





Environmental Lending in Central and Eastern Europe




The Geographical Context

 **Member States**

 **Acceding Countries**, where negotiations for EU Membership have been concluded.

 **Accession Countries**, where negotiations for joining the EU are in progress.

 **Candidate Countries**, where an application for accession has been approved by a European Council Decision.





Introduction

The integration of the Acceding and Accession Countries from Central and Eastern Europe into the European Union (EU) is one of the key challenges and opportunities for the EIB over the coming years.

The EIB provides financing for projects that, in addition to furthering economic development, will assist those countries in meeting the requirements of the Acquis Communautaire and facilitate the enlargement process by the reinforcement and support of EU policy objectives. Projects financed by the EIB include those to protect and enhance the natural and urban environment as well as providing basic environmental services.

This Report is a supplement to the first EIB Environmental Report 2001-2002, to reflect the unique circumstances of current environmental lending in the Acceding and Accession Countries. It should be read in conjunction with other EIB publications, including the Annual Report.

Due to differences in history and geography, environmental lending in Malta, Cyprus and Turkey is excluded from the Report.

Enlargement and the Environment

Protecting and enhancing the environment is today one of the EIB's top lending priorities. As well

as specific environmental lending objectives, the environmental acceptability of every project financed by the Bank is reviewed.

The EIB is already the largest provider of long-term funds to countries wishing to join the European Union. The Bank often works in synergy with the European Commission's Grant Instrument for Structural Policies for Pre-Accession (ISPA) to provide long-term finance for transport and environmental projects, the latter including projects in the water, wastewater and solid waste sectors. The Bank also works closely with other multi-lateral financial institutions,

including the European Bank for Reconstruction and Development (EBRD) and the World Bank Group, as well as commercial banks operating in the region.

The EIB, typically in support of municipalities, is also increasingly helping to strengthen other environmental sectors in the region, including the provision of urban public transport, district heating systems, renewable energy, energy efficiency and urban renewal. Some of this financing activity promotes the Bank's policy on climate change; to reduce greenhouse gas emissions in a cost effective manner. In the wider context of sustainable

Budapest, Hungary



development, the Bank aims to encourage investment in less favoured parts of the region that promotes economic growth consistent with protection and enhancement of the environment.

Finally, in the industrial sector, the Bank promotes the adoption of new environmentally friendly technologies encouraging the use of clean, energy efficient processes and appropriate environmental management practices as opposed to "end-of-pipe" solutions.

The Environmental Context

Environmental investment in the Acceding and Accession Countries of Central and Eastern Europe is required in order to address the environmental legacy of resource-intensive industry that has had little regard to pollution control. Investment is also required to reduce the inefficient use of energy and to provide access to basic environmental services, such as the provision of drinking water and the collection and treatment of wastewater and solid waste.

Investment must be carried out in such a way as to protect and enhance the region's rich environmental heritage, including the maintenance of biodiversity through the protection of habitats. The EIB achieves this by supporting measures mitigating and/or compensating the environmental impact of each project and by investing in specific projects to protect and enhance habitats and the natural environment, for example, sustainable tourism financed through Global Loans.

More formally, investment must satisfy the overall objectives of the EC Treaty (Article 174), in particular to provide environmental services that comply with the requirements of the *Acquis Communautaire*. According to one early estimate, the costs of compliance could amount to an estimated investment of around EUR 80 to 120 billion for Central and Eastern Europe. Whilst high, this cost will result in significant benefits to public health, the environment and consequently the economy.

Where substantial adaptation of infrastructure is necessary to meet the requirements of the EU Directives, investment may be phased in accordance with transitional arrangements. Significant investment will be required in connection with the Water Framework Directive and in particular the Urban Wastewater Treatment

Directive and the Drinking Water Treatment Directive. Similarly, in the field of solid waste management, implementation of the Waste Framework Directive, the Landfill Directive and the Directive on the Incineration of Waste will also require considerable new investment.

Other Directives requiring significant investment include the Large Combustion Plant Directive and the Integrated Pollution Prevention and Control (IPPC) Directive.

Consideration is also being given to meeting the objectives of the EU 6th Environment Action Programme (2001-2010). Finally, environmental investment is more generally being driven by increasing public interest in environmental issues, the liberalisation of markets (including cross-border trade) and foreign direct investment.

Kaunas, Lithuania



Constanta Port, Romania





Lending Activity

Projects

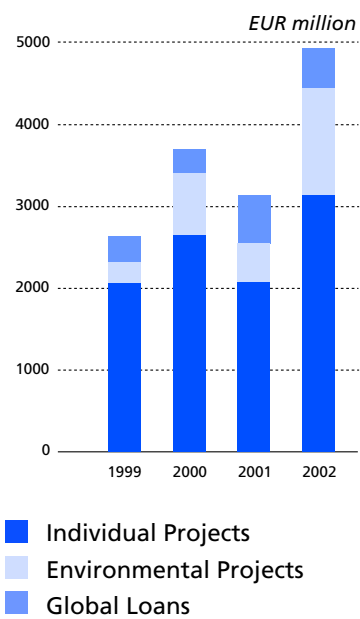
For the four-year period 1999-2002, the EIB provided EUR 11.6 billion in financing to countries in Central and Eastern Europe, including EUR 1.7 billion through Global Loans. Of the financing provided directly by the Bank, 28% concerned environmental projects, with a gradual increase over time. This expansion in investment in environmental projects would appear to be the result of:

- A growth in public and political awareness of environmental issues;
- The investments required to make the transition towards membership of the European Union;

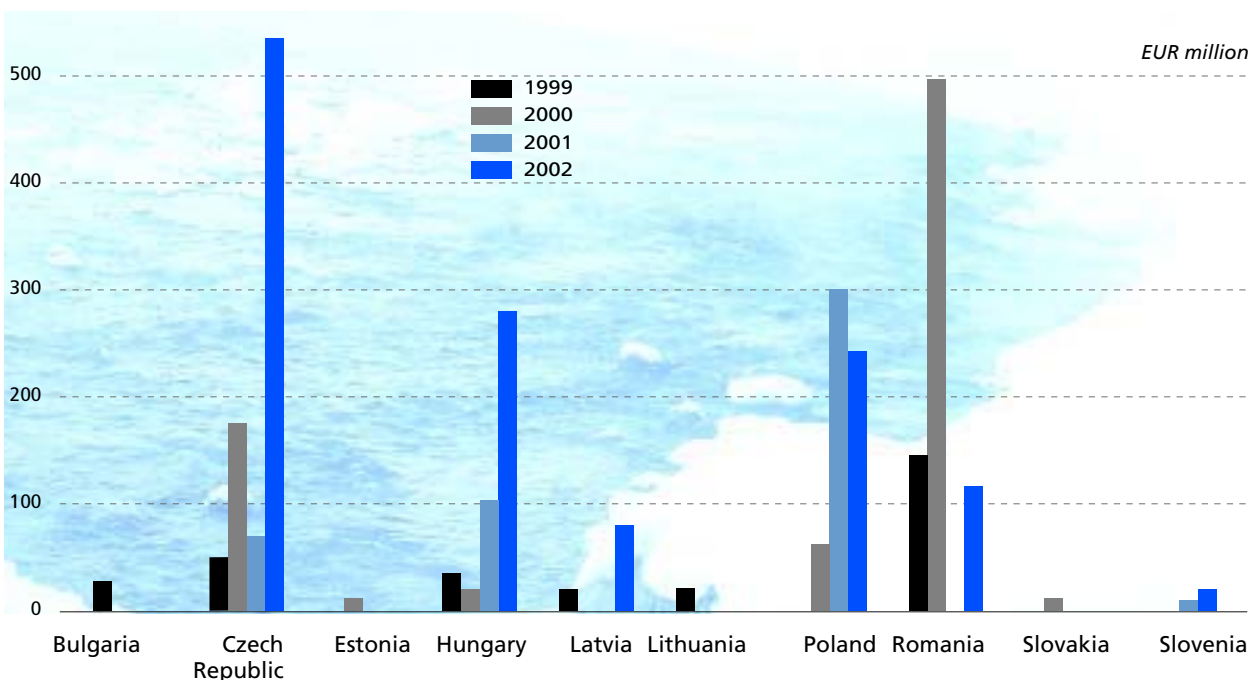
- An increased availability in grants (in particular ISPA) to stimulate the preparation of environmental investments and to facilitate co-financing opportunities, associated with the Bank's advisory role to the Commission in this respect;
- Improvements in the institutional and policy framework and enhanced borrower capacity;
- A deliberate increase in the environmental lending activity on the part of the Bank.

The distribution of environmental lending by country tends to reflect the national priority given

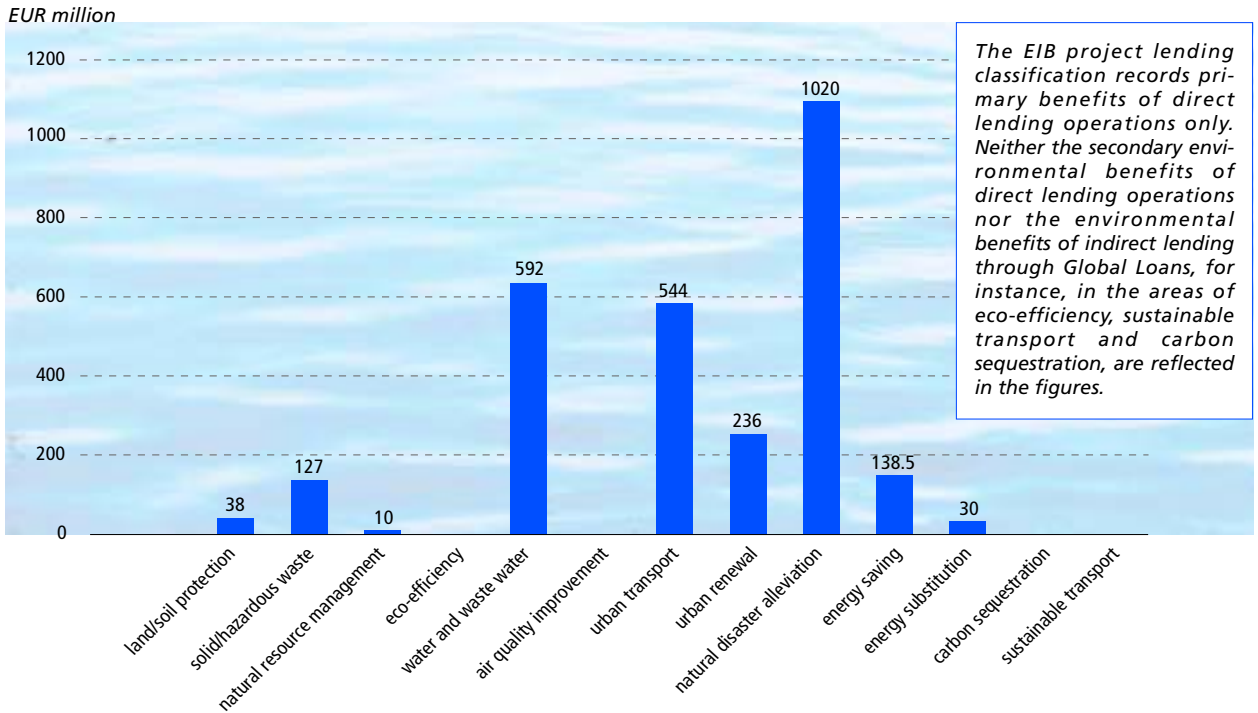
Lending in Central and Eastern Europe, 1999-2002



Environmental Lending by Country, 1999-2002



Environmental Lending for Individual Projects, 2001-2002



to environmental investment as well as demand brought about by chance events, such as severe flooding. In addition, large single investments, for example, for urban metro projects in Romania and the Czech Republic, can have a disproportionate effect on the country distribution.

One of the most significant sectors for EIB financing is water, including the provision of drinking water, wastewater treatment and associated infrastructure. This reflects the investment required to meet the ambient and emissions standards of the Water Framework Directive. The

Case Study: Hungary

The EIB has agreed two environmental Sector Loans (2001 and 2002, EUR 123 million in total) in Hungary. Both loans complement ISPA grants to Regional Municipal Waste and Water Associations for a series of schemes to support a national programme for investment in water supply, wastewater treatment and solid waste management.

The projects are necessary to improve the supply of critical environmental services, to standards required by EU Directives.

Waste water Treatment Plant, Debrecen, Hungary





Case Study: Flood Protection and Damage Reconstruction

The EIB has signed loans with the authorities in the Czech Republic, Hungary, Poland and Romania for emergency programmes for the reconstruction of basic infrastructure following severe flooding, as well as investment programmes to mitigate flood risk and landslides in the future.

Following floods in Romania in April 2000, a EUR 250 million framework loan was agreed to part finance urgent repair work, in particular to damaged infrastructure and services and for flood protection measures.

Flooding in Hungary in March 2001 led to a similar emergency programme for the reconstruction of basic infrastructure. A EUR 60 million loan was agreed in 2001 to assist in the restoration of economic and social activity, with investments also including reconstruction of nature reserves and replanting, repair of public buildings, including government offices and churches, and the repair of residential property.

Similar programmes were established for Poland in 2001 (EUR 250 million) concentrating on repairing and expanding flood management provisions, and the Czech Republic in 2002 whereby EUR 60 million was allocated to flood prevention and EUR 400 million to damage reconstruction.

In terms of disaster prevention, in 2003 the EIB will support a landslide protection framework loan, co-financed with the Polish Government, to protect vital infrastructure against landslide risk. Projects may range from landslide stabilisation and infrastructure relocation to landslide risk mapping and warning systems.



Case Study: Prague Metro

The city of Prague has suffered from escalating car ownership, equivalent to over 500 private cars per 1000 inhabitants; this is one of the highest levels of vehicle ownership for a city in Europe. In addition, in Prague a declining percentage of passengers use public transport, recently stabilising at approximately 60%. This stabilisation has been due to both the improvements in the metro system and the increasing congestion at street level.

The EIB has financed a number of projects relating to the extension and upgrading of the metro, including new lines, tunnels, power generation units, rolling stock and the construction of stations.

The project should help to encourage the use of public transport in the city as an alternative to private vehicle use.



availability of grants is a major factor in stimulating water investments.

Natural disaster alleviation, including flood protection and the reconstruction of damaged infrastructure, has, however, been the largest area of investment required during this period due to the serious floods in 2000 (Romania), 2001 (Hungary, Poland) and 2002 (Czech Republic). The EIB responded quickly to these events in order to contribute to the restoration of economic activities and environmental services, and wherever possible, to

help to reduce the impact of flooding in the future (see case study).

Urban transport projects also attracted large volumes of EIB financing during this period, though the main investments were limited to 3 large ongoing projects, namely the modernisation of the Bucharest Metro, the rehabilitation of Bucharest Urban Transport and the Prague Metro (see case study).

There has been an increasing trend in so-called EIB environmental Framework Loans that support municipalities and regional

authorities implement small and medium sized projects in the water, wastewater and waste management infrastructure sectors. In the period 1999-2002, the Bank financed 15 such projects in Central and Eastern Europe with a total loan volume of EUR 568 million, i.e. the Czech Republic (3 projects totalling EUR 220 million), Estonia (EUR 12 million), Hungary (2 projects totalling EUR 123 million, see case study), Latvia (EUR 20 million), Lithuania (EUR 15 million), Poland (5 projects totalling EUR 113 million), Romania (EUR 55 million) and Slovenia (EUR 10 million).



The Borrower

There has been a gradual shift in the type of borrower of EIB loans, similar to that seen elsewhere in Europe for Bank-financed activities. This in itself has implications for the environmental lending of the EIB.

First, there has been a gradual move away from lending to Central Government towards lending directly to regional authorities and municipalities. At the same time, loans are becoming more diverse, such that an increasing number of loans have been agreed for multi-sector programmes, including projects where the objective is to encourage regional development, regenerate the urban environment and/or provide basic (albeit mixed) environmental infrastructure.

Second, foreign direct investment (FDI) is increasing in the region. This is encouraged by the EIB, which has also increased its capacity for working in this area, including public-private-partnerships (PPP). FDI is often an effective way to bring about a transfer of knowledge, technology and practices in the field of environment (see case study).

The EIB often supports projects that encourage sector reform, usually in conjunction with other financial institutions, such as the World Bank and the EBRD. The Bank is also co-operating with the Administrations of some of the countries and the European Commission to initiate actions to render the institutional framework more efficient. Where uncertain-

ties in a sector exist, the Bank may conduct a sector analysis to help inform project financing. The Bank also conducts evaluation studies of its own financing activities, which are available on the EIB website, e.g. "EIB Financing of Energy Projects in the EU and in CEE countries".

Standards

The EIB applies the same approach and standards to environmental assessment of projects in Central and Eastern Europe as in the EU Member States. During project appraisal, the Bank considers the economic, technical, financial and environmental aspects of the project, including compliance with EU policy and legislation and national legislation. Any derogation must be consistent with agreements reached between the EU and the Acceding or Accession Country and be justified in cost benefit terms.



Case Study: Foreign Direct Investment, Poland

In 2002, the EIB signed a EUR 30 million loan with Saturn Energy (Poland), for the major refurbishment of a combined heat and power generation plant supplying steam and electricity to a pulp and paper mill at Swiecie, Poland. The investment is for the construction of a new fluidised bed boiler, fed by a combination of biomass and coal.

The project includes an overhaul of 3 existing coal-fired boilers and the upgrade of electricity generation equipment. The project will improve environmental performance of the plant through greater energy efficiency and reduced emissions.

Saturn Energy is a Special Purpose Company set up to supply energy to the paper mill. The company is 95% owned by the Polish Enterprise Fund, which is one of the largest foreign investors in Poland.

Future Activity

There are a number of factors that may have so far constrained EIB environmental lending in Central and Eastern Europe, including the following:

- The environment is often not among the highest priorities for public expenditure.
- Public sector promoters may be inexperienced at putting together bankable projects, i.e. presenting projects that meet the economic, technical, financial and environmental requirements of the Bank.
- The environmental service may not be affordable to the consumer.

As experience grows, the capacity to implement projects increases and co-financers gain confidence, lending for environmental projects is expected to increase. Though the loans can sometimes find themselves in competition with grants, generally growth in lending will also be facilitated by grants from the European Commission and donor countries in reducing the overall costs of finance and for strengthening project preparation and implementation capacity.

The EIB expects its lending activity to increase in Central and Eastern Europe. In addition, the Bank also envisages the percentage of its total lending dedicated to the environmental sector to match the targets set for the existing EU.

This will include a continuation of environmental lending through sector specific lending, providing loan finance to regions and municipalities for multi-sector lending, including regional and urban development, encouraging foreign direct investment and also broadening the range of environmental projects financed to include more projects targeted at improving air quality and protecting natural habitats.

The EIB will also aim to promote the carbon market through reduc-

tions in greenhouse gases and energy efficiency measures, among others. At the same time, the Bank will continue to assess carefully the environmental acceptability of projects undertaken for other than environmental reasons, being the majority of its lending. In this regard, it will continue to cooperate with the European Commission - Directorate General for the Environment.

Such developments will be partly facilitated by co-financing opportunities with EC structural funds.

Co-financing with European Commission Grant Financing

The EIB may provide loans for projects co-financed by European Commission grant aid; for example, the ISPA grant instrument provides support to investments in transport and environmental protection.

In 2000 and 2001, the European Commission approved 169 ISPA projects (including 100 dedicated to the environment) with a total project cost of EUR 6.1 billion, of which ISPA grants financed EUR 3.9 billion.

During 2000-2001, around 22% of the EIB lending in the Acceding Countries was dedicated to projects co-financed by EU grants. In the context of the enlargement of the EU, Cohesion Funds will replace the ISPA programme. Grant aid in the 10 new Member States will increase from EUR 1.14 billion per annum (under ISPA) to EUR 2.8 billion.

The EIB will continue to work closely with the European Commission to achieve the best combination of grants and loans in the expanded European Union.



The EIB expects to co-operate further with the Commission's Directorate General for Regional Policy and Directorate General for Enlargement as advisor in project preparation and appraisal and as a lender in order to maximise the benefits of combining EIB loans with Community grants.

The EIB will aim to work generally with others able to provide technical assistance grants to support capacity building in project preparation and implementation.

The EIB will seek to increase lending through financial intermediaries, including loans targeted at environmental projects.

The EIB continues to develop its experience of working through river basin and regional seas programmes to facilitate investment in prioritised environmental projects.

Finally, the EIB recognises its role in improving environmental awareness, information disclosure and public participation in the Region, and seeks to collaborate with representatives of civil society in terms of general policy dialogue.

Case Study: Co-financing, Bulgaria

The rehabilitation of the Maritza East II power plant, Units 7 and 8, and installation of flue gas desulphurisation (FGD) - part financed by the EIB - was completed in November 2002. The project involved the engineering, construction, commissioning, full acceptance tests and continuous commercial operation of 2 units of an 840 MW lignite-fired power plant located near Stara Zagora in south central Bulgaria. The project complies with the Bulgarian law on emissions from large combustion plants. During commercial operation, the degree of desulphurisation is not to be less than 90% and dust emissions are to be kept below 50mg/Nm³.

The cost of the rehabilitation was EUR 104 million. The EIB provided EUR 45 million for the launch; the EBRD loaned EUR 40 million, while EUR 7.5 million was released under the Phare grant-financing program.

EIB/EBRD involvement in the rehabilitation project was key to the implementation of the environmental measures.



“Environment for Europe”

The EIB has been a member of the “Environment for Europe” process since its inception at Dobris Castle in 1991. The Bank subscribes to its main objectives, of harmonizing environmental quality and policies on the continent of Europe.

The EIB is committed to regional cooperation in the field of environmental protection, supporting a number of initiatives through technical support and lending activity. This includes the DABLAS Task Force (addressing pollution hotspots in the River Danube and Black Sea catchment areas) and Baltic 21 (addressing pollution hotspots in the Baltic Sea catchment area).



European Investment Bank

100, boulevard Konrad Adenauer • L-2950 Luxembourg
Tel. (+352) 43 79-1 • Fax (+352) 43 77 04
E-mail: info@eib.org

For further information please consult the EIB's web site:
www.eib.org

or contact:

Peter Carter
Environment Unit
Tel. (+352) 43 79-3424
Fax (+352) 43 79-3492
E-mail: p.carter@eib.org

Yvonne Berghorst
Information and
Communications Department
Tel. (+352) 43 79-3154
Fax (+352) 43 79-3189
E-mail: y.berghorst@eib.org



© EIB - EN - 05/03

Material which appears in this EIB publication may be freely reproduced;
an acknowledgement and clipping of any article published would be appreciated.

Lay-out: *EIB Graphic Workshop.*

Photos: *Barcs Endre, Eyewire Images, Isopress: Keystone Praha/Rex Features and Stanislav Zbynek/CTK/Getty Images, PhotoDisc, Sue Cunningham, Digitalvision.*

