

ACTION FICHE FOR 2007 ENPI-EAST ANNUAL ACTION PROGRAMME

1. IDENTIFICATION

Title	Support to Energy Market Integration and Sustainable Energy in the NIS (SEMISE) - CRIS reference: 18661/4		
Total cost	6 M €		
Aid method / Management mode	Project approach – Centralised management		
DAC-code	23010	Sector	Energy policy and administrative management

2. RATIONALE

2.1 Sector context

Energy supply, conservation and diversification have become an overriding challenge for the EU and its Eastern European and Central Asian partners in the past two years. Uncertainties over reserves, added to stronger international competition for access to hydrocarbon sources and control of energy companies, have boosted oil and gas prices, highlighting the need for Europe and its neighbours to develop more integrated energy markets on a region-wide basis. Energy supply has become an integral element of security, not only due its impact on economic activity and social welfare, but also because it appeared to be a political lever on several occasions during that period.

As a result, a major overhaul of EU energy policy, including with regard to its external dimension, was carried out in 2006. This process started with the EC Green Paper ("A European Strategy for Sustainable, Competitive and Secure Energy") in March, was reasserted by the Commission, the Secretary-General and the High Representative for the European Council in a common paper advocating a renewed EU strategy for external energy relations issued in May, and culminated in the orientations adopted at the Heads of States' Summit in Lahti on 20 October 2006.

"In the framework of the Strategic EU Energy Review publicised in January 2007, the priorities proposed by the Commission regarding external policy aspects include: strengthening EU relationships with its neighbours; contributing to the improvement of legal frameworks to facilitate investments in international projects; developing financial instruments to enhance energy security through inter alia enhanced cooperation with the EIB and the EBRD; and encouraging energy efficiency and the development of renewable energies."

The European Council of June and December 2006 and of March 2007 endorsed this approach.

These goals are fully consistent with the EU international commitments (Kyoto Protocol, UNFCCC, and MDGs - especially in relation to environmental sustainability).

As far as EU relations with Eastern Europe and Central Asia are concerned, the process initiated in November 2004 in Baku with the aim of strengthening inter-regional energy cooperation was speeded up and deepened. An Energy Ministers' conference held in Astana, Kazakhstan in November 2006 provided directions for future cooperation, with a particular focus on the necessary convergence of energy markets, the enhancement of security of supply, diversification of sources and energy efficiency, as well as the need for furthering investments.

Memoranda of Understanding were, in addition, negotiated between the EC and Ukraine, Azerbaijan and Kazakhstan and political dialogue with Russia was reactivated.

The INOGATE programme⁵, which has already evolved since 2004 to encompass, not only oil and gas, but also the electricity sector, and to address energy-related environmental issues, needs to be pursued and reinforced to best tackle these new challenges. A key role is entrusted to the INOGATE Technical Secretariat (ITS) based in Kiev, in this context. The important areas to be covered by the ITS indeed include: information collection and dissemination, coordination of the inputs from all the INOGATE projects, liaison with energy stakeholders, as well as dialogue with, and support to the national authorities.

2.2 Lessons learnt

Following the "Evaluation and Orientation Study for the main themes of INOGATE's future development", carried out in 2003, four potential areas of improvement were identified:

- Strengthening of its regional dimension and better targeted support to beneficiaries by inter alia creating additional region-based offices;
- Reinforced investment focus by preparing pre-feasibility and feasibility studies for suitable projects;
- Transfer of know-how throughout the process of identifying and developing sound and bankable investment projects in the oil and gas sectors;
- Increased collaboration with IFIs to facilitate project financing, besides the above-mentioned pre-investment measures.

In line with these recommendations, the capacity of the ITS was strengthened and two projects making available technical assistance resources for pre-investment purposes were launched. Close contacts were developed with IFIs, the EBRD in particular. A regional office was established in Tbilisi, Georgia and a supplementary office is to be set up in Almaty, Kazakhstan in the course of the year 2007.

At the Energy and Transport Ministerial Conference organized in Baku, Azerbaijan, on 13-14 November 2004, the EU Member States, the European Commission and representatives of the Governments of Azerbaijan, Armenia, Bulgaria, Georgia, Iran, Kazakhstan, Kyrgyzstan, Moldova, the Russian Federation (as observer), Romania, Tajikistan, Turkey, Ukraine and Uzbekistan, reached consensus on the necessity of enhancing co-operation in both the energy and the transport sectors and launched the

⁵ INOGATE originally stands for « Interstate Oil and Gas pipelines to Europe » but could be seen nowadays, because of its enlarged scope, as the "Gate to innovation in the energy sector" in the region.

"Baku Initiative". Conference participants defined energy priorities for the future, based on mutual interest, and agreed to:

- Support the development of regional energy markets in the Caspian Littoral States and their neighbouring countries in order to facilitate the progressive integration of their respective energy markets as well as their consistency with the EU market;
- Make funding for new infrastructure more attractive;
- Embark on energy efficiency policies and programmes; and
- Use the existing INOGATE structures to help attain the objectives of this reinforced co-operation.

On 30 November 2006, at a Ministerial Conference held in Astana, Kazakhstan, the Baku Initiative partners endorsed a Road Map and agreed to focus cooperation on the convergence of energy markets, investment in energy safety and security, support of sustainable energy development, and on attraction of investment.

In order to best respond to the expectations expressed by the Energy Ministers in Astana, INOGATE needs to continue its transition process towards:

- The adoption of a programme approach, involving closer cooperation between the INOGATE projects, an enhanced coordination role for the INOGATE Technical Secretariat, and more inputs from the National Coordinators;
- Increased information exchange and collaboration between the INOGATE programme and all energy stakeholders, including regulators and professional representatives of the sector;
- The improvement of INOGATE image and the amplification of INOGATE ownership within the participating countries;

New means should also be made available to increase country support in areas such as: regulation, harmonisation of legislation, the preparation of national action plans (regarding e.g. energy efficiency and renewable energies) and the identification and promotion of investments through specific pre-investment measures (supplementing those to be covered by the Neighbourhood Investment Fund that will be set up in 2007).

2.3 Complementary actions

The efforts of SEMISE will be supported by the action of the ITS and the pool of resources available under the other INOGATE projects. They will also be accompanied by country-specific EC cooperation initiatives (such as in Ukraine, Azerbaijan and Kazakhstan, as a consequence of the Memoranda of Understanding signed with the Commission). Working collaboration with lending institutions (EBRD, EIB, Member States institutions and the World Bank) will be actively pursued.

In addition, synergies will be developed with the EU Member States in the framework of their bilateral cooperation activities and possibly with other countries.

2.4 Donor coordination

Particular attention will be given to this issue. Donor coordination will be sought on a systematic basis by SEMISE, with the support of the ITS and of the National Coordinators designated by their governments, as well as the network of energy correspondents set up by the Commission in early 2007. The EC Delegations will also play an active role in this regard locally.

3 DESCRIPTION

3.1 Objectives

Overall objectives:

Help materialise the recommendations of Astana's Conference, namely:

- (1) ensuring the convergence of energy markets and prepare the ground for the creation of an integrated energy market, based on the principles adopted for the EU market regarding fair competition as well as environmental, efficiency and safety standards;
- (2) enhancing the safety and security of energy supplies through:
 - the modernisation of existing infrastructure;
 - the substitution of old and dangerous power generation plants, for environment-friendly power generation infrastructure;
 - the development of new infrastructure, particularly network interconnections;
 - the implementation of an up-to-date monitoring system for their operation;
- (3) improving energy supply and demand management; and
- (4) promoting financing of commercially and environmentally-viable energy projects of common interest, to be identified according to agreed criteria.

Specific objectives:

Enlarge the content and improve the overall consistency and sustainability of EC energy cooperation in the region, by addressing the needs in three particular areas: harmonisation of legislation, pre-investment studies and sustainable energy (i.e. environmentally-safe, used efficiently/wisely, and renewable whenever possible).

3.2 Expected results and main activities

Assistance to partners' countries in their efforts towards updating their energy-related legislation, preferably based on peer-to-peer cooperation mechanisms and with the support of networks of government professionals both from the region and the EU, will be one of the key components of the project. Convergence with the principles embedded in the EU Directives will be encouraged in parallel through e.g. targeted awareness-raising campaigns, exchange of staff and seminars.

Another aspect of the project activities will consist of identifying infrastructure investments which may be of interest to IFIs and subsequently, to carry out

feasibility studies in the oil, gas and electricity sectors⁶, but also, to open the way to substantial IFI involvement in the fields of energy efficiency and renewable energy. This will necessitate market demand studies and energy audits in the industry, transport and building sectors, as well as contacts with the local banking sector.

To promote sustainable energy effectively, a combination of additional inputs will also be required, such as: awareness-raising and capacity-building activities, as well as punctual assistance to governments to adapt national energy strategies or fiscal regulations, in order to open effectively new markets for energy efficiency and renewable energies in the region.

The achievements of the energy efficiency project implemented by the EBRD in Ukraine and Moldova under EC funding will be used as a reference to put this work in motion in other partner countries.

3.3 Stakeholders

The widening of the scope of INOGATE activities – originally focusing on oil and gas – to electricity, energy efficiency and renewable energies, provides opportunities for new categories of stakeholders to benefit from EC cooperation. This is true for the civil societies in general as well as for specific economic sectors (industry, construction, transport, etc).

Partner governments involved, which confirmed in Astana their interest for strengthening the planning, legislative and management capacities of their national administrations, are now becoming key beneficiaries of INOGATE, beside oil and gas companies, which were the primary target groups in the earliest phases of this programme.

3.4 Risks and assumptions

The energy policy of Russia (which has an observer status in the Baku Initiative) will influence programme implementation to some extent, but not necessarily in a negative manner (for instance, higher gas prices in Ukraine have considerably improved the profitability of energy efficiency investments, in addition to raising the interest of the participating countries in developing stronger cooperation links with the EU).

Tensions in the Balkans may also be a factor of instability that would undermine the security of supply and the investment climate.

Up to now, however, there is no evidence that the Baku Initiative has suffered much from this situation. On the contrary, it clearly appeared as a factor of rapprochement between all the participants.

Moreover, the support that partner governments have provided to INOGATE since the launch of the Baku Initiative and subsequently, throughout the sessions of the Working Groups that prepared the ground for Astana's Ministers Conference, is a good indication of the project prospects for sustainability.

⁶ Based on the experience of the ongoing projects: "Pre-feasibility studies and facilitation for developing gas transit interconnection in Caucasus and Central Asia" and "IFI technical assistance support fund for facilitating investments in oil and gas projects", which is aimed to facilitate investment in regional oil and gas transportation infrastructure.

3.5 Crosscutting Issues

The new phase of the INOGATE programme of which this project is a part fully integrates sustainability goals in its design: it aims to consolidate a process which already enjoys credibility and support by embedding national policies and priorities into a coherent regional undertaking, addressing more fully existing institutional and legislative deficiencies.

Better governance is addressed through improved access of citizens to energy-related information and energy sources as well as new legislations promoting procurement transparency and fair competition and enhancing consumer protection against environmental impact.

4 IMPLEMENTATION ISSUES

4.1 Implementation method

Centralised management.

This type of project can hardly be devolved to any EC Delegation in the region due to the linkages with the EU policy to be established and because it covers both Eastern European and Central Asian countries. Regular liaison between the EC DGs directly or indirectly involved in the follow up of its activities (i.e. EuropeAid, RELEX and TREN) as well as with the EBRD and the EIB, will need to be maintained and this can be achieved more easily in Commission headquarters. Regular exchanges will however be developed with the EC Delegations in the region, especially those taking care of large EC-funded bilateral energy initiatives, such as Ukraine, Azerbaijan and Kazakhstan.

4.2 Procurement procedures

All contracts implementing the action must be awarded and implemented in accordance with the procedures and standard documents laid down and published by the Commission for the implementation of external operations, in force at the time of the launch of the procedure in question.

4.3 Budget and calendar

The total project budget, of 6 M €, will be used for technical assistance purposes, to be recruited on the basis of one or more service contracts.

Implementation will cover indicatively a three year period, starting in 2008.

4.4 Performance monitoring

Progress in the implementation of Astana's recommendations will be an integral part of the mission of the consultants working under SEMISE, which will develop performance and impact indicators and carry out regular reviews to assess these aspects, with the assistance of the network of INOGATE National Coordinators. The performance of SEMISE itself will be monitored by Commission headquarters, with country-level inputs from the Delegations. Contracted consultants will also ensure regular project monitoring, as is done for ENPI/DCI operations carried out at the regional level.

4.5 Evaluation and audit

The external evaluation will be carried in the last few months of project implementation. Audit missions will be undertaken by EC headquarters or entrusted to specialised consultants where necessary.

4.6 Communication and visibility

The project will take advantage of the actions initiated in 2007 by the ITS to improve INOGATE communication and visibility, including with regard to Internet communication (e.g. re-vamping of the web portal and publication of a newsletter). Ongoing efforts to improve data collection and dissemination of information on energy-related issues in the region will be pursued in particular.