leverage loans and grant co-financing from IFIs that complement national IPA grants. Most importantly, through this project, private sector investors will be encouraged to maintain and eventually increase their investments both through public private instruments, such as the European Fund for South East Europe, but also in energy efficiency projects.

The project will also have a significant **catalytic effect** through increased synergies between grants and loan financing of investments and improving capacities of beneficiary institutions to face future similar situations. The grants measures of this project to support access to finance for the private and public sector are likely to generate a leverage effect of more than EUR 600 million in loans from IFIs. This grant support will allow for more SME investments and energy efficiency investments to take place that would otherwise not have been financed. It will provide SME and public and private beneficiaries of energy efficiency projects with technical expertise to prepare bankable projects in the future. Embedding the reform process in the field of banking supervision and financial stability within a single regional programme offers several economies of scale and scope. First, organising training and capacity building to all banking supervisors in the region offers obvious advantages in terms of use of resources, at a time where supervisors in all EU countries are subject to severe challenges. Second, some key credit institutions with head quarters in the European Union operate across the entire region, offering an obvious argument for enhanced cross-border cooperation between supervisors, both within the region as well as with their counterparts in the relevant countries of the European Union.

With regard to **sustainability**, this has to be distinguished at several levels. Firstly, beneficiary ownership and participation in the process will be essential to ensure political and policy sustainability of response measure to be supported through this project. Secondly, financial sustainability will be guaranteed through early involvement of IFIs as major partners in the implementation of the various activities. Through modest but focused institution building measures with strategic partners such as the ECB and the OECD, the project contribute to supporting the Western Balkans and Turkey with the implementation of urgent future reforms. The use of a fund structure to support microfinance as well as energy efficiency is to ensure sustainability of the actions benefiting the target group beyond the end of the project support.

Finally, as to the **cross-border impact**, efforts to raise the competitiveness of the economies at regional level through the creation of regional clusters and regional sector specific working groups will all have a strong cross border impact too. Reforms in the field of financial sector supervision and regulation will allow for increased co-operation among the Beneficiaries. As regards banking sector supervision and regulation, all supervisors in the Western Balkans and Turkey depend upon information originating from the euro area supervisors where the major lenders are headquartered (Austria, Italy, Greece, etc.). Conversely, the Euro area authorities

have a crucial interest to make sure that the supervisors in the candidate and potential candidate countries be equipped to participate in the colleges of supervisors in line with FSF/G20 recommendations. Cross-border cooperation between project Beneficiaries and Euro area authorities is therefore the key for success of the entire banking supervision component of the programme.

### **3.3 Results and measurable indicators:**

The project will focus on the achievement of the following three results

**Result 1:** Continued availability of finance for private and public sector operations is ensured in the short and medium term

**Indicators for Result 1:** a) through the European Fund for South East Europe (EFSE), the investment portfolio in financial intermediaries of the Western Balkan will have increased by at least EUR 81 million by the end of 2009; b) Technical Assistance (TA) projects with average size of EUR 60.000 have reached at least 75% of EFSE's eligible partner lending institutions by 2013. Total assistance volume increased by 100% by 2013 (baseline 2006-2008: EUR 3.5 million) depending on funding availability and PLI demand; c) approximately 1.125.000 people have benefited from micro and small enterprise loans under EFSE: i.e. total sub-loans refinanced approximately 125.000 by 2013; each sub-loan/enterprise employing on average 9 people; d) private sector involvement in EFSE will have increased from 29% to at least 50% by 2015; e) at least 10 financial intermediaries have received re-financing for at least 120 investments, for energy efficiency or SME competitiveness upgrades, and approximately 6 companies have benefited from direct lending for larger energy efficient investments, for a combined total of at least EUR 110 million from the Private Sector Support Facility in the Western Balkans over a period of 3 years; f) at least 4 financial intermediaries have received re-financing for approximately 50 energy efficiency investments in Turkey for a total of at least EUR 100 million g) at least 250 SMEs have benefited directly from the TAM crisis-response programmes in Western Balkans and Turkey involving transfer of management skills (leading to restructuring and improvement in all aspects of business); h) within the IPA/EBRD MSME Facility for Turkey, at least 4 financial intermediaries have received refinancing for a total of at least EUR 150 million over a period of three years, for on-lending to at least 600 MSMEs for working capital or investment needs; i) Within the IPA/EIB Facility for Turkey it is expected that through the co-operation with 2 to 3 local financial intermediaries, some 100 sub loans will be provided with an average sub-project cost expected to be of the order of EUR 1,000,000.

**Result 2:** Banking sector supervision and regulations are adequately reformed

**Indicators for Result 2:** a) regional training will have been delivered to the Beneficiaries' banking supervisors over a period of two years; b) Beneficiary targeted technical assistance in the field of banking supervision and financial stability will have been implemented within two years, according to a modular basis and depending upon availability of resources.; c) an informal network of financial sector supervisors from EU Member States and Western Balkans and Turkey will have been established.

**Result 3:** Reforms increasing the competitiveness of the economies in place

**Indicators for Result 3:** a) Institutional review and establishment of multi-ministerial coordination groups which will be operational in all Beneficiaries within a period of three years; b) Regional and national strategies and action plans on competitiveness-enhancing measures involving firms, universities and research institutions will be established over a period of three years; c) An interregional coordination group established to identify synergies among national strategies and action plans, as well as identifying collaborative research and innovation projects involving two or more Beneficiary countries will be operational within three years; d) A public-private sector regional network established to identify opportunities for - and to promote and support – inter-firm networking around clusters and value chains will be implemented involving two or more Beneficiary; e) Regional sector specific policy working groups will be set up within a period of three years and indicators for monitoring progress will be available.

The achievement of these results will be verified via the above mentioned indicators of achievement with the following **sources of verification:** EIB and EBRD progress reports, EFSE and Energy Efficiency Fund Annual Report, Quarterly Reports and Business Plans, OECD Investment Compact progress report and the European Central Banks project progress reports and other publications.

Key **assumptions** underlying the successful impact of all project results include:

- EU based parent banks will not reduce their engagement in the region to safeguard their operations in home markets. It is highly unlikely that parent companies would reduce their engagement given the overall positive economic effect their operations have had on their home markets.
- It must also be assumed that governments will not impose any further restrictions limiting the possibilities of financial intermediaries to access refinance.
- It is also expected that central bank expertise will be available in sufficient quality and quantity to support the financial sector supervision project.
- To drive competitiveness it is assumed that policy makers accept to base policy reform on sectors with the highest potential for global competitiveness (demand driven prioritisation of policy reform) and recognise the added value of regional co-operation to increase competitiveness of the region.

### **3.4 Activities**

#### **Activities for Result 1**

Result 1 will be implemented through the following three activities based on cooperation with the EFSE (via EIF), the EBRD and the EIB respectively:

- Activity 1.1. Increase of the European Commission participation in EFSE
- Activity 1.2. An IPA/EBRD/EIB Tri-partite Private Sector Support Facility
- Activity 1.3. An Energy Efficiency Fund
- Activity 1.4. An IPA/EBRD Turkey Micro, Small and Medium size Enterprise (MSME) Finance Facility.

## Activity 1.5. An IPA/EIB Turkey SME Recovery Support Programme

**Activity 1.1: Increase the European Community participation in EFSE:** this activity will provide additional refinancing loans to Micro and Small Enterprises<sup>8</sup> and equity participations in selected financial institutions via the EFSE, through:

- a) re-financing local financial intermediaries to extend loans to micro enterprises.
- b) technical assistance to financial intermediaries
- c) equity participations in local financial intermediaries

EFSE is based on the following key features:

- Eligible Beneficiaries: Albania, Bosnia and Herzegovina, the former Yugoslav Republic of Macedonia, Montenegro, Serbia as well as Kosovo<sup>9</sup>.
- Luxembourg registered investment fund with a total volume of more than EUR 500 million dedicated to re-financing local financial institutions to provide micro credits to small businesses (average EUR 5.000);
- May also take small equity positions in local financial institutions and offer other financial products (up to 5% of total Fund volume according to current Fund rules);
- TA is provided to financial institutions through a special Development Facility funded from the income of EFSE and specific donor contributions;
- 56 partner lending institutions in the Western Balkans, Romania and Bulgaria, as well as Moldova and Ukraine (EC contribution is limited to the Western Balkans);
- Multi-donor instrument: shareholders<sup>10</sup> include public donors such as EC via the European Investment Fund (EIF), Member and non Member States, IFIs, national development finance institutions and private investors (e.g. Deutsche Bank, Sal. Oppenheim Lux, Crédit Co-operatif)
- First loss risk cover of public investors including EC attracts private investors to EFSE;
- Strong local ownership: local EFSE offices employ local staff and EC shares in EFSE will be transferred to complete ownership to Beneficiaries at the latest in 2015 following an assessment of the Beneficiaries administrative capacities and a Commission Decision on the transfer; central bankers constitute the advisory board of EFSE and are closely associated to EFSE;
- Re-financing micro-loans provided at market rates;
- Through this additional contribution the EC participation in EFSE will increase to approx. EUR 93 million. Currently the EC is the third largest shareholder after Germany and KfW.
- EFSE is in the position to mobilise quickly additional support to its partner institutions and support them with additional re-financing opportunities or equity, or technical assistance, alone or if necessary by teaming up with other IFIs.

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<sup>8</sup> According to the Commission Recommendation on SME definition (in particular if Community funds are involved), SME definition already includes micro enterprises. (ref. Commission Recommendation C (2003) 1422 of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises

<sup>9</sup> Under UNSCR 1244/99

<sup>10</sup> The next annual shareholder meeting will take place in May 2009 in Serbia, Novisad; occasion for wide publicity of EFSE and Crisis Package Measures;

**Table 1**  
**EFSE portfolio development per Beneficiary**

<b>Beneficiary</b>	<b>Outstanding Portfolio 2008 (EURm)</b>	<b>New investments 2009 (EURm)</b>	<b>Repayments 2009 (EURm)</b>	<b>Total outstanding portfolio end 2009 (EURm)</b>
Albania	8.3	10.5	-	18.8
Bosnia and Herzegovina	163.2	42.5	26.4	179.3
Kosovo	41.1	19.3	4.4	56
Montenegro	65.7	14.5	8.4	71.8
Serbia	79.5	15	5.6	88.9
The Former Yugoslav Republic of Macedonia	31.2	9.2	0.8	39.6
<b>Total Western Balkans</b>	<b>389</b>	<b>111</b>	<b>45.6</b>	<b>454.4</b>
Total for other eligible countries of the EFSE (Ukraine, Moldova, Romania, Bulgaria)	126.7	69.1	6.2	189,6
Regional investments are not attributable to one single Beneficiary <sup>11</sup>	13	5.5	-	18.5
<b>Total EFSE</b>	<b>528.7</b>	<b>185.6</b>	<b>51.8</b>	<b>662.5</b>

**Activity 1.2: Establish a Private Sector Support Facility:** this activity will establish a new Private Sector Support Facility incorporating an SME Competitiveness Support Window and an Energy Efficiency Window in co-operation with EBRD and EIB. The Facility will provide loans and technical assistance for a) industrial investments necessary for SMEs to be in line with *acquis* and b) energy efficiency investments in the private sector. Practically, this will involve:

- re-finance financial intermediaries (loans combined with EC funded financial incentive) for on-lending to SMEs to carry out industrial upgrading in line with EU *acquis* and in energy efficient and renewable energy investments;
- provide direct lending to end-borrowers for energy efficient and renewable energy investments;
- provide financial intermediaries and end-borrowers with technical assistance;
- provide end-borrowers with a cost reduction on their loan.

<sup>11</sup> EUR 18.5 million invested in TCX (The Currency Exchange) Foreign Exchange Fund ([www.tcxfund.com](http://www.tcxfund.com)) to benefit from fund hedging currency risks and allow for local currency loans and investment in ProCredit Holding to strengthen the capacity of local ProCredit institutions to raise re-financing.

The key features of this Facility include:

- Eligible Beneficiaries: Western Balkans (indicative allocation EUR 26.5 million for both windows leveraging at least EUR 110 million in loans for investments) and Turkey (indicative allocation EUR 5 million for technical assistance supporting energy efficiency investments including renewable energy, which will leverage EU 100 million in loans supporting such investments)
- EBRD and EIB to identify partner lending institutions or potential end-borrowers and propose a grant/loan package intended to provide investment support for private enterprises.

The EBRD/EIB loan will be combined with a European Community grant to:

- Co-finance end-borrowers loans of up to 20% - 25% of the sub-loan amount (such co-financing will not apply to the investments in Turkey);
- Provide financial incentives for the financial intermediary of *up to* 5% of the EBRD/EIB loan to compensate for additional costs and risks; of engaging in lending under the two Windows i.e. SME Competitiveness Support Sub-Window and Energy Efficiency Sub-Window (such financial incentives will not apply in the case of Turkey);
- Provide technical assistance to end-borrowers (SMEs and Beneficiaries of energy efficiency investments) and financial intermediaries to assist with the preparation of eligible sub-projects and sub-project implementation verification; in addition there will be a strong element of technical assistance, direct to potentially viable SMEs, provided by TAM/BAS, and this will encompass crisis management, new business plans and rapid implementation of required actions (will apply both to the Western Balkans and Turkey);

EC grant resources will be allocated to projects and disbursed in accordance with eligibility criteria and procedures to be defined in the contribution agreement. The following eligibility criteria apply to end borrowers:

**Table 2**  
**Eligibility Criteria for borrowers from the Private Sector Support Facility**

Eligibility criteria	SME Competitiveness Support Sub-Window (Western Balkans)	Energy Efficiency Sub-Window (Western Balkans)	Energy Efficiency Sub-Window (Turkey)
End-borrower ownership	Majority private sector ownership		
End-borrower size	Comply with the EU definition of SME as per Commission Recommendation <sup>12</sup> Due to the industrial focus of the project, most Beneficiaries are expected to be medium	Unrestricted, however majority of end-borrowers are expected to be small or medium sized companies.	Unrestricted, however majority of end-borrowers are expected to be small or medium sized companies.

<sup>12</sup> OJ L 124, 20 May 2003, p. 36

	sized companies		
Sector	Unrestricted but primarily the industrial and industrial related services.	Unrestricted, but primary targets will be the industrial sector, large commercial buildings and households.	Unrestricted, but primary targets will be the industrial sector, large commercial buildings and households.
Sub-loan size	Maximum EUR 1 million (for benefitting from EC incentives).	Maximum EUR 5 million (for benefitting from EC incentives).	Maximum EUR 5 million.
Eligible investments	All capital investments in industrial premises, equipment, machinery, software, improvement of enterprise management systems and general upgrading aimed at improving production quality and efficiency, environmental protection or occupational health and safety.	(a) Investments on the energy demand side contributing to the improvement of the energy performance of commercial buildings, industrial operations or private dwellings which achieve certain minimum energy savings or reductions of Greenhouse Gas emissions, to be defined in the contribution agreement between the EBRD and EC.  (b) Investments in renewable energy technology on the demand or supply side supporting energy generation and heating/cooling which comply with certain technical specifications, to be defined in the contribution agreement between the EBRD and EC.  (c) Working capital or investment loans to suppliers/installers of energy efficient equipments/materials and renewable energy technology (no incentive payment to end-borrower)..	(a) Investments on the energy demand side contributing to the improvement of the energy performance of commercial buildings, industrial operations or private dwellings which achieve certain minimum energy savings or reductions of Greenhouse Gas emissions, to be defined in the contribution agreement between the EBRD and EC.  (b) Investments in renewable energy technology on the demand or supply side supporting energy generation and heating/cooling which comply with certain technical specifications, to be defined in the contribution agreement between the EBRD and EC.  (c) Working capital or investment loans to suppliers/installers of energy efficient equipments/materials and renewable energy technology.

Technical assistance will be provided to support the technical preparation and implementation of investments involving intensive assistance by teams of international and local consultants according to the size of the company and the complexity of the immediate challenges. Technical assistance will include TAM/BAS programmes with an allocation of EUR 7.5 million (over 3 years and with an indicative allocation of EUR 5 million for the Western Balkans and EUR 2.5 million for Turkey).

**Activity 1.3: Set up an Energy Efficiency Fund:** an Energy Efficiency Fund will be set up by the EIB. The Fund will:

- re-finance financial intermediaries for on-lending to end-borrowers and to ESCOs (Energy Saving Companies) of energy efficient investments
- provide direct lending to end-borrowers of energy efficient investments in line with the *acquis* in the field of energy efficiency in line with the objectives of the Energy Community Treaty
- provide technical assistance to end-borrowers and financial intermediaries to engage in energy efficient lending.

The key features of the fund include:

- European Commission contribution through equity participation
- Eligible Beneficiaries: Western Balkans and Turkey;
- Luxembourg registered Energy Efficiency Fund following the EFSE model;
- EIB is the promoter of the Fund; a professional Fund Manager will be selected;
- Re-financing of financial intermediaries and direct lending as main activity and separate window for Technical Assistance; foresee possibility to provide new products in the future under the Fund structure;
- Initial size estimated at EUR 80 million (EUR 20 million EC, EUR 20 million EIB, EUR 20 million KfW, EUR 10 million CEB and EUR 10 million private investors);
- Open to further public and private investors, including EBRD;
- EC participation in the Fund: funds available for on-lending and as first loss risk cover;
- Local ownership EC shares in the EEF will be transferred to complete ownership to Beneficiaries by the end of 2015 following an assessment of the Beneficiaries administrative capacities and a Commission Decision on the transfer.
- Quick turnaround of financial assistance into projects (EC initial contribution of EUR 5 million) – EUR 1.5 million Turkey earmarked/EUR 3.5 million all Beneficiaries.
- Fund has unlimited duration (is self-sustainable)

**Activity 1.4: IPA/EBRD Turkey Micro, Small and Medium size Enterprise (MSME) Finance Facility.**

Based on EBRD experience in other countries where the financial crisis has deeply affected the financial sector, some of the key concerns are to encourage financial institutions to continue lending to micro, small and medium size enterprises (“MSMEs”) and also to facilitate the flow of private and other medium-long term funds to the financial institutions. In addition, as a consequence of the economic conditions and the inevitable impact on the real economy, portfolio quality deterioration in the MSME portfolios of financial institutions can be expected. To mitigate the impact of this increased risk of the sector on the risk appetite and lending conditions of the financial intermediaries with respect to MSME sector, credit enhancement support and targeted technical assistance is seen as critical to reinforce lending skills and risk



management practices, as well as to introduce corporate recovery tools in these financial institutions.

EC Funds will be combined with EBRD loans to financial intermediaries (commercial banks including pre-privatisation state-owned banks, micro-finance institutions and leasing companies).

The IPA/EBRD MSME Finance Facility for Turkey will combine EBRD loans to financial intermediaries for on-lending to eligible MSMEs, with EC grant resources to support MSME lending during the crisis period and beyond. The anticipated grant funding for Turkey of a total of EUR 15 million could be expected to support a framework of up to EUR 150 million in loans to financial intermediaries for MSME lending.

Participating financial intermediaries (PFIs) may include (i) commercial banks registered and operating in Turkey, including pre-privatisation state-owned banks, (ii) micro-finance institutions, (iii) leasing companies<sup>13</sup>. EBRD loans to PFIs will be provided with terms and conditions consistent with the EBRD’s normal policies and procedures and will be for a tenor of 3-5 years. Loans to PFIs are expected to be in the region of up to EUR 50 million per PFI.

On-lending under the EBRD MSME credit lines will comply with the following criteria:

<b>Eligibility criteria</b>	<b>Turkey – SME Facility</b>
End-borrower ownership	Majority private sector ownership
End-borrower size	Comply with the EU definition of SME (which encompasses a definition of micro-enterprises) as per Commission Recommendation <sup>14</sup> .
Sector	All excluding financial intermediaries, real estate, munitions, gambling, tobacco, hard liquor and activities included on EBRD’s Environmental and Social exclusion list
Sub-loan size	Maximum EUR 5 million
Use of proceeds for eligible sub-loans	Working capital and investment needs of eligible MSMEs, excluding land purchase, speculation in real estate, currencies or securities

Initially EBRD operations will have a special focus on the micro and small enterprise sector (MSE) with lower maximum sub-loan size of EUR 200,000.

EC grant funds will be used primarily as Credit Enhancement support for financial intermediaries to leverage the amount of new lending by PFIs to MSMEs. Support will be provided in the form of first loss risk cover on the portfolio of sub-loans funded under the EBRD credit line, up to a maximum of 10% of the disbursed amount of the EBRD loan. PFIs will be able to obtain a full recovery of confirmed losses which arise on the portfolio of sub-loans funded from the EBRD credit lines, net of proceeds arising from the exercise of any security. This recovery will be capped at an amount equal to up to 10% of the amount of the EBRD loan which has been drawn down from time to time. First loss cover will be available for losses confirmed in the period up to five years from the date of signing of the EBRD loan. Recoveries will be in respect only of the principal amount of sub-loans written off (i.e. not including interest, fees and costs of recovery). EC funds allocated for the purpose of first-loss

<sup>13</sup> It is anticipated that the majority of PFIs will be commercial banks, however, MFIs and leasing companies are included in scope to ensure flexibility of the programme covering the full implementation period of IPA2009.

<sup>14</sup> OJ L 124, 20 May 2003, p. 36

cover for approved projects will be held in an interest bearing bank account by the EBRD pending disbursement to PFIs to reimburse them for verified losses. On expiry of the 5 year period any unutilised grant funds together with interest earned on the bank account balance will be available to be reallocated to new projects so the funds will have a revolving nature.

Under this structure, EBRD leverage of EC funds used for first loss of up to 10 times can be achieved initially, followed by larger leverage through reallocation to new projects. The existence of the first loss cushion will help to mitigate the deterioration in the risk profile of the MSME sector and should therefore enable PFIs to continue to lend to this sector as the crisis deepens.

EC grant funds may also be used to provide institution building **technical assistance** for financial intermediaries to support the sustainable development of MSME lending. In addition support in the form of **business advisory support** for MSMEs under the EBRD's TAM/BAS programme will be available as provided for under Activity 1.2 above.

With the exception of TAM/BAS advisory support, EC resources will be used only where EBRD also provides resources in the form of credit lines to financial intermediaries earmarked for MSME lending. The ratio of EBRD resources to EC resources will be at least 10:1 (inclusive of TA resources allocated to projects with PFIs).

Considering the grant nature of the funds, remaining EC resources at the end of implementation period of the Activity shall be transferred to complete ownership to the Beneficiary; the Turkish Treasury following a verification of the results and correct implementation of the Activity.

### **Activity 1.5 IPA/EIB Turkey SME Recovery Support Programme**

This programme aims at providing Turkish SMEs a bundled loan instrument consisting of both an IPA and an EIB funded component to finance their eligible productive investments, including the increase in permanent working capital requirements. The concessional SME loans will be composed of two parallel funding sources: the interest free loan component from EC funds and EIB funding based on the EIB Loan for SME instrument. The funds will be pooled with the proportion of 20%-80% respectively and will be made available to eligible SMEs through two/three private intermediary banks. No technical assistance is foreseen.

The overall objective of the Programme is to mitigate the crisis impact and contribute to the Turkish economic development and employment. The project purpose is to support the SMEs which have concrete productive investment plans by providing access attractive and longer-dated debt financing. The programme will thus increase the resilience of the companies and improve the affordability of their investments to cope with the negative consequences of the global financial crisis, while assisting them to strengthen their capacity to address the challenges associated with Turkey's EU accession process.

The Final Beneficiaries are autonomous small and medium sized enterprises (SMEs) established in Turkey with less than 250 employees and with an annual turnover of less than EUR 50 million, in compliance with the EU definition of SME as per the relevant Commission Recommendation. The medium-sized companies in Turkey are both critical in terms of employment and growth prospects for the country and have been significantly hit by the crisis. Whilst accommodating also smaller SMEs, the Support Programme is more

particularly tailored to medium-sized end-beneficiaries for which the longer-term concessional lending will be of particular benefit in their efforts to overcome the crisis, reinforce their financial structure and improve the affordability of their investments.

By combining the IPA funds with the EIB Loan for SMEs in Candidate and Potential Candidate Countries, the Support Programme aims for a rapid deployment of the available funding to bring tangible results at the level of the final beneficiaries.

Two to three Intermediary Banks from the private sector will be selected by the EIB following a tender. The selection criteria will include (i) the quality and reach of the branch network; (ii) the existing SME client relationship base; (iii) the credit policy and lending capacity of the bank toward these companies as well as; (iv) the policy of transfer to the final beneficiaries of the funding advantage linked to the programme.

In line with the EIB Loan for SMEs in Candidate and Potential Candidate Countries, there will not be a priori definition of eligible sectors, but rather the identification of a series of investments which are not eligible or not proprietary. Working capital can be accepted only if it is long-term and related to the eligible investment. The working capital component will be limited to a maximum of 50% of the eligible project costs.

On-lending under the **IPA/EIB Turkey SME Recovery Support Programme** will comply with the following criteria:

<b>Eligibility criteria</b>	<b>Turkey – SME Recovery Support Facility</b>
End-borrower ownership	private sector ownership
End-borrower size	Autonomous SMEs established in Turkey with less than 250 employees and with annual turnover of less than EUR 50m, in compliance with the relevant EC Recommendation.
Sector restrictions	Excluded sectors encompass arms, tobacco, waste incineration, financial services, gambling, real estate development, ethically or morally controversial activities, use of live animals for experimental and scientific purposes. Specific restricted and excluded sub-sectors within the agro-industry.
Sub-loan size	Between EUR 200,000 and EUR 5m
Use of proceeds for eligible sub-loans	The purchase, renovation or extension of tangible assets other than land; Investments in intangible assets (development, planning and financing costs during the construction phase of a tangible asset, R&D expenses and innovation components of the activity); building up of distribution networks; Increased working capital needs, representing a maximum of 50% of the eligible project costs.

The cost of the eligible projects will be between a minimum of EUR 200,000 and a maximum of EUR 5,000,000. The Project targets small to medium-sized enterprises, but not micro-financing which will be addressed by a separate product offered by the EIB.

The indicators of the programme are a) the additional funding volume provided to SMEs, b) the number of loans provided and c) the financial advantage generated and passed on to final beneficiaries as compared to alternative funding conditions. It is expected that the number of

loans given will be of the order of a 100, depending also on the effective sub-project size. The average sub-project cost can be expected to be of the order of EUR 1 million.

The loans will be advantageous in terms of interest rate and well adapted in terms of maturity to the financing needs of the SMEs and the economic requirements of their investments (flexibility of the loan repayment conditions depending on the nature of the investment). Funding will be made available in EUR or Turkish Lira, adapting the currency requirement to the nature of the revenues of the respective SMEs.

The leverage effect that can be generated will be 1:12. To 30 million of EC funds will initially be added EUR 120 million of EIB resources without accounting for the possible revolving nature of the programme. Assuming a one time revolving of the IPA funds and the accompanying EIB loans under the Programme, the total amount of funding that could be leveraged would be EUR 240 million.

The EUR 150m programme will be financed from two sources:

- IPA sources EUR 30m for the provision of non-interest bearing loans blended with the loan below;
- A EUR 120m loan from the EIB, provided to the Intermediary Banks for onlending to eligible SMEs;

Each disbursement from the EIB to the Intermediary Banks will consist of 2 components with the following characteristics:

- an interest free tranche covering 20% of the amount disbursed, funded by the EC non-interest bearing loan, at risk at the level of the intermediary institution and the trend in the exchange rate;
- a tranche covering the remaining 80% funded by EIB, under applicable interest rate and security conditions of the EIB.
- funding will be provided by the EIB to the Intermediary Banks in line with their funding needs and progress achieved in the implementation of the Programme.
- both EIB tranches will have the same repayment schedule;
- both tranches will be strictly *pari passu* in financial terms; repayment of one or the other tranche separately will not be possible;
- disbursement to Intermediary Banks could be in EUR or TRY;
- the intermediary institutions will tailor the repayment profile of the sub-loan to the final beneficiaries reflecting their particular investment needs and risk profile. The conditions will reflect the funding advantage provided by the Support Programme.

The Programme will be implemented in two phases: 1) A first phase expected to be of the order of 12 months for disbursement and allocation of the loan to the Intermediary Banks and on-lending to the final beneficiaries following the signature of the finance contracts with the intermediary institutions. 2) A repayment period of up to 6 years for each loan disbursement from the EIB to the Intermediary Institution.

During the investment period of the Programme, the Intermediary Banks are to provide semi-annual reports describing progress achieved and updates on project allocations. Following the

investment period and during the full life of the Programme, annual reporting on the allocations will be required.

The EIB will ensure the whole back-office functions around the loan (contractual framework; disbursements to intermediary banks, monitoring, reimbursements from the banks).

Considering the grant nature of the funds, remaining EC resources at the end of implementation period of the Activity shall be transferred to complete ownership to the Beneficiary; the Turkish Treasury following a verification of the results and correct implementation of the Activity.

## **Activities for Result 2**

Result 2 will be implemented by joint management with the European Central Bank through the following activities

- Activity 2.1: provide training for banking sector supervisors/regulators from 8 Beneficiaries
- Activity 2.2: provide country tailored assistance in the field of banking supervision and financial stability, according to a modular basis and depending upon availability of resources
- Activity 2.3: depending upon availability of resources, build-up the institutional capacity of the supervisors to cooperate across the borders, including with supervisors within the European Union

**Activity 2.1:** provide training for banking sector supervisors/regulators from 8 Beneficiaries: the central banks of the candidate and potential candidate countries will be asked to identify a core group of experts (among 100 and 150) who would be able to implement cross-border cooperation and will be intensively trained. Region-wide training courses attended by 100-150 staff of all competent authorities of the Beneficiaries on post crisis lessons for banking supervisors against the main principles set by the G20/Financial Sector Stability Forum (FSF). It is proposed to make use of resources available within national central banks disposing of their own training centres. Alternatively, stable working relations with specialised training institutes should be established. It might also be envisaged to provide training in the region. The Regional Cooperation Council could facilitate regional project meetings.

**Activity 2.2:** provide country tailored assistance in the field of banking supervision and financial stability, according to a modular basis and depending upon availability of resources: specific diagnostic and advisory missions, where experts would visit the authorities of a Beneficiary considering the relevance of the G20/FSF<sup>15</sup> recommendation for the Beneficiary and the steps necessary to implement it in the domestic legal system. This activity will also focus on identification of recommendations to Beneficiaries for preparation to cross-border cooperation, also taking into account the results of the IMF and World Bank

**Activity 2.3:** depending on availability of resources, foster co-operation between supervisors/regulators in the Western Balkans and Turkey and the EU, including with

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supervisors within the EU: identification of need for future co-operation, recognition of common problems, the monitoring and analysis of spill-over effects of measures taken by one Beneficiary on the neighbouring Beneficiaries, etc; technical facilitation of cooperation between financial sector supervisors/regulators in the IPA region and the EU. This facilitation could include problem identification regarding future cooperation, recognition of common problems, the monitoring and analysis of spill-over effects of measures taken by one Beneficiary on neighbouring Beneficiaries etc. Exercises simulating participation in colleges of supervisors, study visits, on-the-job training and workshops will be included in this activity.

The scope of Activities 2.2 and 2.3 will crucially depend upon availability of supervisory staff at the Eurosystem under the current severe tensions. Central bank expertise to support the banking supervision and financial stability programme might be subject to constraints as a consequence of severe tensions in the euro area. If this occurred, priority would be given to the regional training programme over the other two components

### **Activities for Result 3**

Result 3 will be implemented by joint management with the OECD through the following activities:

- Activity 3.1. Promote human capital development
- Activity 3.2. Foster research and innovation
- Activity 3.3. Promote sector specific policy reform

Eligible Beneficiaries: Albania, Bosnia and Herzegovina, Croatia, the former Yugoslav Republic of Macedonia, Montenegro, Serbia as well as Kosovo (in line with UNSCR 12 44).

**Activity 3.1:** Promote human capital development: this will be achieved through the creation of multi-ministerial coordination groups to align supply and demand of required human capital per sector (i.e. to reduce mismatch between skills supply and demand). The co-ordination groups will base their activities on transferred know-how on skills gap measurement.

Typically, the human capital coordination groups will include representatives from the ministries of Education, Economy, and Labour, as well as Investment Promotion Agencies and Agencies for Employment among others. They will be established in each country and at the regional level. Skills gap measurement tools aim at identifying the skills required to better respond to investment opportunities, determining the future skills profiles of the labour force based on analysis of labour market dynamics, and define training and educational objectives in line with current and future skills profiles. These tools will be adapted to the realities of local data constraints and institutional capacities, so that they can be used in a sustainable manner after the project has ended. Institutional design arrangements will be specified in each country, so that skills gap analysis and planning is embedded in government processes.

**Activity 3.2:** Foster research and innovation: this will be based on (a) The promotion of collaboration between firms, universities and research institutions across the region (b) Developing and prioritizing policies that support innovation in the region, for selected sectors.

This activity will:

- help governments in strategically assigning resources aimed at lifting obstacles to productivity growth
- promote programmes and policies across the Western Balkans aimed at enhancing innovation in the enterprise sector. Areas of work could include: absorbing and adapting technology; generating applied technologies; and financing innovation
- support implementation of detailed and prioritised policy actions – and where necessary new institutional designs – for upgrading the business innovation system
- foster regional cooperation in innovation (e.g. sharing the costs of specialised tertiary-level education institutions; exploring opportunities for collective financing of laboratory facilities)
- establish a working group to elaborate the practicalities and financial details of how regional cooperation in innovation will be implemented
- support each beneficiary government in identifying the actions required to foster further inter-firm collaboration building on existing enterprise clusters.

**Activity 3.3:** Promote sector-specific policy reform: this will be achieved through a) developing a strategy and creating regional working groups to support and promote implementation of inter-firm networks and identify and plan collaborative research and innovation projects; b) promote sustainable sector specific policy reform by setting up regional sector-specific working groups and establishing cooperation with EC sector specific working groups. The initial sectors which it is planned to address through this project are: automotive, textiles and garment, information and communication technologies and business process outsourcing.

### **3.5 Conditionality and sequencing:**

All activities shall be implemented as quickly as possible in order to alleviate the impact of the crisis as much as possible. There is no specific conditionality between the different activities. Start of implementation is expected as from October 2009.

The Crisis Response Package will be implemented through a series of direct agreements with key partners of the European Commission for duration of between two and six years (see Annex V for details on implementation arrangements). A Project Committee will be set up chaired by the Commission and including representatives from all relevant project partners to monitor the implementation of the overall Crisis Response Package under the chairmanship of the European Commission.

Cooperation and support from the authorities of the beneficiaries is of utmost importance for the successful implementation of this project. The continued engagement and full cooperation of IFIs is another critical success factor as well as the coordination with all relevant regional horizontal and sectoral mechanisms of investments identification and prioritisation.

The implementation mechanisms sequencing of the various activities (see annex V for more details) has been designed on the basis of a few key principles: a) proactive involvement of the beneficiaries; b) early involvement of and close cooperation with the partner IFIs throughout the cycle; c) continue collaboration between the Commission, the IFIs and beneficiaries throughout in-house sectoral and methodological expertise.**3.6 Linked activities**

**a) Projects financed by the European Community**

Specific actions under the CARDS regional programmes, national IPA Programmes 2008 and 2009 complement the IPA Multi-beneficiary Crisis Response Package, in particular, by supporting the rapid implementation of municipal investments for Beneficiaries, helping to generate employment and improve conditions for businesses and citizens in a deteriorating global environment.

In 2008 the Commission set up the Infrastructures Projects Facility (IPF), which provides Technical Assistance, mainly to support project preparation and implementation. This facility is multi-annual, in line with the IPA programming cycle and implies a long-term engagement from the Commission, EIB, EBRD and the CEB to commit adequate grants and loan resources to facilitate the investment required in the region. Technical Assistance is available for transport and energy infrastructure projects, environmental schemes and for investments which improve energy efficiency and/or use renewable energy. It also covers projects in the social sector such as health, education and urban development. In the context of the IPF, a special window for municipality investments is supported through the IPA 2008 programme. In a first phase, the Municipal Window is focusing specifically on providing grant support for municipal investments in the field of water, sanitation and waste management in cooperation with the IFIs which are also partner of the IPF. The management and implementation of the Municipal Window will be closely coordinated with the IPF.

In addition to these ongoing projects, other crisis response complementary actions are funded under 2008 National IPA programmes . Table 3 below provides a complete overview of the total expected amount of IPA funds that are mobilised for the Crisis Response as well as the expected leverage in terms of co-financing from IFIS. The amounts earmarked under the national programmes correspond to investment projects, mostly in the field of environment (water and waste water) and to a lesser extend transport and energy.

**Table 3**

Source	Amount	Programme/action	Amount	IFI loans
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	(M €)		(M €)	leveraged (M €)
Multi-Beneficiary 2009	125.45	EFSE	10	70
		Private Sector Facility	39	210
		Energy Efficiency Fund	25	60
		EBRD Turkey M SME Facility	15	150
		EIB Turkey SME Facility	30	120
		Banking Supervision	2.65	0
		Competitiveness	3.8	0
<b>Subtotal</b>			<b>125.45</b>	<b>610</b>
Multi Beneficiary 2008 and IPA national 2008	56.5	Albania	8.5	40
		Bosnia	9	45
		Montenegro	5	11
		Kosovo	25	9
		Serbia	9	115
<b>Subtotal</b>			<b>56.5</b>	<b>220</b>
<b>Total</b>			<b>181.95</b>	<b>830</b>

In order to accelerate the implementation of those investments, for some Beneficiaries the European Commission will implement projects in joint management with IFIs and apply the Municipality Window mechanisms of the IPF, which consists of a mechanism that will provide grant co-financing for investment projects funded through IFI loans. Beneficiaries have indicated their interest to receive support, possibly through the IPA National Programmes of 2009 in a number of the same areas covered by the Municipality Window of the IPA. Most projects are identified and ready for implementation (a feasibility study was carried out over the last year) and IFIs are ready to finance these projects with an EC grant support element. A number of the identified projects may also be transferred directly to the Municipality Window of the IPF. In any event, close coordination will be ensured as the key actors (IFIs) are in most cases the same.

**Table 4**

**Overview of indicative pre-identified municipal investments in the beneficiaries**

Country	Project Name	Total Cost (EURm)	Indicative EC grant EURm  (under IPA 2009)	Indicative IFI and other sources (EURm)
Albania	Support to road infrastructure	29	9	20 from CEB/KfW 15 from CEB/KfW
	Support for water supply (Kamza and Berat/Kucova)	20.5	5.5	18 from CEB/KfW

	Support to Water Supply and Sewage (Gjirokastra, Fier)	23	5	11.7 from CEB/KfW
	Support to Wastewater Treatment System (Pogradec)	14	2.3	
Bosnia and Herzegovina	Water Supply and Sewerage collection Project Banja Luka (Republika Srpska)	17	3	14 from CEB/KfW, German Gov. Grant, Municipal funds
	Bjelijna Wastewater system project- Phase II	13	2	11 from EBRD, SIDA Grant, Municipal funds
	Water and Sanitation (several municipalities – Federation)	55	17	38 from EIB, Municipal funds
Montenegro	Water and wastewater infrastructure in mountainous municipalities	23.6	5	18.6 from EIB, Municipal funds and German Gov. Grant
Kosovo	Rehabilitation of Sewerage networks	15	11	4 from KfW
	Improvement of district heating	19	14	5 from KfW
Serbia	Water supply and sewerage system (Kraljevo, )	49.5	3	46.5 from CEB/KfW and German Gov. Grant
	Reconstruction of the Urban transport system (City of Belgrade)	213.7	6	90 from EIB, Municipal funds. 117.7 will have to be sourced from other funds

Other crisis response measures that may be financed under National IPA Programmes include:

- For some Beneficiaries, it is envisaged to provide additional funding under national IPA Programmes to fund specific country windows of EFSE, the Private Sector Support Facility or the Energy Efficiency Fund to increase the impact of those programmes on specific Beneficiaries e.g. Turkey.
- For Serbia it is envisaged that part of the national IPA funding will be dedicated to general budget support aimed at stabilising the economy and the financial sector in the short term.
- The Competitiveness and Innovation Framework Programme has been extended to some Beneficiaries and supports both access to finance for SMEs via the EIF (loan, venture and guarantee instruments) and energy efficiency via the Intelligent Energy Europe Programme.

## **b) Other sources of finance (IFIs and bilateral donors)**

### **European Investment Bank (EIB)**

In addition to its cooperation with the IPA Crisis Response Package, the EIB confirmed its intention to more than double its lending the Western Balkan Region by up to EUR 2 billion in 2009. The EIB's operations in Turkey reached EUR 2.7 billion in 2008 and will be at around EUR 2.2 billion per annum in 2009 and 2010. Furthermore, the EIB demonstrates its growing commitment to the IPA region through its decision to open local offices in Turkey and Serbia. The EIB is co-operating with the EC, EBRD and CEB under the Western Balkans Investment Framework and Infrastructure Initiative (see 3.6, reference to Municipality Window).

### **European Bank for Reconstruction and Development (EBRD)**

The EBRD is also a key partner in the IPA Crisis Response. The EBRD is initiating operations in Turkey in 2009. The EBRD plans to extend loans of up to EUR 150 million in 2009 and EUR 250 million in 2010 mostly to private sector development and infrastructures. A local office will be operational soon in 2009.

In the Western Balkans, the EBRD is also planning to increase its volume of loans from EUR 693 million in 2008 to EUR 820 million in 2009 and EUR 970 million in 2010.

In addition EBRD will increase its activities in the IPA region through amongst others the following instruments:

- The Local Enterprise Facility will be extended with an additional EUR 100 million investment in equity driven projects with local enterprises. In addition the Facility will be extended to Croatia and Turkey;
- A EUR 250 million Western Balkans Financing Framework providing debt and equity investments to financial sector and micro lending institutions;
- The Western Balkans Investment Framework and Infrastructure Initiative in cooperation with the European Commission, EIB and CEB (see reference to Municipality Window 3.6)
- The EBRD is also managing a donor funded TurnAround Management (TAM) and Business Advisory Services (BAS) Programme, which develops micro, small and medium-sized enterprises (MSMEs) through a multi-tiered approach. TAM focuses on substantial managerial and structural changes within companies, providing the advisory services of experienced senior executives from economically developed countries. BAS supports short-term projects with narrowly defined objectives and, at the same time, develops a sustainable infrastructure for business advisory services in the countries of operation. TAM/BAS is fully integrated into the EBRD's activities, alongside banking and investment.

### **Council of Europe Development Bank (CEB)**

CEB has also declared its intention to maintain its activities in the region. Their focus will remain on social integration, housing, employment, environment, health and education. CEB is also actively participating in the Western Balkans Investment Framework and Infrastructure Initiative with infrastructure project financing. (see reference to Municipality Window 3.6).

### **Kreditanstalt für Wiederaufbau (KfW)**

Beyond the co-operation with the European Commission, KfW has also launched a global Micro Finance Liquidity Initiative. The fund, designed by KfW, acting on behalf of the German government, and the IFC, shall have an initial volume of USD500 million (of which USD 310 from IFC and USD130 from KfW and USD60 million from FMO (Netherlands Development Bank)) and aims to support micro-finance institutions. It will include projects in the Western Balkans and Turkey. KfW is also managing deposit insurance schemes in the IPA region funded by bilateral donors, in particular, Germany.

KfW will increase its lending to the Western Balkans from EUR 383 million in 2008 to EUR 443 million in 2009. In Turkey, it will maintain its loan volume at more than EUR 200 million in 2009.

### **World Bank Group**

IFC has launched a number of crisis instruments and invited the European Community to co-finance some of their activities. The instruments are:

- Global Infrastructure Crisis Fund (USD300 million) to bridge the gap in available financing for infrastructure projects;
- Global Micro Finance Liquidity Initiative (together with KfW (USD500 million)
- Global Trade Finance Programme (USD3 billion)
- Global Recapitalization Fund which will mobilise USD3 billion to recapitalise banks in smaller emerging markets.

All of the above initiatives foresee projects in the Western Balkans and Turkey.

The World Bank will provide loans worth EUR 800 million to the Western Balkans and EUR 2.25 billion to Turkey in 2009.

All IFIs together will mobilise at least EUR5.5 billion in loan to the Western Balkans and Turkey in 2009.

### **3.7 Lessons learned**

For the Crisis Response Package to reach its objectives, coordination and good communication between the key partners, namely partner IFIs, the ECB and OECD and Beneficiaries, of the Commission in implementation is essential. Information on progress achieved in implementing this project will also be shared with other IFIs through the IFI Advisory Group<sup>16</sup>, chaired by the European Commission. In view of the rapidly changing global and regional economic environment, i.e. the expected further deterioration of conditions for doing business, it is necessary to keep certain project implementation elements flexible, in particular,

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<sup>16</sup> In March 2007 an IFI Advisory Groups was created focusing on South Eastern Europe. The creation of this Group also responds to the conclusions of the Austrian Presidency in June 2006, in which the Council welcomed the Commission's intention to extend and intensify its cooperation with the EIB and other IFIs in the Western Balkans.

with regards to the parameters for the intervention with an EC grant in the Private Sector Support Facility. Also with regards to the activities on Financial Sector Supervision the content of the training project might require adjustments to follow the discussions at global level on the future financial market architecture.

A comprehensive communication strategy concerning the implementation of the Crisis Package shall be put in place as from the adoption of the project, to ensure a maximum positive political and economic impact on Beneficiaries i.e. authorities, businesses, citizens and foreign investors in the region.

The Regional Cooperation Council shall take an active role in facilitating the implementation of the Package, in particular serving as a prime communication channel, but also through the facilitation of regional meetings, through liaising with Beneficiaries or through other measure.

#### 4. Indicative Budget (amounts in EUR)

			SOURCES OF FUNDING									
			TOTAL EXP.RE	IPA COMMUNITY CONTRIBUTION		NATIONAL CONTRIBUTION					PRIVATE CONTRIBUTION	
ACTIVITIES	IB (1)	INV (1)	EUR (a)=(b)+(c)+(d)	EUR (b)	%(2)	Total EUR (c)=(x)+(y)+(z)	% (2)	Central EUR (x)	Regional/ Local EUR (y)	IFIs EUR (z)	EUR (d)	% (2)
Activity 1.1.		X	80 000 000	10 000 000	12.5	70 000 000	87.5			70 000 000		
contract 1	-	x	80 000 000	10 000 000	12.5	70 000 000	87.5			70 000 000		-
Activity 1.2.	-	X	249 000 000	39 000 000	15.7	210 000 000	84.3			210 000 000		
Contract 2 and part of contract 4	-	X	249 000 000	39 000 000	15.7	210 000 000	84.3			210 000 000		-
Activity 1.3.	-	x	85 000 000	25 000 000	29.4	60 000 000	70.6			60 000 000		
contract 3	-	x	85 000 000	25 000 000	29.4	60 000 000	70.6			60 000 000		
Activity 1.4		x	165 000 000	15 000 000	9.1	150 000 000	90.9			150 000 000		
Contract 4		x	165 000 000	15 000 000	9.1	150 000 000	90.9			150 000 000		
Activity 1.5		x	150 000 000	30 000 000	20	120 000 000	80			120 000 000		
Contract 5		x	150 000 000	30 000 000	20	120 000 000	80			120 000 000		
Activities 2.1 to 2.3	x	-	2 650 000	2 650 000	100							
Contract 6	x	-	2 650 000	2 650 000	100							
Activities 3.1 to 3.3	x	-	3 800 000	3 800 000	100							
Contract 7	x	-	3 800 000	3 800 000	100							
TOTAL IB			6 450 000	6 450 000	100							
TOTAL INV			729 000 000	119 000 000	16.3	610 000 000	83.7			610 000 000		
<b>TOTAL PROJECT</b>			<b>735 450 000</b>	<b>125 450 000</b>	<b>17.1</b>	<b>610 000 000</b>	<b>82.9</b>			<b>610 000 000</b>		

Amounts net of VAT

(1) In the Activity row use "X" to identify whether IB or INV; (2) Expressed in % of the **Total** Expenditure (column (a))

## 5. Indicative Implementation Schedule (periods broken down per quarter)

Contracts	Start of Tendering	Signature of contract	Project Completion
Contract 1	N/A	November 2009	November 2015
Contract 2	N/A	November 2009	November 2015
Contract 3	N/A	November 2009	November 2015
Contract 4	N/A	December 2009	November 2021
Contract 5	N/A	December 2009	November 2021
Contract 6	N/A	November 2009	November 2011
Contract 7	N/A	November 2009	November 2010

## 6. Cross cutting issues

### 6.1 Equal Opportunity

All activities will support actively an equal involvement of men and women.

The following text could also be considered.

The principle of equal opportunities between women and men should be taken into account when evaluating the quality of all projects proposed and during all phases of their implementation.

### 6.2 Environment

All investments shall be carried out in compliance with the relevant *acquis*. As a consequence, since projects might correspond to projects falling within the scope of annex 1 and 2 of the EIA directive<sup>17</sup>, an environmental impact assessment shall be made for each project, equivalent to that provided for by the EIA Directive.

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<sup>17</sup> Council Directive 85/337/EEC of 27 June 1985 on assessment of the effects of certain public and private projects on the environment (OJ L 175 5.7. 1985, p.40 Directive as last amended by Directive 2003/35/EC (OJ L 156,25.6.2003, p.17)



## **ANNEXES –**

- I- Logical framework matrix in standard format
- II- Amounts (in EUR) contracted and disbursed per quarter over the full duration of project
- III- Description of Institutional Framework
- IV- Details per EC funded contract

## ANNEX I: Logical framework matrix in standard format

LOGFRAME PLANNING MATRIX FOR Project Fiche		Programme name and number:	Crisis Response Package 2009/021-373 Amendment 1
		Contracting period expires: 30 November 2010	Disbursement period expires: 30 November 2022
		Total budget: EUR 735 450 000	IPA budget: EUR 125 450 000
<b>Overall objective</b>	<b>Objectively verifiable indicators</b>	<b>Sources of Verification</b>	
Contribute to the stabilization of financial markets and economies in the Western Balkans and Turkey, thus alleviating the impact of the global financial and economic crisis in the region.	<ul style="list-style-type: none"> <li>-stable development in financial sector employment</li> <li>-stable development in other economic sector employment</li> <li>-stable evolution of bankruptcies in financial sector and other private sector</li> <li>-stable development of banking assets</li> <li>-stable development of private sector lending (no drastic fall in private sector lending)</li> </ul>	National/Central Banks reports National Statistical Offices Eurostat	
<b>Project purpose</b>	<b>Objectively verifiable indicators</b>	<b>Sources of Verification</b>	<b>Assumptions</b>
Provide economic operators (financial institutions, micro and small enterprises) with the necessary means (financial, human resources) to offer competitive products and services and support them to face the challenges of the economic and financial crisis in the short and longer term.	<ul style="list-style-type: none"> <li>-The number of micro loans to households and enterprises will increase by at least 50% by 2013 (from 98087 to 150000) under EFSE</li> <li>-Private sector involvement in EFSE will have increased from 29% in 2008 to 50% in 2013.</li> <li>-Local financial intermediaries will have been able to mobilise additional finance, based on re-financing from this Programme.</li> <li>-At least 50% of EFSE end-borrowers have sustained employment or created at least 1 new employment due to the financing by 2013.</li> <li>-125 enterprises carried out upgrade investments or energy efficient investments worth at least EUR 110 million over period of 3 years under the Private Sector Support Facility in the Western Balkans.</li> <li>- 50 enterprises in Turkey carried out energy efficiency investments worth at least EUR 100 million.</li> <li>- 250 enterprises have benefited from TAM/BAS technical assistance in the Western Balkans and Turkey.</li> <li>- 600 enterprises have received financing under the EBRD Turkey MSME Facility totalling EUR 150 million.</li> <li>- 100 enterprises have received financing under the EIB Turkey SME recovery Support Programme totalling EUR 120 million over 6 years.</li> <li>-Energy savings of 30% for investments in the Buildings Sector and 20% for other energy efficiency projects or reduction of CO2 emissions by 20%</li> <li>-Legislative proposals and other measures aligned and co-ordinated within the region initiated</li> <li>-Companies difficulties' to find persons with the right skills will have decreased from 60% to 30% by 2012.</li> <li>-The number of registered patents will increase</li> <li>Legislative proposals and other measures to move forward sector specific reforms under way</li> </ul>	EFSE Annual Report, EFSE Quarterly Report and EFSE Business Plan 2009-2013, Development Impact Study carried out by EFSE, EIB and EBRD reports, EEF Annual Report, EEF Quarterly Report, EEF Business Plan, ECB progress and final report, OECD progress and final report, OECD labour market study, OECD Investment Reform Index 2009,	Major international manufacturing and service companies using local suppliers will not go bankrupt.  Global demand will not fall drastically due to aggravation of the crisis at global level;
<b>Results</b>	<b>Objectively verifiable indicators</b>	<b>Sources of Verification</b>	<b>Assumptions</b>
<b>Result 1:</b> Continued availability of finance for private and public sector operations is ensured in the short and medium term	<ul style="list-style-type: none"> <li>-The EFSE investment portfolio in financial intermediaries of the Western Balkan will have increased by at least EUR81 million by the end of 2009</li> <li>-Technical Assistance projects with average size of EUR 60,000 have reached at least 75% of EFSE eligible partner lending institutions by 2013. financial intermediaries eligible for technical assistance by 2013. Assistance volume increased by 100% by 2013 (baseline 2006-2008: €3.5 million) depending on funding availability and PLI demand..</li> <li>-At least 10 financial intermediaries and 6 companies under the direct lending programme have received financing for at least EUR110 million from the Private Sector Support Facility in Western Balkans over a period of 3 years.</li> <li>-At least 4 financial intermediaries have received financing for at least EUR 100 million under the energy efficiency window of the Private Sector Support Facility in Turkey, over a period of 3 years.</li> </ul>	EIB, EBRD reports, EFSE and Energy Efficiency Fund Annual Report, Quarterly Report and Business Plan	EU-based parent banks will not decide to reduce their engagement in the region (close local banks) to safeguard their operations in their home countries. No restrictions imposed by governments reducing the capacity of financial intermediaries to receive re-financing. No new wave of run on deposits.

-	-At least 4 financial intermediaries have received financing of at least EUR 150 million for on-lending to MSMEs in Turkey under the EBRD Turkey MSME Facility -At least 2 financial intermediaries have received financing of at least EUR 120 million from EIB resources for on-lending to SMEs.		
<b>Result 2.</b> Financial Sector Supervision and Regulations are adequately reformed	- - Regional training will have been delivered to banking supervisors (100-150 persons) from 8 Beneficiaries over a period of 2 years. -Beneficiary targeted technical assistance in the field of financial sector supervision will have been implemented within 2 years. -An informal network of banking supervisors of the EU/Beneficiaries will have been established	European Central Bank Progress and Final report	Expertise from EU national banks will be available
<b>Result 3.</b> Increased competitiveness of economies is achieved through focused reforms	-Ministerial units will be operational in all Beneficiaries within a period of 3 years -A regional strategy on clusters and research policy within a period of 2 years. -A unit dealing with setting up regional competitive clusters and collaborative research initiatives will be operational after 3 years. -Regional cluster implemented covering at least two Beneficiaries.  -Regional sector specific policy working groups will be set up within a period of three years and indicators for monitoring progress in sectors will be available.	OECD Investment Compact semi-annual progress and final report	Policy makers accept the recommendations of the project and accept to base policy reform, in particular with regards human capital, on sectors with potential for global competitiveness.  Policy makers recognise the added value of regional co-operation to increase competitiveness
<b>Activities</b>	<b>Means</b>	<b>Costs :EUR 125.450 million</b>	<b>Assumptions</b>
<b>Activities for Result 1</b>  Activity 1.1. Increase European Commission participation into EFSE  -re-finance local financial intermediaries to extend loans to micro enterprises. -provide technical assistance to financial intermediaries in need.  Activity 1.2. Establish a Private Sector Support Facility  -re-finance financial intermediaries (loans combined with EC funded financial incentive) for on-lending to SMEs to carry out industrial upgrading in line with EU acquis and in energy efficient investments; -provide direct lending to end-borrowers for energy efficient investments; -provide financial intermediaries and end-borrowers with technical assistance; - provide end-borrowers with a cost reduction on their loan.  Activity 1.3. Set up an Energy Efficiency Fund  -re-finance financial intermediaries for onlending to end-borrowers of energy efficient investments -provide direct lending to end-borrowers of energy efficient investments -provide technical assistance to end-borrowers and financial intermediaries to engage in energy efficient lending.  Activity 1.4 Establish an EBRD Turkey MSME Finance Facility -re-finance financial intermediaries for on-lending to MSME borrowers -provide financial intermediaries with credit enhancement support to reduce the risk of on-lending to MSMEs -provide technical assistance to financial intermediaries to improve MSME lending operations.  Activity 1.5 Establish an EIB Turkey SME Recovery Support Programme - re-finance financial intermediaries for on-lending to SMEs - provide interest free loans from EC resources for on-lending to	EFSE Fund Manager and Fund Advisor including local offices EIB and EBRD staff and local offices  Extension of mandate to EIF for EFSE (Activity 1.1.)  Tri-lateral contribution agreement with EBRD and EIB (Activity 1.2 – for the Activities in the Western Balkans)  Mandate to EIF (Activity 1.3)  Bi-lateral contribution agreement with EBRD (Activity 1.4 and Activity 1.2 in Turkey)  Bi-lateral contribution agreement with EIB (Activity 1.5)	<b>Activity 1.1: EUR 10 million (WB)</b>  <b>Activity 1.2: EUR 39 million (WB EUR 31.5 million / Turkey EUR 7.5 million)</b>  <b>Activity 1.3: EUR 25 million (WB / TR)</b>  <b>(Additional EUR 5 million (1.5 TK/3.5 all Beneficiaries))</b>  <b>Activity 1.4: EUR 15 million (TR)</b>  <b>Activity 1.5 EUR 30 million (TR)</b>  <b>Total: EUR 119 million</b>	No sharp drop in demand of finance from micro, small and medium sized enterprises  No sharp drop in demand from end borrowers in the field of energy efficiency  Financial intermediaries have a sufficiently strong capital base to engage in additional re-financing  Sufficient Funding available for TA measures  SME recognise the benefit of industrial upgrading and are willing to engage in capital investments  Enterprises recognise the benefit of energy efficient investments and engage in capital investments  Policy makers are committed and willing to co-operate regionally to undertake human capital reforms, increase innovation and focus reforms on competitive sectors.  Financial sector supervisors of the region are willing to co-operate regionally and share experiences  Sufficient expertise can be mobilised from EU national central banks

SMEs.			
<u>Activities for Result 2</u> Activity 2.1. provide training for banking sector supervisors/regulators from 8 Beneficiaries Activity 2.2. provide country tailored assistance in the field of banking supervision and financial stability on a modular basis and depending on availability of resources Activity 2.3. depending on availability of resources, build-up the institutional capacity of the supervisors to cooperate across the borders including with supervisors within the EU	Consultants to carry out TA for end borrowers and financial intermediaries National Bank experts and IFI financial sector experts  Contribution agreement with ECB (Activities 2.1 , 2.22.3)	<b>Activity 2.1, 2.2, 2.3: EUR 2.650 million</b>	
<u>Activities for Result 3</u> Activity 3.1. Promote human capital development (reduce mismatch between skills supply and demand) Activity 3.2. Foster research and innovation Activity 3.3. Promote sector specific policy reform	OECD Investment Compact for South East Europe staff  Contribution Agreement with OECD (Activity 3.1,3.2,3.3)	<b>Activity 3.1, 3.2, 3.3: EUR 3.8 million</b>	

**ANNEX II: Amounts (in EUR) contracted and disbursed per quarter over the full duration of project**

<b>Contracted</b>	<b>Q4 2009</b>	<b>Q1 2010</b>	<b>Q2 010</b>	<b>Q3 2010</b>	<b>Q4 2010</b>	<b>Q1 2011</b>	<b>Q2 2011</b>	<b>Q3 2011</b>	<b>Q4 2011</b>	<b>Q1 2012</b>
Contract 1	10,000,000									
Contract 2	39,000,000									
Contract 3	20,000,000		5,000,000							
Contract 4	15,000,000									
Contract 5	30,000,000									
Contract 6	2,650,000									
Contract 7	3,800,000									
<b>Cumulated</b>	<b>120 450 000</b>		<b>125,450,000</b>							
<b>Disbursed</b>										
Contract 1	10,000,000									
Contract 2	19,500,000					10,000,000				9,500,000
Contract 3	20,000,000			5,000,000						
Contract 4	7,500,000			7,500,000						
Contract 5	15,000,000			15,000,000						
Contract 6	1,000,000				800,000				850,000	
Contract 7	1,400,000				2, 020,000				380,000	
<b>Cumulated</b>	<b>74,400,000</b>			<b>101,900,000</b>	<b>104,720,000</b>	<b>114,720,000</b>			<b>115,950,000</b>	<b>125 450 000</b>

### **ANNEX III: Description of Institutional Framework**

The main institutional framework relevant for the crisis response package relates to the institutions in charge of designing and implementing policies and laws with regards to financial sector development and those in charge of designing and implementing policies focusing on increasing competitiveness.

#### **Institutional Framework with regards to Financial Sector Development**

A central institution driving the global policy orientations for financial sector regulation and development is the Bank for International Settlements (BIS) located in Basel, Switzerland. It is an international organisation, which fosters international monetary and financial cooperation and serves as a bank for central banks. The BIS hosts the Basel Committee on Banking Supervision, which provides a forum for regular cooperation on banking supervisory matters. Its objective is to enhance understanding of key supervisory issues and improve the quality of banking supervision worldwide and consequently, contribute to an effective functioning of the financial sector. The Committee is best known for its international standards on capital adequacy, the Core Principles for Effective Banking Supervision and the Concordat on cross-border banking supervision. The Basel II Framework describes comprehensive measures and a minimum standard for capital adequacy that national supervisory authorities are now working to implement through domestic rule-making and adoption procedures. Basel II seeks to improve on the existing rules by aligning regulatory capital requirements more closely to the underlying risks that banks face.

The BIS also hosts the Committee on the Global Financial System (CGFS), which monitors developments in global financial markets for the central bank Governors of the G10 countries and issues policy recommendations in this respect. The Committee has a [mandate](#) to identify and assess potential sources of stress in global financial markets, to further the understanding of the structural underpinnings of financial markets, and to promote improvements to the functioning and stability of these markets. The European Commission and the European Central Bank are participating in this Committee.

At an EU level, it is the European Commission which is putting forward policy proposals in the field of regulation of banks and financial conglomerates. The current Community policy framework is the EC's Financial Services Action Plan 2005-2010, the main policy concerning the implementation of the EU Single Market in the field of services. The key policy instrument to achieve this goal is the development, implementation and application of EU banking and financial conglomerates legislation with all stakeholders, covering prudential rules for credit institutions, financial conglomerates and investment firms. This includes the correct and timely transposition of legislation and the pursuit of any necessary infringement procedures, as well as the development of any useful interpretative guidance on the EU banking legislation.

In the Beneficiaries the institutional framework regulating the financial sector is presented as follows:

#### **Albania:**

The banking system in the Republic of Albania has a two-tier structure. The first tier includes the Bank of Albania, whereas in the second tier there are banks and branches of foreign banks and non-bank financial institutions licensed by the Bank of Albania.

The Bank of Albania's activity is conducted in compliance with the Law "On the Bank of Albania". The Bank of Albania is the main regulator of the financial system. It is a fully state owned – bank and is accountable to the People's Assembly of the Republic of Albania. Apart from the appliance of monetary instruments to achieve monetary policy targets, the Bank of Albania supervises the banking activity to ensure banking system stability and issues and revokes banking licenses. It keeps and administers the foreign reserves of Albania, issues and circulates the national currency and promotes the functioning of the payment system.

The banking system activity is conducted in compliance with Law "On banks in the Republic of Albania". There are 16 commercial banks registered by the Central Bank of Albania, 6 non-bank financial institutions, one representative office of a foreign banks, and 3 unions of saving and loan associations. The privatisation of the banking sector is completed in Albania.

The microfinance sector has integrated four big MFIs<sup>18</sup> and a large number of smaller institutions. They are supervised by the Central Bank according to the Banking Law, the Law on Commercial Companies and the Law on Associations and Foundations. There are no limitations for the maximum amount of their loans, and capital adequacy requirements are the same applied to banks.

### **Bosnia and Herzegovina:**

The Central Bank of Bosnia and Herzegovina was established in accordance with the Law adopted at the Parliament of Bosnia and Herzegovina on 20 June 1997.

The main goals and tasks of the Central Bank are defined by the Law and in accordance with the General Peace Agreement in Bosnia and Herzegovina. The Central Bank defines and controls the implementation of monetary policy of Bosnia and Herzegovina. It supports and maintains appropriate payment and settlement systems. In addition the Central Bank coordinates the activities of the Bosnia and Herzegovina Entity Banking Agencies which are in charge of bank licensing and supervision.

Within the Central Bank, 18 banks are registered from the Federation of Bosnia and Herzegovina, and 10 banks from the Republika Srpska. The MFI sector is by far the largest of the region, with more than EUR500 million in total assets. MFIs currently serve more than 250,000 final borrowers in urban and rural areas having a huge development impact. Regulation is differentiated between the Republika Srpska and the Bosnian Federation. In the Republika, new regulations allow MCOs<sup>19</sup> to transform into profit companies under the form of "limited liability companies". All MCOs present in the Republika Srpska are limited liability companies (is this what you mean?). In Bosnia and Herzegovina MCOs are first required to re-register as foundations and only after that they can they become a profit-company. All MCOs in the Bosnia and Herzegovina have already re-registered as foundations. During 2008 the first transformations into companies have taken place. Please check verb tense used.

Since its introduction, the Central Bank has kept the Bosnian Mark (BAM) strongly pegged to the Deutsche Mark and then to the Euro. In the last years, this policy failed in keeping inflation at reasonable levels, while it severely damaged the competitiveness of the economy. The conviction that the parity will hold, made foreign currency debt apparently more attractive and the Bosnian population is highly indebted in foreign currencies. If the Central Bank is

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<sup>18</sup> MFI: Micro Finance Initiative

<sup>19</sup> MCO: Micro Credit Organizations

forced to devalue, defaults and insolvencies would rapidly spread across the economy. For this reason it is essential to ensure a continuous inflow of capital to the country during these turbulent times.

#### **Kosovo:**

The Central Bank of Kosovo was created in 2008, substituting the CBAK in the task of overseeing the financial sector and acting as the financial agent of the Government. As the Financial Services Authority, the institution, among others, sets the rules for the banking and insurance sectors. It also supervises commercial banks, micro-finance institutions, insurance companies and employer-funded pension.

Kosovo has officially adopted the Euro as its own currency, thus renouncing to the possibility of pursuing an independent monetary policy. This disadvantage is to a large extent compensated by a modern regulatory framework and the strong support received from abroad, turning Kosovo in one of the most stable financial sectors in the region.

The MFI sector in Kosovo has made important progress in the last years with four institutions with sizable operations. These leading MFIs reached a total portfolio of EUR50 million by the end of 2007. The regulatory framework took a big step forward in 2008 by proposing one of the first MFI laws in the region, allowing MFIs that fulfil certain conditions to become deposit-taking institutions. The MFI law is still under discussion and pending legal approval.

#### **Montenegro:**

The Central Bank of Montenegro was established on the basis of the Law on Central Bank of Montenegro of November 2000. The Central Bank prepares and participates in the preparation of laws and other regulations concerning the monetary, foreign currency and banking system, in accordance with international standards. It is the regulator and supervisor of the banking system. In this function it issues and withdraws licenses to banks and financial institutions and supervises their operations, bankruptcy and liquidation proceeding. The Central Bank may also provide loans from its reserves to licensed banks; it regulates and supervises the payment system and takes deposits from banks, state agencies and organizations.

There are currently eleven banks registered with the Central Bank of Montenegro. The banking sector has been one the most dynamic sectors in the region during the last years, showing impressive rates of growth which have significantly slowed in 2008 (from 165% in 2007 to 23% loan growth in 2008). The measures taken by the Central Bank to restrict the portfolio growth of banks are no longer effective and the impact of the financial crisis is manifesting itself in the credit crunch proven by a negative growth rate of approved loans.

There are five MFIs in Montenegro. Recent changes in the regulatory framework gave more freedom to MFIs by eliminating – for example – the maximum loan amount and the maximum leverage. Unlike banks, MFIs were not subject to portfolio growth limits. These measures were complemented with requirements to improve operational risk management, an essential feature in order to keep a good portfolio quality in a period of rapid growth.

#### **Serbia:**

The banking system of the Republic of Serbia consists of the central bank (National Bank of Serbia) and commercial banks.

The National Bank of Serbia was established on the basis of the Constitution of Serbia and the Law on the National Bank of Serbia in 2003. Pursuant to Article 2 of the Law on the National



Bank of Serbia, the National Bank of Serbia is the central bank of the Republic of Serbia and as such its main responsibilities are the protection of price stability and maintenance of financial stability. The National Bank of Serbia acts as an autonomous institution and is independent from the government or its bodies. On the basis of the determined economic policy targets and key macroeconomic indicators adopted by the Parliament, the National Bank independently develops the monetary and credit policy measures that are to be implemented. Also, the National Bank of Serbia passes an opinion on the certain enactments related to the budgetary, economic and fiscal policy issues, as well as on the draft laws and other legal regulations within the scope of its authority.

The main responsibilities of the National Bank of Serbia include determining and implementation of the monetary policy, as well as that of the dinar exchange rate policy, management of the foreign currency reserves, issue of banknotes and coins, and maintenance of efficient payment and financial systems. With regards to the financial system the National Bank assumes a supervisory function aimed at monitoring the solvency and legal grounding of operations performed by commercial banks and other financial institutions. The National Bank also provides for the minimal scope of auditing for banks and other financial institutions.

There are 34 commercial banks in Serbia and 7 representative offices of foreign banks registered at the National Bank of Serbia.

The NBS set up a very tight and conservative regulatory framework for financial institutions. In particular, they want to avoid extreme fluctuations of capital inflows and ensure a strong impact of the monetary policies (mostly through policy rates and capital requirements).

Serbia does not allow microfinance institutions to directly disburse funds to clients. Instead, they have to operate through a commercial bank, which significantly hampers the microfinance sector from developing. However, in addition to ProCredit Bank, Opportunity Bank recently obtained a license to operation as a second full-fledged commercial bank specialised in serving low-income households and micro and small entrepreneurs.

### **The former Yugoslav Republic of Macedonia:**

The National Bank of the former Yugoslav Republic of Macedonia has been established based on the law on the National Bank of the Republic of Macedonia. The National Bank is the only supervisory authority responsible for licensing and supervision of banks and savings houses.

The main purpose of the supervisory function performed by the National Bank is the maintenance of a safe and sound banking system and the protection of the depositors and other creditors that had invested their money in the banking system. The National Bank of the former Yugoslav Republic of Macedonia has established supervisory standards that are in compliance with the international standards and practices set by the Basle Committee on Banking Supervision.

While performing their activities, banks are obliged to comply with the existing supervisory standards that are implemented for the purpose of limiting the banks' risk exposure. The supervisory standards established and implemented by the National Bank are derived from the Basle Committee's principles and the European Directives.

The National Bank also establishes and conducts the monetary policy, regulates the liquidity in the international payments, establishes and conducts the Denar exchange rate policy, manages the foreign exchange reserves, regulates the payment system, issues banknotes and

coins and performs activities for the account of the central government and the government administration bodies.

The former Yugoslav Republic of Macedonia enjoys one of the most stable macroeconomic setups of the region. In spite of not having a strong peg against a foreign currency, the National Bank of Macedonia has managed to keep exchange rates relatively stable and inflation low (1.7% yoy in January 2009). This, (together with the relatively small current account deficit) gives the Central Bank a considerable room for manoeuvre during these turbulent times.

There are currently 18 banks registered with the National Bank, one representative office of a foreign bank, and 11 savings houses. Micro clients are mostly reached by savings houses and one NGO with sizable operations. However, saving houses are not allowed to borrow from abroad and therefore have to use commercial banks as intermediaries. NGOs are permitted to borrow but cannot perform any lending activities and therefore need to channel funds through commercial banks similar to Serbia.

### **Turkey**

In 2000, the Turkish government decided to change the fragmented nature of banking supervision by establishing an independent body as the sole authority for the banking sector. The Banking Regulatory and Supervisory Agency (BRSA) has been established in June 1999, becoming operational in August 2000. Following the financial crisis in 2001, the legislative framework has been significantly strengthened. The BRSA consists of the Banking Regulation and Supervision Board and the Chairman's Office. The Board is the decision making body of the BRSA. The Agency has more than 500 staff as of July 2009. The BRSA is in charge of the supervision of the banking sector, factoring, leasing and consumer finance companies.

The BRSA also cooperates with other public institutions overseeing the financial sector. The BRSA also is a member of the Financial Sector Commission, which is composed of representatives of related public institutions such as the Undersecretariat of Treasury (insurance), the Capital Markets Board (securities markets and investment companies), and the Central Bank (monetary policy).

The Savings Deposits Insurance Fund (SDIF) works between deposit owners, banks accepting the deposits and the institutions taking the deposits under insurance guarantee. The SDIF was established in 1983, first represented by the Central Bank (until 1999) and then by the BRSA (until 2000), becoming an autonomous entity since then. Resolution of banking sector assets which were taken over has been an important function of the Fund since its establishment.

The history of the Central Bank of Turkey (CBT) dates back to 1850s, when the Ottoman Bank was established to assume contemporary central banking functions like printing banknotes and external payments. The CBT has become an independent institution after the crisis in 2001. The primary responsibility of the CBT is to maintain price stability.

## **Annex IV: Details per EC funded contract**

### **Activity 1.1 Increase European Community Participation in EFSE**

This activity will be implemented by indirect centralised management. Implementation tasks are delegated by the European Commission to the European Investment Fund (EIF) in accordance with Article 54 (2) (b) of the Financial Regulation. An amendment to the existing Mandate with the EIF extending the scope of the Mandate to the additional participation and request from EIF to subscribe additional shares in EFSE for a nominal amount of EUR 10 million will be signed. The Mandate will expire at the end of 2015. The additional risk cushion through the new EC contribution will leverage additional EFSE investments of at least EUR 60 million in the Beneficiaries. EC shares in EFSE will be transferred to complete ownership to Beneficiaries at the latest in 2015 following an assessment of the Beneficiaries administrative capacities and a Commission Decision on the transfer.

### **Activity 1.2 Private Sector Support Facility**

This activity will be implemented by joint management with the EBRD and the EIB in accordance with Article 53 c of the Financial Regulation. The European Commission will sign a Contribution Agreement with the EBRD in cooperation with the EIB for a period of 5 years. A Facility Steering Committee meeting every 6 months will monitor the implementation of the Facility.

### **Activity 1.3 Energy Efficiency Fund**

This activity will be implemented by indirect centralised management. Implementation tasks are delegated by the European Commission to the European Investment Fund. The European Commission will sign a Mandate with the European Investment Fund for a period of 5 years in accordance with Article 54 (2) (b) of the Financial Regulation. EC shares in the Energy Efficiency Fund will be transferred to complete ownership to Beneficiaries by the end of 2015 following an assessment of the Beneficiaries administrative capacities and a Commission Decision on the transfer.

### **Activity 1.4 IPA/EBRD Turkey Micro, Small and Medium size Enterprise (MSME) Finance Facility**

This activity will be implemented by joint management with the EBRD in accordance with Article 53 d of the Financial Regulation. The European Commission will sign a Contribution Agreement with the EBRD for a period of 12 years. A Facility Steering Committee meeting at least every 12 months will monitor the implementation of the Facility.

### **Activity 1.5 IPA/EIB Turkey SME Recovery Support Programme**

This activity will be implemented by joint management with the EIB in accordance with Article 53 d of the Financial Regulation. The European Commission will sign a Contribution Agreement with the EIB for a period of 12 years. A Facility Steering Committee meeting at least every 12 months will monitor the implementation of the Facility.

### **Activities 2.1-2.3 Regional Programme on Financial Sector Supervision and Regulation**

These activities will be implemented by joint management with the European Central Bank (ECB) in accordance with Article 53 c of the Financial Regulation. The European Commission will sign a Contribution Agreement with the ECB for 24 months. The ECB will be the central co-ordinator of a regional project drawing on experts from Member States' supervisory authorities and from IFIs.

### **Activities 3.1-3.3 Regional Competitiveness Initiative**

These activities will be implemented by joint management with the OECD in accordance with Article 53 c of the Financial Regulation. The European Commission will sign a Contribution Agreement with the OECD for 36 months.