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FOR RECONSTRUCTION AND DEVELOPMENT

TRANSPORT

SECTOR STRATEGY

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ABBREVIATIONS

ABV	Annual Business Volume
ADB	Asian Development Bank
AfDB	African Development Bank
ANSP	Air Navigation Service Provider
ATC	Assessment of Transition Challenges
BCG	Boston Consulting Group
BOT	Build-Operate-Transfer (a type of concession)
CIS	Commonwealth of Independent States
COO	Countries of Operation
CSO	Civil Society Organisations
DEFRA	Department of Environment, Food and Rural Affairs (UK)
EBRD	European Bank of Reconstruction and Development
EIA	Environmental Impact Assessment
EIB	European Investment Bank
EMIS	Energy Management Information System
EvD	Evaluation Department (within EBRD)
ESAP	Environmental and Social Actions Plan
ESIA	Environmental and Social Impact Assessment
ETC	Early Transition Country
EU	European Union
FDI	Foreign Direct Investment
GCR	Global Competitiveness Report
GHG	Greenhouse Gas
ICAO	International Civil Aviation Organisation
IEA	International Energy Agency
IFC	International Finance Corporation
IFI	International Financial Institution
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
IMO	International Maritime Organisation
IPA	Instrument for Pre-Accession Assistance
IPCC	Intergovernmental Panel on Climate Change
IsDB	Islamic Development Bank
IPO	Initial Public Offerings
ISO	International Organisation for Standardisation
JIT	Just-In-Time (logistics)
LEF	Local Enterprise Facility
LPI	Logistics Performance Index (World Bank)
MARPOL	International Convention for the Prevention of Pollution from Ships
MDB	Multilateral Development Bank
MEI	Municipal and Environmental Infrastructure
MTOE	Million Tonnes of Oil Equivalent
NGO	Non-Governmental Organisation

NIF	Neighbourhood Investment Facility
NCBV	Net Cumulative Business Volume
PIU	Project Implementation Unit
OCE	Office of the Chief Economist
OECD	Organization for Economic Co-Operation and Development
PPP	Public Private Partnership
PPR	Procurement Policies and Rules
PSO	Public Service Obligations
SEA	Strategic Environmental Assessment
SEETO	South Eastern Europe Transport Observatory
SEMED	South and East Mediterranean
SEI	Sustainable Energy Initiative
SEP	Stakeholder Engagement Plans
SOE	State Owned Entity
SPI	Strategic Performance Indicators
TC	Technical Cooperation
TEN-T	Trans-European Network
TIMS	Transition Impact Monitoring System
TIR	Transition Retrospective
TRACECA	Transport Corridor, Europe – Caucasus-Asia
WBIF	Western Balkans Investment Framework
WEF	World Economic Forum
WHO	World Health Organisation

EXECUTIVE SUMMARY

This document sets out the Strategy which will guide the Bank's operations in the transport sector. The Strategy will build on the achievements under the previous EBRD Transport Operations Policy (BDS04-72(Final)), and describe how the Bank will respond to the new challenges which have emerged.

The Role of Transport

The transport sector is a key enabler of economic growth and transition in the region. By providing the physical networks and services upon which the economy and society depends for the movement of people and goods, transport increases the access of businesses and consumers to markets and services, promotes economic diversification and regional integration, supporting growth of the wider economy. From a social perspective, transport supports individual mobility so all people can benefit from access to essential public services such as health and education, and access to labour markets, which can also have important implications for economic inclusion and gender equality. It is also an enabler of international trade – in the modern global economy no nation is self-sufficient, each relies on goods produced elsewhere – and transport provides the means for emerging markets to integrate into the global economy. This integration creates opportunities for businesses in the region to expand and develop, thereby supporting job creation. Alongside facilitating economic development for the region, transport investments also have the potential to generate detrimental environmental and social impacts, including resettlement and livelihood issues, health impacts from congestion and pollution, and loss of biodiversity. The Bank recognises the fundamental role that transport networks and services play in improving the quality of life of the citizens of the region, and increasing the opportunities for commercial development. At the same time, it recognises the need to develop sustainable of transport systems which align economic growth with regard for the environment and social sustainability.

Achievements under the Previous Policy

The Bank has delivered on transition in the transport sector, with the transport portfolio scoring well above the Bank's average for transition impact. For example, the Bank has supported complex rail reforms in 19 of its Countries of Operation ("COOs"). Whilst challenges remain to achieve financial sustainability, most of these railways have been restructured broadly in line with international practice, with a dynamic private sector developing in a number of markets. In the road sector, the Bank has supported increasing financial sustainability of the sector in at least 21 COOs, as well as helping to improve road maintenance practices and increase private sector participation. This engagement has culminated in the successful promotion of road concessions in Central Europe, Russia and Turkey and strong interest in such public private partnerships ("PPPs") in other COOs. The Bank's support for PPPs has also extended to ports and airport sectors, including the first airport PPP in Russia and the first airport PPP in the Western Balkans.

Sustained engagement with governments and state-owned enterprises has been central to achieving this impact in the transport sector, as the Bank has engaged in policy dialogue on key issues to support the transition process across the region. The Bank has also been in dialogue with its clients on important sustainability topics, such as reducing energy consumption and improving environmental management. Policy dialogue has provided a platform to develop Technical Cooperation projects, deepening the Bank's support for addressing complex issues in the transport sector.

The transport needs of the region have changed dramatically from the previous era, when the countries were largely insulated from the global economy. Since then, new patterns of trade have emerged, and there has been increasing individual mobility as the market economy has developed. The Bank has played an important role in this development, financing key transport corridors across the region, the modernisation of railcar, truck, airline and shipping fleets, and the expansion of capacity at ports and airports. From 2005 to 2012, the Bank signed 116 transactions totalling EUR 6.7 billion in Net Cumulative Business Volume. The volumes effectively doubled in 2009, as the Bank responded swiftly to the impact of the financial crisis and ensuing economic downturn to ensure priority investments remained on track and existing clients had access to long term financing. Project sizes have ranged from less than EUR 5 million, such as private sector transactions in ports, shipping and aviation, to transactions of EUR 200 million or more, which tend to be capital intensive rail and road projects, including PPPs. This demonstrates the Bank's flexibility in meeting the diverse needs of the transport market.

Importantly, there has been a substantial shift in the type of transport projects the EBRD finances. The Bank has steadily increased the proportion of private sector operations and loans to state owned entities ("SOE") structured on a commercial basis. In 2005, private and non-sovereign projects accounted for just 10 per cent of net cumulative business volume, in 2012 this had increased to 51 per cent. This reflects the specific risk taking ability of EBRD in an advancing transition process, with the private sector and autonomous SOEs playing an increasing role in the provision and financing of transport infrastructure and services, including new service areas such as intermodal and door-to-door logistics services.

The transport sector is a focus area for the EBRD's flagship programme, the Sustainable Energy Initiative (SEI), in recognition of the significant contribution of transport activities to global CO_2 emissions. Since 2007, the Bank has provided almost EUR 870 million for energy efficiency investments in the transport sector under the SEI programme. This investment is expected to reduce CO_2 emissions by an estimated 600,000 tonnes per year. The promotion of energy efficient technologies and sustainable transport networks is a key area for further development under this Strategy.

From 2005 to 2012, the Bank has mobilised a total of EUR 14 billion of complementary financing, including IFI co-financing, loan syndication and parallel commercial loans by anchoring PPPs. IFI loan co-financing accounts for EUR 7.9 billion, with the Bank's key IFI partners over the period including the European Investment Bank ("EIB"), the Asian Development Bank ("ADB"), the World Bank and the International Finance Corporation ("IFC"). In addition, around EUR 400 million has been provided by the European Union. The EBRD works closely with its IFI partners not only on project financing, but also on co-ordinating sector policy dialogue and promoting reform.

Between 2005 and 2012, a total of EUR 30.3 million in grant funding has been secured to support project preparation and implementation, assist in sector reforms, and promote energy efficiency. The EBRD gratefully acknowledges the generous contribution of multilateral and bilateral TC donors in the transport sector.

The Strategy

The Bank's Vision for the Transport Sector. The Bank's vision for the region is for the achievement of safe, secure and sustainable transport systems, which embody market principles, balance economic, environmental and social needs and are responsive to the needs of industry and the individual. To achieve this vision, the Bank will finance well-structured public and private sector projects, working with domestic and international companies, offering a diverse range of financial products to meet the financing needs of its clients and the transport projects they sponsor. Alongside its investments, emphasis will continue to be placed on policy dialogue as a key instrument for the Bank to meet its strategic objectives. This on-going dialogue provides the forum for the Bank to engage with governments across the region on sector reform, energy efficiency, environmental and social practices, and other policy issues. The predominant focus of the Bank's approach will be to build on its transition and sustainability achievements to date, taking a strategic and long term view of the reform process and key policy issues in each transport subsector. This engagement will be supported by targeted Technical Cooperation projects, providing practical assistance to address key reform issues across the transport sector.

Market Based Transport. The Bank will continue to place transition at the core of its activities in the transport sector. Whilst significant progress has been made, much remains to be done to improve efficiency, market-orientation and financial sustainability; develop the private market for transport services; and increase private sector participation in the provision of transport infrastructure through concessions. The Bank will leverage its substantial and wide-ranging experience to continue assisting the public and private sector in the transition process of the transport sector. Where transition challenges are limited, the Bank would not consider a sovereign approach. The Bank will continue to support the trend of the preceding period, placing emphasis on private and public non-sovereign investments, including commercial loans to state-owned enterprises.

Sustainable Transport. The Bank is committed to supporting the development of sustainable transport networks in the region, and is a signatory of the joint IFI statement issued at the Rio+20 United Nations Conference on Sustainable Development in 2012. Sustainability in the transport sector encompasses a broad range of topics, including environmental, social and economic issues. Climate change mitigation and adaptation, integrated network development, pollution prevention, air quality and biodiversity protection, economic inclusion and gender equality, and road safety, are important sustainable transport issues covered by this Strategy. The Bank will address sustainability at the policy and project level, and ensure a participatory approach to project preparation and implementation.

Broadening the Sector. The Bank will expand the boundaries of its activities in the transport sector, for example seeking opportunities to finance the developing intermodal and logistics sub-sectors across the region. The need for freight services is growing, and Bank will respond to this demand by financing these emerging sectors, including road freight, and in doing so will aim to promote sustainable development and reducing CO2 emissions given the potential of logistics operations to lower energy consumption through optimised networks. It will also respond to market needs in other areas of the sector, such as railway station development and intercity bus and coach services.

Measuring Success. In line with the challenges identified in the Strategy and the Bank's proposed response, a series of Strategic Performance Indicators (SPIs) have been devised which will serve as the basis for the Bank to evaluate the transition and sustainability achievements under this Strategy. These SPIs are defined and explained in Section 4 of the Strategy.

1 INTRODUCTION

1.1 The Role of Transport

Transport is a key enabler of growth, providing the physical networks and services upon which the economy depends for the movement of people and goods. By connecting areas of economic activity within a country, transport increases access to markets and services. From a social perspective transport provides the individual mobility that is critical for the people of the region, in terms of access to markets and essential services such as health and education. The provision of efficient, safe and sustainable transport is therefore fundamental for economic growth and the development of well-functioning markets.

Transport is also an enabler of international trade. In the modern global economy, where no nation is self-sufficient, transport is key to trade development, providing the means for emerging markets to integrate into the global economy. Export access is crucial for the companies in the Bank's region, increasing and maximising opportunities for expansion and economic development.

The transport needs of the region have changed dramatically from the previous era when these countries were largely insulated from the global economy. Since then, new patterns of trade have developed, and the region now exports a significant proportion of its good and services. The Bank has played an important role in this development, financing key transport corridors across the region with projects contributing towards the development of Trans-European Networks, west-east links across Russia, as well as the Central Asia Regional Economic Cooperation Programme all of which are important elements for economic growth, employment creation and social cohesion. The modernisation of wagon and shipping fleets, and capacity expansion at ports and airports have contributed to the further development of interconnection and interoperability of national networks as well as access to such networks. An equally important change has occurred in the provision of transport. Previously the state was virtually the sole provider of transport infrastructure and services. The private sector is now playing an increasingly important role in the provision of transport infrastructure and services. The Bank has been successful in encouraging and supporting this change, tackling some of the most complex transition challenges, such as rail freight liberalisation, and pioneering the use of Public Private Partnerships (PPPs) in new markets. This is manifested in the increasing number and complexity of private sector transport operations.

Nevertheless, despite large investment programmes in many countries, the investment needs remain vast, as the existing transport networks are inadequate to support the economic aspirations of the region. Infrastructure which promotes national integration, linking suppliers with consumers and balancing national economies; and trade facilitation, integrating countries of the region into the regional and global marketplace remains a priority. Much also remains to be done to advance sector reform, which often requires a deep and lengthy engagement with the public sector. Across the region the Bank has supported the commercialisation of state enterprises, private sector participation in financing and operating transport infrastructure, and development of the private market for transport services. However, the level of transition varies greatly in the region and more needs to be done to progress the transition process in those countries and transport subsectors which are lagging behind.

Transport, as a universal human activity, has significant environmental implications. It is estimated that transport accounts for almost a quarter of the global CO^2 emissions. Whilst the figure is lower for the Bank's region at approximately 14%, reflecting the relatively low level of car ownership, transport's share of emissions is growing in line with socio-economic development and this represents a key challenge for the region. This requires focusing on sustainable transport development - centred on the development of integrated and optimised transport networks where the relative strengths of each mode are exploited, and the adoption of new technologies to minimise emissions. The promotion of environmentally and socially sound development will remain of importance, addressing key issues such as passenger safety, road safety and resettlement.

2 PAST PERFORMANCE AND ACHIEVEMENTS

2.1 Evaluation of the Previous Policy and Projects

The Bank's Evaluation Department (EvD) prepared a Special Study of the Transport Operations Policy, 2005-2008 (BDS04-72 (Final)). This study, prepared in 2010 with the assistance of an independent consultant, was reported to the EBRD Board of Directors in April 2011 (SGS11-13). The previous policy set out a vision for the sector focused on de-monopolisation, decentralisation and privatisation, by:

- Seeking to promote productive, competitive private sector activity (this may be by direct finance or by providing the necessary transport infrastructure to allow for such activities);
- Mobilising foreign and domestic capital and support its activities;
- Investing in infrastructure where it is necessary to support private and entrepreneurial activities;
- Promoting in its full range of activities environmentally sound and sustainable development.

The overall results for the previous Transport Operations Policy are shown in the table below, with the previous policy rated as *Good* or *Satisfactory* across all criteria.

Table 1: Results of Special Study on 2005 Transport Operations Policy

Overall Criteria	**Overall Sector Rating**
Relevance	Good
Effectiveness	Good/ Satisfactory
Efficiency	Satisfactory
Impact/Sustainability	Satisfactory

Alongside the Special Study, the Bank's Evaluation Department also regularly carries our evaluations of individual transport projects. The results of these evaluations are shown in Table 2.

Table 2: Summary of Transport Project Evaluations

Sub-sector	Highly Successful	Successful	Partly Successful	Unsuccessful	**TOTAL**
Air	1	9	7	3	**20**
Rail		12	3	2	**17**
Road		10	4	2	**16**
Maritime	1	5	6	4	**16**
Inter-modal	2	2			**2**
TOTAL	**4**	**38**	**20**	**11**	**71**

The results show a broad range of ratings for transport projects, including 11 projects rated as ‘Unsuccessful’. These projects generally suffered from implementation difficulties in terms of physical implementation and/or transition objectives. The physical implementation of transport projects, particularly large sovereign infrastructure projects, can be challenging with issues such as limited local procurement capacity or complex interfaces with other projects and IFIs. Similarly, many of the transition milestones are linked to sector reform, such as the adoption of new legislation or institutional restructuring, and are reliant on difficult political decisions being taken which are often subject to delay. The Bank has continued to use the lessons learned from the evaluation of these earlier projects to improve the structuring and implementation of transport projects where possible.

The key lessons and recommendations from the EvD Special Study to be taken into account in the development of the Bank's future transport operations are summarised below. Further detail on the Special Study, can be found in Annex A.

Reform Expectations. Reforms in the transport sector tend to be complex, and require substantial political will to deliver, and therefore implementation of reform programmes often takes place over a long period. The level of transition impact that can be achieved through a single operation should be realistic, focusing on supporting a smaller number of aspirational but yet ultimately achievable objectives, through targeted policy dialogue and Technical Cooperation projects.

IFI/Donor Coordination. Given the size of transport investments, many of the transport operations are carried out in cooperation with IFI partners, and in fewer cases, bilateral donors. Where the Bank is cooperating with IFI or donors, strong coordination is required, both at the corporate and working levels, including on due diligence, a harmonised approach for sector reforms where possible, and project implementation. This will ensure the benefits of this cooperation are fully realised.

Emphasis on Environmental Standards and Associated Technologies. With the heightened importance of energy efficiency in the context of climate change mitigation, the Bank will look for opportunities to engage in sustainable transport development. For infrastructure projects, projects should aspire to meet the EU Environmental Standards where applicable, across all modes. Environmental implications of transport development also extend to social issues, including applying best practice in road design in terms of road safety.

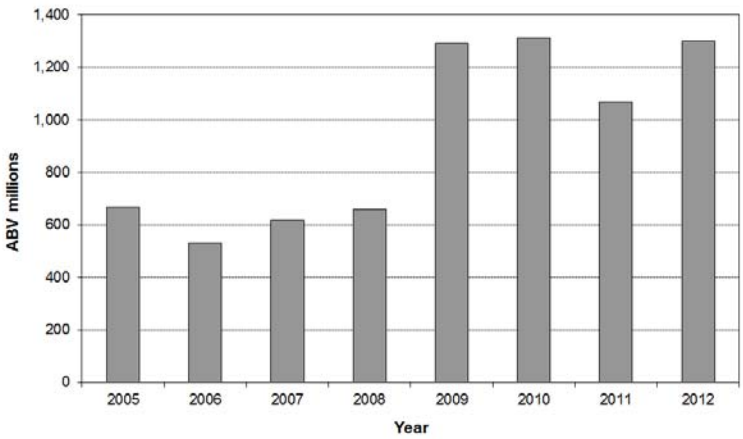
Systemic Approach. Often transport investments, due to their size, are split into components, each being handled by a different lender. This is most often seen in road corridor development. In these cases, there is a risk that each lender focuses solely on their component, potentially to the detriment of the overall investment programme. The EBRD’s approach and strength is working as a project-based institution, however there is scope to adopt a more systemic approach, for example through IFI coordination as discussed previously.

The above recommendations are being taken into consideration in the identification and development of the Bank’s transport operations.

2.2 Portfolio Growth and Diversification

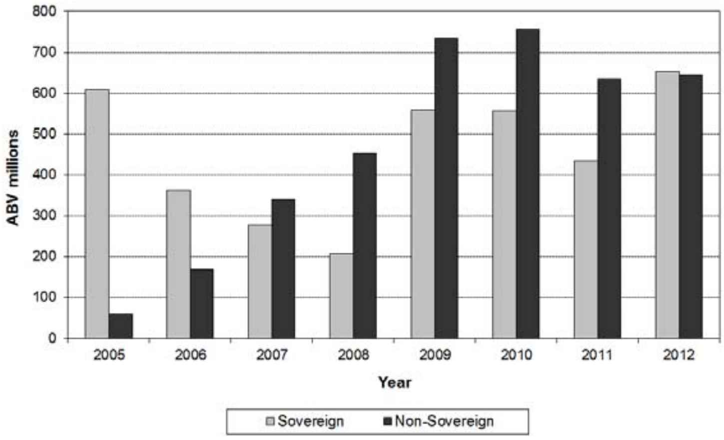
Since commencing transport operations in 1992, the Bank has signed 226 transport projects, investing a total of approximately EUR 10 billion, up to the end of 2012. The total annual volume of transport operations has increased substantially from 2005 to 2012. Figure 1 shows the annual Bank's investments or 'Annual Business Volume' (ABV), for transport operations from 2005 to 2012. This illustrates the sharp increase in ABV since 2009, as the Bank responded swiftly to the impact of financial crisis and ensuing economic downturn to ensure priority investments remained on track and existing clients had access to long term financing. The average size of the Bank's transport operations overall is around EUR 50 million. However this masks a large variation in project size. Project sizes have ranged from less than EUR 5 million, such as private sector transactions in ports, shipping and aviation, to transactions of EUR 200 million or more, which tend to be capital intensive rail and road projects, including PPPs.

Figure 1: Annual Business Volume for Transport Operations (2005-2012)



Historically, the Bank's transport operations have been heavily oriented towards the public sector, reflecting both the dominant involvement of the state in the provision of transport infrastructure and services, and the stage of transition across the region. As the transition process has advanced, the Bank has steadily increased the proportion of private sector operations in response to the market, supporting private companies, commercially financed infrastructure projects (concessions and PPPs), as well as the non-sovereign loans with state-owned entities ("SOEs"), which are structured on a commercial basis. Figure 2 shows this orientation away from sovereign operations in the Bank's transport operations, with less than EUR 100 million in non-sovereign sector investment financed by the Bank in 2005 as compared to over EUR 600 million in 2012.

Figure 2: Sovereign vs Non-Sovereign ABV in Transport Operations (2005-2012)



Figures 3 and 4 show transport project numbers by region and by mode. Emphasis is placed on supporting priority investments across all modes and countries, to ensure the development of sustainable transport networks and the presence of the sector in key initiatives, such as SEI, ETC and Western Balkans infrastructure support. However, the allocation of the Bank's resources in the transport sector is not static. It is a dynamic response to the needs of region in the transition process.

Figure 3: EBRD Transport Project Numbers by Regional Grouping (2005-2012)

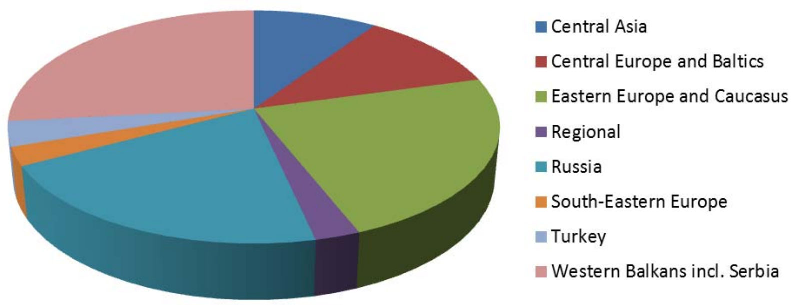
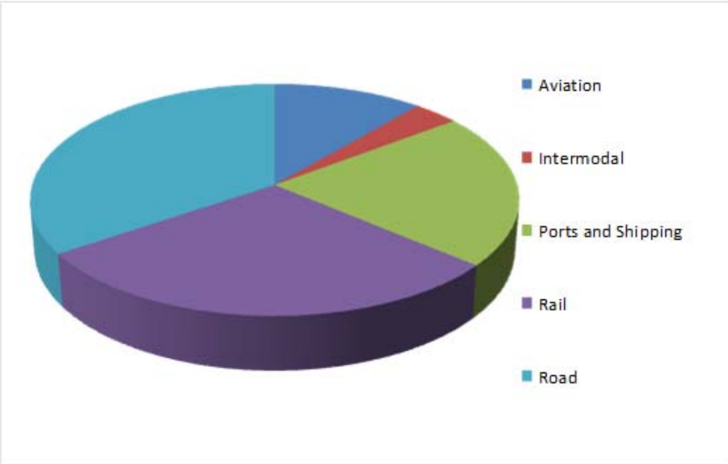


Figure 4: EBRD Transport Project Numbers by Mode (2005-2012)



2.3 Transition Achievements

From 2005 until 2012, 119 projects have been rated ex-ante by the Office of the Chief Economist ("OCE") in the transport sector. Of these projects, 87 per cent were classified as "Excellent" or "Good" (see Annex B for Summary of Transition Impact Retrospective). Policy dialogue, primarily with governments and state-owned enterprises, has been critical to achieving this successful result. Case studies describing the Bank's policy dialogue in the transport sector in Serbia and Ukraine can be found in Annex C.

An "Excellent" rating was applied to eleven operations in the transport sector. Five of them have had strong demonstration effects by supporting the airport and road concessions awarded by competitive international tenders in Albania, Hungary, Russia and Turkey. The other three excellent-rated operations contributed to increased private sector participation in the sector by supporting a privately-owned low-cost airline company, a private rail group, and a large private cargo and container operator in Russia. Two projects were rated as Excellent due to their positive impacts on policy dialogue and significant overall reform of the road sector in the Kyrgyz Republic, and the rail sector in the Russian Federation. Finally, the Bank's participation in an equity fund for infrastructure projects, undertaken by the private sector on a concession basis, was also assessed as having Excellent transition potential.

Fifteen operations were assessed as having "Satisfactory" transition potential. Three of these were operations with existing clients, where significant transition had already been achieved, meaning these priority investments had important but lesser transition potential. Five of the projects in the transport sector were rated Satisfactory due to smaller transition gaps or reforms already happening independently of the Bank's involvement. The remaining operations were rated Satisfactory due to market deficiencies and political constraints limiting sector reform.

The transition performance of the Bank's transport operations exceeds the Bank's average. This is illustrated in Figure 5, showing the average TIMS (Transition Impact Monitoring System) portfolio ranking, which measures the transition performance of EBRD projects. In TIMS, the lower the average ranking, the greater the level of transition achieved.

Figure 5: TIMS Rank Distribution of Active Operations, 2009-2012

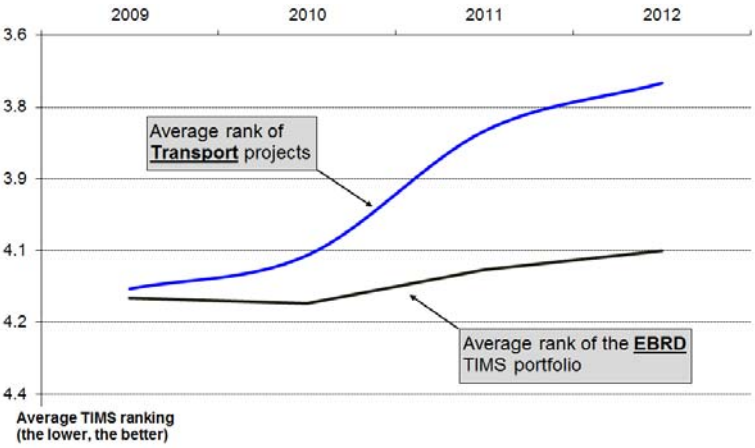
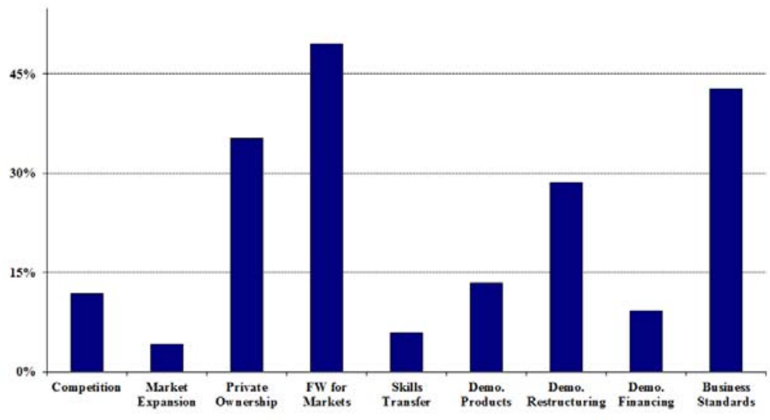


Figure 6 shows the transition objectives as a share of projects between 2005 and 2012. Transport projects support a diverse range of transitions objectives, including promoting private ownership and improving business standards. Framework for Markets ("FW for Markets") is the transition objective which deals with market creation and development, and can be found in over half of the Bank's transport operations. Through the provision of targeted financing, the EBRD has contributed to the creation and/or strengthening of public and private institutions, directly supporting the efficiency of markets and improving the functioning of regulatory entities and practices. Active engagement in the transport sector across the Bank's region has led to the successful restructuring of both transport companies and the institutions that regulate them.

Figure 6: Transition Objectives (as share of projects), 2005 –2012



2.4 Energy Efficiency Achievements

The Bank is at the forefront of efforts in the region to address climate change and energy efficiency, through the EBRD's flagship programme, the Sustainable Energy Initiative ("SEI"). The transport sector was identified as a key focus for the second phase of SEI, in recognition of the significant contribution of transport activities to global CO_2 emissions.

From 2007 to 2012, the Bank provided almost EUR 870 million for energy efficiency investments in the transport sector under the SEI programme. These investments included more fuel efficient rolling stock, ships and other vehicles, as well as better use of traffic management systems and supporting the adoption of best practice in terms of energy efficiency standards in the built environment for transport infrastructure, such as airports and port terminals. Together, these projects are estimated to reduce CO_2 emissions by an estimated 600,000 tonnes per year. SEI has now been integrated into the Bank's transport operations, and the Bank has dedicated in-house sustainable transport expertise. Enhancing the focus on sustainability of the Bank's transport operations is a core theme of this Strategy.

2.5 IFI Co-financing and TC Donor Support

IFI and EU Cooperation. The period covered by the previous policy saw increasing cooperation with other IFIs and the EU. From 2005 to 2012, the Bank has invested EUR 6.7 billion in investments alongside EUR 8.3 billion by other IFIs and the EU. The Bank's key IFI partners include the European Investment Bank ("EIB"), the Asian Development Bank ("ADB"), the World Bank and the International Finance Corporation ("IFC"). In recent years, the Bank has co-financed transport projects alongside European Union Instrument for Pre-Accession Assistance ("IPA") grants in the Western Balkans and European Union Neighbourhood Investment Facility ("NIF") grants in neighbourhood countries, such as Moldova, further enhancing the cooperation between the Bank and the EU. The area of cooperation is broad, spanning both project financing and policy dialogue with each IFI bringing its own capabilities and expertise, leveraging the relative strengths of each institution to benefit the region.

Technical Cooperation. Donor-funded Technical Cooperation ("TC") funds are grant resources which the Bank uses to support its mandate. TC funds, amounting to EUR 30.3 million over the period, have been used across the whole investment life-cycle, including feasibility, design, supervision, Environmental and Social Impact Assessments and procurement support.

Sustainable Transport

In recent years, with the support of the donor community and in line with the introduction of sustainable transport systems as a powerful instrument in the Bank's efforts to mitigate and adapt to climate change, the Bank has increasingly provided TC funding to support its clients activities in this area. This has included undertaking energy audits in order to unlock opportunities to achieve sustainable reforms and developing capacity building programmes with some clients. These efforts have also been extended to road safety initiatives and other areas.

In this context, the launch of the Sustainable Transport Technical Assistance Programme in 2011 has been of key importance, as the Programme is an essential tool for the Bank to leverage its support for introducing best practice.

Reform and Restructuring
The Bank has used TC projects extensively to promote its transition objectives, in its public sector operations. These TC projects are typically developed in parallel to the investment projects, and are targeted on specific areas of reform, in order to utilise efficiently the grant resources. In some cases, the Bank has also mobilised TC funding to support strategic sector reviews and capacity building such as in the complex area of PPP development.

In order to increase the level of engagement and commitment, most of the TCs are directly implemented by the beneficiaries, which include both transport entities and the government itself. However, the Bank has worked closely with the beneficiaries of these TCs to develop the objectives and scope of these assignments and has played an overseeing role during the implementation to ensure successful outcomes.

Project Preparation and Implementation
Another primary focus for TC resources has been on the critical need to ensure timely and successful physical implementation of projects. Through the mobilisation of donor funds the Bank has ensured that its clients receive the essential support required to deliver complex public infrastructure projects of national, regional or international significance. In recent years, there have also been an increasing number of TCs focused on energy efficiency measures, such as energy audits and energy management information systems which have been strongly supported by donors.

The EBRD gratefully acknowledges the generous contribution of multilateral and bilateral TC donors in the transport sector, and recognises that these resources are critical to the delivery of the Bank's core mandate to achieve transport impact[1].

[1] Donor Funding over the previous policy period has been provided by up to 23 separate donors or funds, including but not limited to the Austria, Canada, Central European Initiative, EU (and related funds); ETC Fund; France, Germany, Netherlands, Italy, Japan, Spain, Taiwan Business, UK, USTDA and the Western Balkans Fund.

3 STRATEGIC FRAMEWORK

The Bank's vision for the region is for the achievement of sustainable transport systems which embody market principles, balance economic, environmental and social needs and are responsive to the demands of industry and the individual.

An efficient transport network, which meets the needs of a modern market economy, is central to economic growth and development. The development of transport systems should address both the infrastructure bottlenecks, with an emphasis on raising private and commercial sources of finance where possible, and the demand for market-responsive transport services. Transport development should be aligned with the needs of industry, from SMEs to international companies, in order to unlock suppressed demand for goods and services in the region, support balanced economic development, increase international trade, and facilitate the broader transition process in the wider economy. Transport development also needs to meet the needs of the individual, providing equal access to labour markets and essential public services, increasing economic opportunities for all citizens in society.

To support its vision for an efficient transport system, the Bank's strategy is to promote transition towards a market-based transport sector. This means transport infrastructure and services should be provided increasingly by the private sector or at a lower cost to the state through commercialisation of State-owned Enterprises (SOEs), thereby freeing public resources for other critical areas of state activity. Allowing the private sector to participate more fully in the sector, will capitalise on the private sector's capacity to innovate and reduce costs.

As well as promoting efficiency, the Bank's vision for the transport sector also places emphasis on sustainability, safety and security. The Bank recognises that transport can greatly impact the lives of citizens and the natural environment, and makes a significant contribution to climate change. The Bank is working with other IFIs to promote sustainable transport, and is a signatory of the joint IFI statement issued at the Rio+20 United Nations Conference on Sustainable Development in 2012, which recognises the existing challenges and demonstrates the IFIs' support for sustainable transport development across all transport modes.

The Bank's strategy will be to support sustainable transport, which applies energy efficient technologies and standards and encourages lower-emission modes to reduce energy consumption in the sector. Other sustainability elements include improvements in corporate governance standards. Transport operations will continue to be designed and implemented in compliance with the Bank's Environmental and Social Policy, using a participatory approach to protect the physical environment and those affected by EBRD-financed projects. As part of the broader sustainability agenda, the Bank will seek to address safety improvements in the transport sector, focusing on improving road safety through its transport operations.

In line with the strategic emphasis on market-based transport and sustainability, the strategic framework will also encompass new areas of activity for the EBRD's operations in the transport sector. The EBRD will look increasingly to support expansion of logistics and intermodal services predominantly by the private sector and sustainable national bus and coach services. This may require lower annual Bank funding of transport operations as the focus on smaller niche projects increases. The Bank will also seek further cross-sector financing opportunities for dedicated transport operations serving major industrial clients in order to leverage in full the Bank's expertise in these sectors. A highly selective approach will be applied to the financing of airlines and other airline investments, such as aircraft maintenance, to ensure strong value added based, for example, on environmental improvements, energy efficiency and higher safety standards.

While there are common challenges, the Bank makes a distinction between urban and non-urban transport projects, reflecting the different nature of the borrowers. Urban transport projects, where the counterparty is a local authority or their utility enterprise, are classified as Municipal and Environmental Infrastructure ("MEI"). The Bank's policy for municipal transport projects is addressed in the MEI Sector Strategy, and is therefore not included in this document.

3.1 Transition

3.1.1 Key Challenges

Supporting the transition from centrally-planned to market-based economies is at the core of the EBRD's mandate. In the transport sector, transition is achieved by supporting reforms aimed at achieving a more market-based approach to providing transport infrastructure and services to the wider economy. Increasing commercialisation and private sector participation are key objectives of this approach, which involves applying the principles of accountability, legitimacy, transparency, competence, competition and efficiency.

The region presents a 'matrix' of transition challenges, by country and mode, which vary significantly reflecting the diversity of the region, differences in the complexity of the transition challenges by mode, and the reform steps already taken. To determine the transition challenges, the Bank prepares an Assessment of Transition Challenges ("ATC"), specifically for the road and rail sectors, which represents a snapshot of the remaining transition challenges by country. The results of the ATC for 2012 can be found in Annex D. The challenges for other modes are assessed at the project level.

As discussed in Section 2.3, the Bank has supported significant transition achievements over the period 2005 to 2012. While the transition process is advancing in the transport sector and transition gaps are narrowing in some areas, progress varies widely. Often the transition challenges are complex and addressing these challenges takes time, requiring a range of reform measures and on-going Bank engagement in policy dialogue and support through a number of sovereign projects to maintain momentum and ensure planned reforms are achieved.

Beyond the traditional transition themes, measures and actions which promote a systemic reduction in energy intensity, such as the introduction of energy efficiency standards, or introducing energy monitoring and public disclosure of performance to reinforce demonstration effects may be considered transition challenges. In addition, infrastructure bottlenecks and raising private capital and non-sovereign funding add to the challenges in the current economic climate.

Transport Bottlenecks

Despite significant investment in transport infrastructure in recent years, bottlenecks remain in the region, particularly in the port sector, and these will increase as the economies begin to recover. The infrastructure deficit varies significantly across the region, ranging from the need to renew existing regional road and rail networks to development of port infrastructure and intermodal facilities to address growing containerisation. These bottlenecks will constrain economic growth creating difficulties not only for large scale industries and SMEs to export and import, but also hampering development of tourism and restricting access of local communities to essential services, such as education and health. Developing efficient transport networks and services, such as rail services, rural road networks and logistics solutions is therefore a key challenge for the sector. Transport services need to adapt to the dynamics of the market-based economy. For customers manufacturing and trading higher value goods, just-in-time ("JIT") logistics is increasingly required, placing higher demands on transport services in terms of efficiency, flexibility and reliability and also requiring new investment in infrastructure.

The financial crisis engulfed the EBRD's traditional region relatively late compared with the US and Western European countries. However, when the full brunt of the economic crisis was felt, it became clear that the region had been badly affected. A contraction in output of this magnitude had not been experienced since the transition process began. Certain countries adopted stimulus packages, including accelerating transport investment programmes, however these measures were considered short term fiscal policy responses to the crisis, and soon led to concerns about levels of public indebtedness. In the new SEMED region political instability has had a significant impact on availability of public funding.

Mobilising Private Capital and Non-sovereign Financing

The financial crisis, political upheaval and recent developments in the global economy have had severe impacts on the public budgets of countries across the EBRD region. This in turn has profoundly impacted the availability of public finances to fund infrastructure. Funding gaps have materialised in major transport investment programmes, with many projects being phased or postponed. Governments across the region are increasingly looking to private sources of capital to finance transport infrastructure, using privatisation or concession structures such as PPPs.

The private sector can bring additional resources and know-how, provided projects are well structured to ensure an efficient allocation of risks between the public and private sector and are competitively tendered to ensure value for money for users and taxpayers. Increasing the use of private capital for transport infrastructure, through privatisation or concessions, is therefore a key transition challenge. An important pre-condition for successful private sector participation in infrastructure is developing the necessary legislative and regulatory framework to attract private sector financing for PPPs, as well ensuring the financial soundness of PPP structures. Most countries in the region are yet to develop an adequate legal and regulatory framework and lack the skills to develop bankable projects. They have therefore been unable to utilise this source of capital and capitalise on the potential private sector efficiencies.

Fiscal constraints can also result in less funding being made available for maintenance of existing assets. This has long term implications for countries in the region, as inadequate maintenance results in infrastructure which fails to meet the needs of market, and presents higher whole-life costs due to the requirement for rehabilitation or reconstruction. This forms part of the wider sustainability policy agenda, to improve the financial sustainability of transport networks, and there is now greater interest in performance-based maintenance contracts as a way to mobilise the private sector to help address this issue.

At the same time, the region is currently witnessing the withdrawal of many commercial banks and foreign direct investors due to liquidity constraints brought about by the financial crisis. Finding new and additional ways of raising private finance for transport infrastructure projects will be a key challenge and may require greater reliance on domestic and international capital markets to provide funding, including from institutional investors.

Prior to the crisis there was a growing trend of deployment of institutional capital[2] that was in search of a higher but stable yield over the long-term. This trend was further facilitated by the persistent low interest environment and the availability of cheap leverage saturating the credit market. Due to the scarcity of infrastructure assets that could meet the requirements of such institutional capital, most of the Bank's countries of operation have been unsuccessful in attracting this class of investor to private sector infrastructure projects to date. In addition, the financial crisis has adversely affected the investors' appetite to increase exposure to higher risk, illiquid assets in emerging markets. In the current market environment, hurdles for attracting institutional quality capital beyond traditional bank finance remain very high, especially when lending activities by commercial banks have been significantly curtailed, potentially reducing the overall return of investments. Nonetheless, the risk appetite in the market is in a phase of gradual recovery and the search for higher yielding assets continues in the countries that can offer a stable economic outlook or growth prospects.

SOEs with good corporate governance and commercial business practices can also attract funding on commercial terms without recourse to constrained public budgets. Structural reforms may be needed to create financially autonomous entities outside of the direct control of governments and which can support commercial funding. Identifying new opportunities to fund such entities on commercial terms is another challenge.

3.1.2 Strategic Approach

Through its investments, the Bank will continue to promote transition with the following strategic objectives:

- Promoting private ownership, financing and operation of transport infrastructure, where necessary, by engaging firstly on a non-sovereign basis financing SOEs;
- Supporting the creation and expansion of competitive markets for transport services;
- Improving the efficiency of management of public sector transport assets.

[2] Such institutional capital often takes a form of a pooled investment vehicle, most notably an infrastructure fund. Broadly speaking, an infrastructure fund raises capital from long-term investors such as pension funds, life insurance companies and endowments and invests in infrastructure projects on behalf of those investors. Some very large institutional investors have an in-house capability to invest in or lend to specific large ticket projects directly. Such a case is rather an exception than a norm. The other new form of institutional capital that has been attracting a great deal of attention in recent years is sovereign wealth funds (SWF). Like traditional institutional investors mentioned above, SWFs' investment capacity, strategy and approach vary significantly from one fund to another

To achieve these objectives the Bank will focus on the key themes of deepening private sector participation, institutional reform, increasing competition, financial sustainability, and improving regulation. Increasing private sector participation in the provision of transport infrastructure and services is a key objective of the transition process and the Bank will continue to promote this objective in its transport operations.

The Bank will increase its selectivity in respect of public sector investments in the transport sector, focusing on those projects which target significant gaps in institutional and sector reform. However, caution is needed in interpreting the transition challenges in the road and rail sectors captured Annex D, where scores of two or below would suggest that the transition potential is not sufficient to justify the Bank's engagement. While this is a helpful guide, it may not capture aspects of transition such as the need for deeper reforms in the railway sector in some countries to achieve financial sustainability. It is this granular aspect of transition that might lead the Bank to consider supporting governments in the further restructuring of national railways, for example, in countries where the sector might be considered more advanced in terms of the progress of the reform process. The Bank will also continue to engage in policy dialogue on sector reform and sustainability issues, supported by targeted technical cooperation. At the same time, the Bank will support the trend of the preceding period, with emphasis on private sector investments, and supporting new market developments such as the emergence of private intermodal operators and the provision of door-to-door transport logistics services. The Bank will continue to support greater involvement of the private sector by supporting the growth of financially viable businesses and business segments, including where appropriate commercial loans to SOEs without a sovereign guarantee with the aim of creating financially sustainable and commercially-oriented entities, which can compete with the private sector and eventually be considered for partial or full privatisation.

To elucidate further the Bank's strategy to deliver more efficient transport systems, it is useful to divide the sector into two highly inter-connected, yet broadly distinct components – transport infrastructure and transport services.

Market-Based Infrastructure

For transport infrastructure, the private sector offers potentially large efficiency improvements in asset management compared to the public sector, stemming from increased commercial focus and financial discipline. The benefits of private sector participation are generally recognised across the region, and over the last decade the private sector has played an increasingly important role in the provision of transport infrastructure. The Bank has been successful in encouraging and supporting this transition, through its policy dialogue and investments, tackling some of the most complex transition challenges, such as port privatisation and pioneering the use of PPPs in new markets. This is manifested in the increasing number and complexity of private sector and non-sovereign transport operations, with their share in project number terms increasing from 10 per cent of the Annual Business Volume in 2005 to 51 per cent in 2012 (the share includes commercial loans to state owned entities). Since 2005, the Bank has financed 12 PPP projects in the roads and aviation sectors, providing a total of EUR 910 million to concessionaires. However significant transition challenges remain, including amongst the Bank's COOs which are now EU Member States, to establish PPPs as a mechanism for delivering key infrastructure. This demonstrates the persistent and complex issues in improving the efficiency of infrastructure management.

Deepening Private Sector Participation. Transport infrastructure presents a spectrum for private sector participation. This spectrum starts with management and operational contracts, where the private sector is responsible for providing specific services, and assumes operational risk e.g. road maintenance, airport security and stevedoring (cargo-handling) at ports. Performance-based road maintenance further enhances the role of the private sector in this operational activity, as the contractor assumes the risk of meeting the required outputs. Further along the spectrum, the private sector is involved in investment in the construction and management of infrastructure, such as Build-Operate-Transport (BOT) projects under PPP structures. Here the private sector can assume construction and operational risk, and potentially fixed term ownership. At the end of the spectrum is full privatisation, with divestment of assets by the state.

The Bank's strategy is to support projects which enhance the level of private sector participation in transport infrastructure along this spectrum, tailoring its approach to each country based on the stage of transition and the specific circumstances, for example the legal and regulatory framework, and addressing operational activities such as performance-based road maintenance through the reform aspects of the projects it finances. For the Bank to finance concession arrangements in transport infrastructure, the project would need to be compliant with the Bank's existing Policy for the Financing of Private Parties to Concessions, which ensures EBRD finances concessions which are awarded in an open, fair and transparent manner. Privatisation projects are also carefully assessed to ensure the project rationale is underpinned by a sound economic justification for divestment of assets.

Institutional Reform. The Bank supports institutional reform measures which result in improved transparency and accountability in the management of transport infrastructure. These are the attributes which attract longer term private sector interest, and increase the scope for private sector participation as described above. The primary means to achieve this objective is through reforms aimed at decentralisation and commercialisation. The Bank supports the structural reforms to separate transport infrastructure policy and management functions, through the creation of autonomous SOEs outside of direct government control, for example independent road agencies. This has been achieved across most modes in most countries in the region. Where this has not yet occurred, this is a reform priority for the Bank. Further reform is often required for these entities to perform their role effectively, and Bank will support SOEs to improve their corporate governance, business practices and ability to attract funding on commercial terms.

Where infrastructure and operations remain within a single entity, mainly in the rail sector, the Bank generally supports vertical separation to increase efficiency. This principle may not be applicable to small railways, where the transaction costs offset efficiency gains. The Bank will carefully assess the institutional arrangements for railways on a case by case basis.

Regulatory Improvements. Governments are responsible for introducing effective laws and sector regulations to establish the regulatory environment for private sector participation based on transparency and accountability. Regulation should relate both to monopoly and competitive aspects of businesses, aimed at preventing the abuse of market power, where monopolies exist, and anti-competitive behaviour in competitive markets. Additionally regulation should provide a stable environment for both domestic and Foreign Direct Investment. The regulatory framework includes rail access charging regimes, competitive tariff structures and concession law. Through its transport operations, the Bank will support development of the regulatory framework, including institutional strengthening of regulatory agencies.

Financial Sustainability. The Bank supports measures to improve financial sustainability, by increasing and stabilising funding for infrastructure maintenance and operations, such as road maintenance. In terms of expenditure, reforming tariff structures and streamlining operations are both means by which the Bank supports efforts to improve cost recovery. The Bank also supports contractualisation, the creation of contracts between the government and SOEs responsible for providing transport infrastructure and services. This principle also applies to socially desirable loss making transport services, such as passenger railways through Public Services Obligation contracts.

Improving financial sustainability is particularly important in the context of future privatisation or concessions, ensuring stable and sufficient cash-flow for private investors. For the road sector, financial sustainability incorporates the ‘user pays’ principles, for example through the use of road tolling, whilst ensuring that affordability constraints are taken into account. In the rail sector the Bank supports deeper reforms, particularly in response to the recent economic crises, to address financially unsustainable railway networks which place a huge drain on public resources.

Market-Responsive Services

Developing transport services which meet the needs of the market economy is a key challenge across the region. The Bank will support the development of optimised transport networks, which minimise journey time and cost, and maximise flexibility and reliability. For freight transport, the overarching objective is to reduce the transportation costs of goods in order to raise the competitiveness of the region. For passenger transport the aim is to provide efficient and affordable services to increase individual mobility and equal access to labour markets and essential public services.

In many COOs, a competitive market already exists in the intermodal, logistics and shipping sectors, and in a growing number of COOs rail freight markets are being liberalised. The EBRD has supported the development of these markets, financing intermodal service providers, shipping lines, rail operators and leasing companies. Where markets for transport services already exist, the Bank’s strategy is to support market expansion and increased competition; new product development and innovation; and improve corporate governance through the introduction of international standards. Where markets are yet to be liberalised for freight, the Bank supports the commercialisation and corporatisation of state operators, streamlining operations, and the transition to market-based tariffs. The Bank supports privatisation of commercial transport services, for example through participation in Initial Public Offerings (IPOs) or private placements, and will continue to engage in dialogue with COOs on the privatisation process.

3.1.3 Measuring Success

In line with the challenges identified above and the proposed response, two specific Strategic Performance Indicators (SPIs) have been devised which will serve as the basis for the Bank to evaluate the achievements under the Strategy. These will focus on supporting the transformation of sovereign clients into commercially-oriented entities which can raise finance on a non-sovereign basis or contract-out on a private basis and setting the minimum percentage of projects financed on a non-sovereign or private basis. These performance indicators and other performance indicators introduced throughout this document are defined in Section 4.6.

3.2 Sustainability

Under this strategy, sustainability is an area of strategic focus. Sustainability is a broad concept, and spanning a range of issues in the transport sector. This section articulates the challenges and the Bank's strategy with regard to the environmental and social aspects of sustainability.

3.2.1 Key Challenges

Economic development is closely associated with growth in the volume of freight and logistics services and the mobility of a growing population. The transport sector is of key importance for the socio-economic development of the region, since it facilitates access to markets, jobs, health care and education, and to all economic and social groups, with a wide geographic coverage.

However, the transport sector also consumes resources with associated externalities. Most significant are road safety, congestion, air pollution and GHG emissions. Collectively these externalities can cost to up to 10 per cent of GDP according to a recent UNEP study[3], and this is expected to grow as the demand for transport rises. The International Transport Forum, based on figures of the International Energy Agency, has estimated freight traffic to grow by 4 to 5 times from 2000 to 2050 in non-OECD countries, with passenger transport growth forecast to grow at rates of 2.5 to 3.5 times over the same period (ITF Transport Outlook 2012).

The challenge is to create sustainable transport systems, which align economic growth with regard for the environment, and reduce oil dependency without sacrificing transport efficiency and mobility. Therefore, sustainable transport can be defined as a system which allows the access and development needs of individuals, companies, and society to be met safely and without compromising the quality of life of future generations. Alongside facilitating economic development for the region, transport investments also have the potential to generate detrimental environmental and social impacts, including resettlement and livelihood issues, health impacts from congestion and pollution, and loss of biodiversity. The transport sector is a significant source of noise and pollution of air, watercourses, soil and groundwater, and these adverse impacts are increasing as transport volumes increase. The sector faces challenging issues including the relative inefficiency of old transport fleets, poor quality of local fuels, the need to renew and develop integrated transport networks, and the requirement for better and participatory transport planning.

[3] *Transport – Investing in Energy and Resource Efficiency*, UNEP 2011

Biodiversity. New transport infrastructure is increasingly facing land use constraints due to increasing efforts to protect environmentally-sensitive areas and valuable biodiversity from encroachment and fragmentation. Global action for biodiversity conservation, especially in areas of high biodiversity value and/or international or regional importance, has resulted in biodiversity protection objectives taking precedence over economic land use in an increasing number of cases.

Climate Change Mitigation. Worldwide transport is one of the major contributors to climate change, accounting for approximately 23 per cent of global CO_2 emissions (IEA 2011, 'CO2 Emissions from Fuel Combustion 2011 Edition Report"). In the Bank's region the share is somewhat lower at 14 per cent reflecting the region's relatively low levels of car ownership, and relatively high emissions from power generation and heating. However this proportion is growing in line with socio-economic development and increasing goods and passenger transport. Whilst rail generally remains the mode of choice for long distance surface freight, the region is seeing significant modal shift from rail to road. Economies are becoming increasingly consumer-oriented, with steep increases in car ownership and growth in road freight. The region also has some of the world's most energy-intensive economies, particularly the Central Asian states, such as Kazakhstan and Uzbekistan. Besides the climate change implications, fuel scarcity and its price volatility can have severe impacts on the economic development of the region, which makes technologies and strategies on energy efficiency a business opportunity to strengthen market competitiveness without constraining growth and transition in the region. This is particularly so in the maritime and aviation sectors, where replacement of old fleet with energy efficient vessels and aircraft can have a significant impact on reducing fuel consumption. Mitigation against climate change through energy efficiency interventions, both investments and policy, is a key challenge for the Bank.

Climate Change Adaptation. Even if mitigation measures are effectively implemented, climate change represents an existing risk to the region, with particular infrastructure types and countries faced with being disproportionately affected. The impacts of climate change are primarily sea level rise, changing patterns of precipitation, heatwaves and increased extreme weather events. These have consequences for the design, construction, and alignment of ports, roads, railway tracks, and other transport infrastructure. At the same time, the development of transport infrastructure can inadvertently increase vulnerability to climate change effects, for example by reducing natural flood control ecosystems and disrupting migratory patterns of sensitive species. Adaptation is particularly applicable to coastal transport infrastructure, such as coastal roads and ports, which have a high susceptibility to these climate change impacts. Areas such as Central Asia, the Caucasus and SEMED are particularly vulnerable.

Road Safety. Road safety is among the most important aspects of sustainability in the transport sector, requiring an urgent and co-ordinated response from all organisations engaged in the sector. Across the world, road fatalities and injuries have been increasing rapidly. This is as a result of rapid motorisation and road expansion, and the fact that road safety management has failed to keep up with these changes. The Bank's region is particularly affected by this issue. Whilst there are exceptions, most COOs have seen sharp increases in accident rates, reflecting the accelerated growth in private car ownership in recent years. Currently in Eastern Europe and the former CIS, on average, 16.3-19 per 100,000 population die each year in road accidents. This compares with 11-12 per 100,000 in Western Europe (World Health Organisation (WHO)).

These figures understate the issue considering the relatively low levels of car ownership in the region. The WHO estimates the direct and indirect costs of road accidents to account for between 1-3 per cent of GDP of European countries (WHO, European Status Report on Road Safety, 2008).

Economic Inclusion. Transport plays an important role in supporting economic diversification and increasing opportunities for enterprise and citizens across the region. By creating connections at the local, regional, national and international level, transport provides the access which is essential for a well-functioning economy. This can be access to product markets, access to labour markets, and access to essential public services, such as health and education facilities. Within the countries of the region, including both the 'traditional' region and the new SEMED region, recent patterns of economic growth have resulted in regionally unbalanced development, with growing disparities between urban and rural areas. Large demographic variations have emerged, particularly but not only in the SEMED region, with the younger demographic often facing the greatest chance of unemployment. Other groups also suffer disproportionately from poor access to markets and essential public services, such as low income groups, women[4], ethnic minorities and the disabled[5], with the level of inequality varying significantly across the region. Supporting economic diversification and improving access will contribute to addressing these inequalities and regional imbalances.

3.2.2 Environmental Sustainability: Strategic Approach

Transport infrastructure and operations present significant environmental challenges, in terms of the local impacts on the immediate environment, such as air and noise pollution, or the encroachment and fragmentation of environmentally-sensitive areas and valuable biodiversity, and the global impacts, such as climate change from GHG emissions. Environmentally sound development is an important element of the Bank's operations.

Low Carbon Transport. Worldwide transport is one of the major contributors to climate change, accounting for approximately 23 per cent of global CO_2 emissions (2007 figure, IEA 2009). Transport's share is growing as economic development results in increasing levels of goods and passenger traffic, particularly in the region EBRD serves, with steep increases in car ownership and freight transport.

Supporting the development of a low carbon economy is a Bank-wide strategic objective, though the Bank's Sustainable Energy Initiative (SEI). The Bank will build on its achievements to date, and through its investments and policy dialogue promote an "Avoid-shift-improve" strategy for transport development, where:

- *Avoid* means reducing the need to travel and the distance travelled, for example by integrating transport planning, developing multimodal logistics networks which optimise the use of transport resources or the introduction of new traffic management technologies;

[4] *Gender and Transport Resource Guide,* World Bank, Online resource
[5] *Improving transport access and mobility for people with disabilities,* DfID, 2004

- *Shift* means shifting to more energy efficient modes or routes, such as encouraging the use of rail or inland waterway networks where feasible, or introducing policy measures such as internalising external costs through pricing instruments; and
- *Improve* means using technologies that are more energy efficient for every mode, such as through improving vehicle standards; and improving transport efficiency using information technology.

In line with this approach, the Bank will look for opportunities to apply energy efficient technologies, operational practices and standards, alongside supporting the development of low-carbon modes of transport to reduce energy consumption in the transport sector and the development of logistics services and new technologies to reduce the need to travel. To leverage the impact, the Bank's financing will be blended with TC funding and policy dialogue to support the introduction of sustainable transport policies and best practice.

Environmental Appraisal. There are many environmental issues which must be addressed when developing transport projects, including land use constraints, biodiversity and cultural conservation objectives, noise and pollution of air, watercourses or soil and groundwater. The assessment of environmental impacts forms an integral part of the project appraisal process for all EBRD operations. All transport projects, whether in the public or private sector, will continue to be designed and implemented in compliance with the Bank's Environmental and Social Policy. The Bank's approach is to avoid or minimise adverse impacts through appropriate mitigation and, where appropriate, introduce off-set measures, which ensure the Bank's transport projects are conducted in an environmentally sound manner. The Bank will also identify opportunities to enhance the environmental benefits of projects through the environmental appraisal process.

Pollution Prevention and Abatement. The transport sector is a major source of noise and pollution of air, watercourses, soil and groundwater. The Bank requires EU environmental standards to be applied to its projects to avoid or mitigate harmful environmental impacts and pollution.

Biodiversity. The construction of new transport infrastructure is increasingly facing the challenge of balancing the land use needs between transport and protection of environmentally-sensitive areas and valuable biodiversity from transport encroachment and fragmentation. In accordance with its Environmental and Social Policy, the Bank adopts a precautionary approach to the protection of valuable biodiversity and living natural resources, and includes biodiversity impact assessments as an integral part of its environmental appraisal of projects. Biodiversity may also be impacted through accidental releases of pollutants into the environment during transportation or spreading of invasive and alien species to new areas through transportation, particularly in the ballast water of ships. The Bank promotes international best practices to avoid and mitigate such impacts.

Climate Change Adaptation. The risks of sea-level rise, together with the likelihood of increased storms and flooding as a consequence of climate change, have significant implications for coastal infrastructure in particular, such as ports and coastal roads. The Bank will aim to take these issues into consideration in its investments in the sector, drawing lessons from international best practice as appropriate.

3.2.3 Social Sustainability: Strategic Approach

To promote social sustainability through development of transport systems, projects will continue to be designed and implemented in a manner which is socially sustainable and demonstrates respect for the rights of people affected by the project. The Bank is also enhancing its efforts to tackle road safety, a major global health issue, through project level interventions, and collaboration with other IFIs and international agencies.

The Bank recognises that transport projects can also play an important role in the broader sustainability agenda, including economic inclusion. Access through transport development helps reduce disparities in opportunity and development, particularly for women and vulnerable groups or those living in remote rural or underserved urban areas.

Road Safety. In November 2009, in order to help meet the targets established in the UN Decade of Action on Road Safety, the EBRD, alongside the other major IFIs, issued a joint statement supporting a wide range of measures with the aim of reducing worldwide road fatalities and injuries. The joint statement recognises that to address road safety, a coordinated approach is required across a broad range of issues including institutional capacity, physical infrastructure improvements, land use planning, driver behaviour and vehicle condition. The Bank is now actively working with the IFIs under the Multilateral Development Bank Road Safety Initiative to coordinate global IFI road safety efforts and scale up road safety investments. The EBRD is leading the private sector outreach work under this initiative, which aims to engage private sector partners into the road safety improvement agenda.

At the project level, the Bank will address road safety by ensuring that it has been given the appropriate level of consideration in the planning and design stages. This already forms part of the Bank's appraisal of road projects, and increased emphasis will be placed on the identification of safety design improvements in line with the EU Directive on Road Infrastructure Safety Management (2008/96/EC). The Bank's approach extends to road safety considerations during the construction and operational phase of projects, including road maintenance practices.

The Bank will seek opportunities to finance road safety infrastructure improvements, whether as part of a wider road project or on a standalone basis. The Bank will also support its multilateral partners where possible in the implementation of wider road safety measures, including institutional capacity building, driver behaviour campaigns, and improving traffic law enforcement.

Social Appraisal. Infrastructure projects have the potential to have wide-ranging social impacts including community health and safety, gender and involuntary resettlement impacts. Gender impacts include improving women's access to services such job markets and health and education. The construction phase also has specific social considerations, such as labour and working conditions, and community health and safety. All EBRD projects are structured to meet the requirements of the Bank's Environmental and Social Policy, including the Performance Requirements, in terms of both project design and implementation. The approach is to avoid adverse social impacts as far as possible, and where avoidance is not possible, to reduce or compensate for impacts as appropriate. Clients of the Bank are required to adopt and implement Environmental and Social Actions Plans ("ESAPs") to ensure compliance with the Bank's policies.

Resettlement and Livelihood Restoration. Transport infrastructure projects often require land acquisition, which may result in the need for resettlement. Projects may also result in the loss of access to the means from which income is derived. The Bank's approach is, initially, to minimise resettlement and livelihood impacts where possible through considering alternative options or alignments. Where resettlement and/or livelihood restoration are required, the Bank mitigates the adverse impacts by requiring that a) compensation reflects the full cost borne by people affected by the project; b) resettlement is carried out with appropriate consultation; and c) livelihoods are restored to pre-project levels. Often resettlement and livelihood are complex issues with a number of stakeholders involved in the process. A key lesson from previous projects is the need to identify resettlement and livelihood impacts early in the project preparation process, as well as applicable legal rights. This ensures the requirements of the Bank can be discussed with clients from the outset. This will allow for the necessary provisions to be made in the project in order to meet the Bank's requirements, and furthermore to ensure that people and communities affected by the project can participate fully in the decision-making process.

Stakeholder Engagement. Stakeholder engagement is a key mechanism to ensure there is a meaningful and inclusive consultation process for EBRD-funded transport projects, in order for the needs of people affected by projects to be met as far as possible. This aligns with the Bank's corporate governance agenda, to improve business working practices in the region. More complex social impacts require a deeper level of stakeholder engagement, for example, where resettlement is unavoidable, and the Bank will continue actively to support clients to meet the requirements. The Bank requires its clients to reach out to as many stakeholders as possible, particularly local communities, by publishing relevant documents in the local language as well as in English and arranging local consultation meetings. Once the key stakeholders have been identified, the Bank requires clients to prepare Stakeholder Engagement Plans ("SEPs"), setting out the level of engagement and consultation throughout all stages of the project. Stakeholder engagement extends to dialogue with civil society on project impacts, through Civil Society Organisations ("CSOs"), which the Bank supports, particularly through the disclosure of information on projects. All EBRD's transport projects are subject to the Bank's policies on disclosure of information, both in the Environmental and Social Policy, and the Bank's Public Information Policy.

Economic Inclusion and Gender. Inclusion ensures equality of economic opportunity regardless of an individual's gender, age, parents' education or ethnicity. Within the countries of the region, both the traditional EBRD region and the new SEMED region, certain groups in society have less opportunity to participate in the economy and less access to essential public services. The Bank is conducting gap analyses to determine the existing exclusion groups, and identify where the Bank could have an impact. Based on initial analyses, the most likely channels for economic inclusion will be through access to employment (including the construction phases of large transport projects), access to public and other services, skills transfer and improved corporate standards and practices. In the context of increasing urbanization, this will necessarily entail differentiation among the needs of the different groups in the rural and urban context, with a particular focus on gender. While pursuing its transition mandate the Bank will give active consideration to these issues, in particular in supporting projects which facilitate rural access, such as regional road rehabilitation, and national corridor investments, which help to integrate regions into the national economy.

Opportunities will be sought to address gender gaps, in line with the forthcoming EBRD's Strategic Gender Initiative. The Bank will work with its clients to promote equal opportunities in the work place. Also, the projects will be designed and implemented so as to ensure that services are sensitive and responsive to the needs of both men and women, be it physical access to the services or maximising the safety and use by women of the facilities the Bank finances.

3.2.4 Measuring Success

In line with the challenges identified above and the proposed response, two specific SPIs have been devised which will serve as the basis for the Bank to evaluate the achievements under the Strategy. These will focus on mapping out a sustainability agenda for the port sector and increasing the emphasis of the Bank's road projects on road safety. These performance indicators and other performance indicators introduced throughout this document are defined in Section 4.6.

3.3 Other Sector Initiatives: Broadening the Offer

The boundaries of the transport sector in the EBRD region are shifting. As the Bank will increasingly look at financing new sectors, such as intermodal, logistics (including postal services), road freight services and long distance coach services, it will inevitably need to reduce its focus on more traditional areas of activity in sectors where the transition gap is narrowing. The Bank will also seek further cross-sector financing opportunities for dedicated transport operations serving major industrial clients in order to leverage in full the Bank's expertise in these sectors and mainstream the same principles in those projects which do not fall under this strategy.

Logistics, Intermodal Transport, including Postal Services. The logistics market in the region has grown substantially in recent years, with the need for integrated services covering transport, storage and management of freight. This trend is closely tied with the growth of containerisation, which has created demand for intermodal facilities and multi-modal operators, to streamline freight movements and lower transportation costs for industry. The Bank has been engaged in the logistics sector for several years, financing innovative private multi-modal operators in the larger markets of Russia and Turkey. Under this Strategy, the Bank will enhance its support to the logistics subsector across the region, including door-to-door services, and the development of associated infrastructure such as intermodal terminals and logistics centres (warehousing facilities). Such projects support the development of cost-efficient and flexible transport services, which are able to adapt to the needs of industry. Improving logistics also has the potential to lower energy consumption through optimised networks, and the Bank will support the adoption of international energy efficiency standards for operations and buildings.

The Bank will consider opportunities for financing the postal sector, which includes pick-up, transport and delivery of letters and parcels, post office counter services, and related services. With a few exceptions, public postal services are loss-making across the region, with significant and complex restructuring required. The Bank will consider opportunities to finance the public postal services companies, where there is a clear commitment of the government to implement reforms. Where opportunities emerge, the Bank will support the private postal services market, such as parcel delivery companies.

Intercity Bus and Coach Services. Buses and coaches are a key component in a sustainable transport system. They provide safer, flexible and affordable transport services, which can particularly benefit low income groups, women, and other groups which may suffer from poor access. Frequent and comfortable coach services can also support modal shift from cars, reducing carbon emissions from road transport and alleviating congestion.

In some countries of the region, particularly in ETC countries, bus and coach transport makes up to a third of intercity transport in terms of passenger kilometres (Study of passenger transport by coach, European Commission). However the average age of intercity buses in the region is over 15 years, compared to eight years in Western Europe, illustrating the need for investment in new vehicles (Study of passenger transport by coach, European Commission). In many countries, the sector is characterised by a fragmented private market with a large number of small operators and a few larger operators. The Bank will seek opportunities to finance intercity bus and coach services, and associated infrastructure such as bus terminals. The Bank will also promote the renewal of buses with higher energy efficiency and environmental performance, in line with EU standards.

Road Construction and Maintenance. The Bank may look selectively at opportunities to finance private road construction and maintenance companies. A key issue affecting this sector is the demand being largely driven by government funded contracts, meaning the sector is particularly vulnerable to economic conditions and the countries' fiscal conditions, as well as lack of transparency in the award of contracts. Should bankable projects arise in this sub-sector, the Bank will support market expansion and increased competition, alongside supporting the adoption of best practice in operations and technology.

Railway Property Development. Beyond the traditional assets financing in the rail sector (infrastructure and rolling stock), the rail sector also offers commercial opportunities from the significant land and property assets held by state railway companies. Often these assets are in prime locations in the centre of cities, as is the case with major railway stations. Stations offer significant commercial opportunities in terms of retail development and parking, and this economic potential can be realised with well-structured contracts or concessions with the private sector. The Bank has already participated in energy efficiency station modernisation in Russia, and provided equity for a long term concession to develop of rail stations in Czech Republic during the previous strategy period. The Bank will continue to look for opportunities to support property and station commercial development in the rail sector.

3.3.1 Measuring Success

While it is difficult to set a meaningful 5-year target for emerging business areas, in line with the strategic approach to further diversify the offer, the Bank will focus on increasing the number of projects financed in these extended boundaries.

4 OPERATIONAL APPROACH

The core of the Bank's strategy in the transport sector, articulated in Section 3, is to advance transition, support sustainable transport development and expand transport operations into new areas of activity. The Bank's primary instruments for achieving its strategic objectives are its investment operations, policy dialogue and technical cooperation projects. This section describes how these instruments will be used to meet the Bank's objectives under this Strategy. The Bank's coordination and cooperation with the Bank's IFI partners and the European Union is also considered an operational priority, and is described in this section as well as it co-operation with local staff in the Bank's Resident offices. The Bank's modal approach in the transport sector is described in Annex E and its geographical approach in Annex G.

Assessing the progress in meeting the Bank's objectives under this Strategy will be important going forward and this section also defines a series of Strategic Performance Indicators ("SPIs") to support the evaluation process.

4.1 General Investment Approach

The Bank is committed to advancing transition in the transport sector, and sector reform remains the primary objective under this Strategy. As described in Section 2.1, reforming the transport sector is a complex and multi-faceted process, including lengthy legislative and restructuring reform processes. Typically reform processes extend beyond the life of a government administration, meaning that changes in governments can add significant delays to the transition process. This means that the Bank's engagement in policy dialogue, which is promoted through the transport projects it finances, may also need to be extended to achieve the required reform goals. The Bank's approach to policy dialogue by region is further elaborated in Section 4.2. The Bank will reinforce its focus on sustainable transport by seeking opportunities to introduce sustainable transport components in to its investments, such as energy efficiency or road safety components. Through its investments, the Bank will seek to address transport bottlenecks in the region by financing well-structured public and private sector projects.

Sovereign Lending as a Platform. Given that the reforms, particularly at the earlier stages of transition, generally target state sector players (line ministries, regulators, state-owned entities etc.), an important strategic instrument the Bank has to support the reform process is sovereign and sovereign guaranteed lending, which will vary in size depending on investment needs. Sometimes a series of sovereign investment projects will need to be supported before the reforms reach the stage where: (i) financially sustainable SOEs emerge that can borrow on commercial terms without recourse to the state; and/or (ii) the legal, regulatory and institutional environment has developed to a level where the private sector can be mobilised to invest in transport infrastructure and services. Whilst the Bank's aim is to increase the number of private projects as a proportion of the transport portfolio in the coming strategic period (and the volume depending on the mix of private projects), sovereign and sovereign guaranteed lending will remain an important financing instrument for the Bank in the transport sector, where clear transition gaps remain and state-ownership of transport assets continues to dominate.

Mobilising Private Capital and Commercial Funding. In line with its reform mandate and against a backdrop of challenging market conditions, the Bank will seek to mobilise private capital and commercial funding in the region, wherever possible, to relieve the pressure on public budgets and speed up the development and maintenance of critical transport infrastructure and services. This is expected to require tailoring of financing structures to meet the needs of the Bank's clients by providing a range of financing instruments from senior and mezzanine debt, in hard and local currency, through to capital market instruments, guarantees and equity participation. These instruments are described in more detail in Section 4.3.

Co-financing Partners. The Bank will seek to mobilise co-financing partners and will continue to enhance its cooperation with other IFIs and multilateral institutions including the EU, leveraging the relative strengths of each institution to maximise the benefits and reform potential of co-financed projects as outlined in Section 4.4. It will also seek to share risk and encourage higher levels of commercial bank funding through syndication or parallel lending structures. Across the Bank's region, where otherwise well-structured transport projects are stalling because of a lack of commercial finance due to the on-going volatility in the financial markets the Bank will consider closing funding gaps where the projects have a solid commercial basis.

Promoting Regional Solutions. The Bank has played, and intends to continue playing, an important role often alongside its co-financing partners in promoting regional integration by financing key transport corridors across the region. Over the previous period, the Bank financed a number of projects to support the development of trans-European Corridors, which directly contribute to strengthening economic and social cohesion in the region. The Bank has also provided financing for pan-European corridors and more recently has focused on supporting the development of key corridors and networks in South Eastern Europe and the Early Transition Countries, with the aim of strengthening regional cooperation and furthering the promotion of economic growth and sustainable development.

Technical Co-operation. Sovereign projects, and to some extent projects with SOEs, often require substantial technical co-operation to support the Bank's policy dialogue and achieve the reform objectives, as well as to assist with the preparation and implementation of the investment projects. As explained further in Section 4.5 the Bank will continue to mobilise technical co-operation funds to support its transport operations.

Leveraging Local Knowledge. The Bank's transport projects are typically staffed with sector and country team (Resident Office) bankers, combining sector knowledge with a deep understanding of the country and reform context. The Resident Offices of the EBRD have played a significant role in the policy dialogue and successful preparation and implementation of transport projects. They are expected to continue to play this critical role in the executing of this Strategy. Collaboration between sector and country team bankers therefore remains a high operational priority. This Strategy also supports cross-sector collaboration in order to bring to bear the full expertise and experience of the Bank on transport investments, whether they are multi-user or dedicated facilities.

4.2 Approach to Policy Dialogue

As illustrated in the case studies presented in Annex C, policy dialogue is an on-going process between the Bank and the governments of the region, where key policy issues, relevant to the Bank's mandate, are discussed and promoted. This dialogue is therefore part of the policy formulation process, providing a forum for the Bank to engage governments on transition related reforms, environmental practices, energy efficiency and other important policy areas. However policy dialogue is also an exchange of ideas and information. This provides the Bank with valuable insight into the practical issues and implications of the transition process in the transport sector. The knowledge gained through this feedback allows the Bank to refine its approach, develop more efficient measures to promote transition, and better serve the region.

The use of Integrated Approaches, where the Bank considers the transition impact of multiple operations under a single transition framework, is not excluded under this strategy and may be appropriate, for example, in the case of capital market interventions in the transport sector. However, it has proven to be challenging to apply in the transport sector in the past, due to the uneven distribution of transport projects over time across the region. This has made it difficult to define the pipeline of projects which is essential to preserve the integrity of the approach. The Bank will therefore predominantly build on its transition and sustainability achievements to date, and take a strategic and long term view of the reform process and other policy issues in the sector.

The Bank will focus on the following areas of policy dialogue:

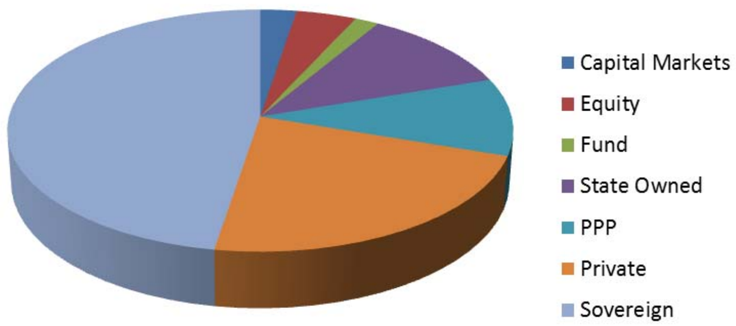
- Central Eastern Europe and Baltic States (including Croatia): Policy dialogue will focus on energy efficiency investments, financial sustainability of state railways through restructuring, privatisation and commercial activities such as rail freight operations and rolling out of PPP structures.
- South Eastern Europe: state railway restructuring and rail regulatory development, sustainable transport policies including energy efficiency standards, institutional strengthening of road agencies, development of landlord ports, and the framework for PPPs particularly for roads, airports and ports.
- Turkey: corporate governance of SOEs and application of international best practice for project finance transactions, particularly PPPs, as well restructuring of the railway sector.
- Eastern Europe and Caucasus: institutional reform, commercialisation, restructuring and financial sustainability of SOEs, regulatory development, sustainable transport policies, framework for PPPs and creating an environment for the emergence of private transport service providers, particularly of rail, intermodal and logistics services.
- Russia: developing a stronger regulatory framework; promoting cost-based non-discriminatory tariff regimes and equal access to infrastructure for all market participants; creating an effective legal and regulatory framework for sustainable transport development, and implementation of PPP projects.
- Kazakhstan: rail restructuring including corporate development of subsidiaries, road sector reform to create autonomous SOEs in the sector, as well as developing the framework for PPPs and adopting best practice in the development of PPP projects.

- Central Asia ETC: separation of policy from management functions, separating infrastructure from operations, measures to increase state funding for road maintenance, commercialisation of state owned entities and institutional strengthening.
- SEMED: at this early stage the envisaged policy dialogue will focus on commercialisation and restructuring of SOEs as well as development of the framework for PPPs where these do not exist or require further refinement.

A common area of policy dialogue is supporting the development of the legislative and regulatory framework for the successful implementation of PPPs. This objective is addressed in collaboration with the Bank's Legal Transition Programme. PPP/concessions represent one of the nine core commercial legal areas being addressed by this programme.

4.3 Financing Approach

Figure 8: EBRD Transport Project Numbers by Product Type (2005-2012 NCBV)



The Bank has a broad range of financial structures and instruments it can utilise to support its clients in the transport sector and deliver its strategic goals. The type of financial product is closely tied to the transition process, and the Bank has considerable flexibility to meet the needs of its clients, while ensuring the principle of sound banking is met. The Bank will continue to finance well-structured public and private sector projects, working with domestic and international companies, and offering a diverse range of financial products to meet the financing needs of its clients and the transport projects they sponsor.

Sovereign Lending. Sovereign and sovereign guaranteed loans are an important instrument through which the Bank supports sector reform by providing a platform for project led policy dialogue. Historical trends in the Bank's transport operations have demonstrated a transition from sovereign lending to non-sovereign structures, and in some cases to private sector lending where a private placement or privatisation has taken place. Over the previous period 47 per cent of the projects signed where Sovereign or Sovereign guaranteed facilities, representing just under 52 per cent of the total volume committed over that period. The Bank will continue to finance sovereign projects, where clear transition gaps remain and further reform is needed to create the conditions for greater private sector involvement. However, under this strategy a more selective approach to sovereign lending will be undertaken and, as noted in Section 3, where transition challenges are limited, the Bank would not consider a sovereign approach.

State Owned Enterprises (SOE). The Bank will promote lending to financially sustainable SOEs on commercial terms, where transition gaps remain and there are sufficient cashflows to service the Bank's debt without the need for recourse to the state. This intermediate financing stage improves the financial discipline and commercial orientation of SOEs, potentially preparing them for competition and future partial or full privatisation. Such engagement with SOEs, which, as the transition process progresses by sector and by country, may be viable in areas such as rail freight, port infrastructure and air navigation systems upgrading, allows the

Bank to continue to support sector reform, while at the same time freeing up limited sovereign capacity for allocation to other government priorities.

Private Sector. During the previous strategy period over 45 per cent of the Transport projects signed, representing 53 per cent of the Net Cumulative Business Volume over the period, were with private sector or non-sovereign clients. The Bank will continue to offer a flexible range of financing products to the private sector, including senior loans, equity and quasi-equity instruments, particularly in the rail, ports, shipping, intermodal and logistics sectors. The Bank will promote the use of new financial products in the region through its operations, such as bond issues and hedging instruments, supporting financial innovation by demonstrating the viability of such instruments in the market. Where opportunities emerge, the Bank will consider risk sharing facilities, such as investment frameworks or credit lines with local banks for smaller transactions, particularly in the SEMED region. Transactions with smaller companies may also be processed through existing EBRD facilities such as the Local Enterprise Facility ("LEF").

Project Finance. Promoting private capital for infrastructure is a key objective and as such the Bank places emphasis on supporting project finance structures including PPPs and concessions in the roads, airports, ports and potentially rail sectors. Twelve such projects have been signed during the previous strategy period representing just under 15 per cent of the business volume over the period. Based on the substantial experience of such operations across the region, the Bank is able to apply the lessons learnt from the early experiences in the structuring and execution of PPPs. Nevertheless, it is acknowledged that the Bank may not support all of the PPPs proposed by governments in its region and will continue to select only those projects which are well structured and delivered in line with best practice. Within project finance structures, the Bank can provide a range of products, including senior debt and in selective cases equity. The Bank can also provide junior (subordinated) debt in project finance transactions, especially where this can facilitate access to long term capital.

Capital Markets. The Bank will consider selectively additional ways of financing transport infrastructure by supporting access to the capital markets, which may be more liquid than commercial banks in the current environment. This may involve supporting initiatives such as revenues bond or credit enhancement structures to improve the attractiveness of bond financing for infrastructure development such as PPPs or supporting the debut issues of transport operators, such as public and private railway operators. The Bank will continue to engage as a core investor to facilitate successful bond placement, foster further development of the relevant bond market, and where transition impact can be achieved either through the direct use of EBRD funds, such as for energy efficiency investments, or through conditionality reflected in a framework agreement. Recent examples of the Bank's activity in the bond market, include anchor investments in bond issues by Russian Railways, independent Russian rail operators, and Kazakh Railways, which represent just under 5 per cent of the business volume committed during the previous strategy period. Mobilising institutional capital beyond the conventional commercial bank lending is also part of the Bank's transition mandate and it plans to engage with suitable institutional investors when prospective projects satisfy their financing criteria.

Equity. The liberalisation and development of transport services markets in the region has led to limited privatisation, in the form trade sales, private placement and initial public offerings

("IPOs"), and created opportunities for the entry of new market participants, which may not have the profile for debt finance, but may be candidates for equity investments. The Bank will consider participation in privatisations provided projects are well structured and strategic partners are competitively selected. It will also consider equity investments alongside new entrants, where feasible, in recognition of the strong signal this provides to potential investors in new markets.

Local Currency Financing. The EBRD has provided local currency loans to private clients and state-owned enterprises in the transport sector in Roubles, Kazak Tenge and Romanian Lei and is looking to expand this further where revenue streams are denominated largely in local currency. The approach has shown mixed results, in the main due to interest rate volatility. However, most recently in 2012, a new approach - to mitigate such risk in Russia by offering a Rouble-denominated loan based on Roisfix, a less volatile base than MosPrime - was pioneered by the Bank in the transport sector and is proving a more attractive option for Russian domestic borrowers. The Bank will continue to offer local currency financing to its transport clients, where required and available, and will support the development of local currency lending including the new overnight interest rate swap index, Roisfix, in the Russian Federation.

Guarantees. Alongside directly financing transport projects, the Bank can provide guarantees where infrastructure projects are unable to secure private capital due to perceived revenue risk. Whilst opportunities are likely to be highly limited, indeed during the previous strategy no such guarantees were provided, the Bank will consider offering guarantee products, particularly in the context of project finance transactions such as the previous M5 Motorway Project, Hungary.

4.4 IFI and EU Cooperation

Cooperation with other institutions is an important part of the Bank's approach to meet its strategic objectives in the transport sector. The Bank will continue working closely with its strategic partners, including other IFIs, bi-lateral donors and the European Union to promote those initiatives which support the necessary reforms and priorities contained in this strategy and the Bank's mandate.

This cooperation has been formalised under a Memorandum of Understanding separately with each of the EIB and ADB, which sets out the key areas of cooperation. The Bank will continue to work closely with other IFIs such as the World Bank, IFC and, in the new SEMED region, the Islamic Development Bank ("IsDB") and African Development Bank ("AfDB") in a number of different ways. First, the Bank will co-finance projects with IFIs across the region. Transport infrastructure projects often have investment costs which are larger than the capacity of any single institution, therefore, co-financing represents the means to raise the necessary finance for priority investments. Similarly, there are high costs associated with the preparation and implementation of infrastructure projects, and co-financing can pool grant resources to meet project needs, increasing the efficiency of IFI financed projects.

In the poorest countries in the region, IMF concessionality requirements mean the EBRD may be unable to finance projects as the sole lender. Other multilateral institutions have access to considerable grant resources for investments and can offer soft loan terms, therefore co-financing allows the ERBD to participate in projects as part of a concessional financing package. Cooperating with IFIs is therefore critical for the EBRD in countries with concessionality requirements, and the Bank will continue to seek opportunities to co-finance transport projects in these countries.

IFI cooperation extends to mutual areas of policy focus including transition related sector reforms. Under this Strategy, the Bank will enhance its cooperation with other IFIs in terms of coordinating reform objectives. This has been identified as a 'lessons learnt' from the review of the previous policy, and the Bank will work to align the reform conditionality of co-financing IFIs where possible. To reduce complexity for clients, the Bank contributes to IFI efforts to harmonise the requirements enshrined in each IFIs environmental, social and procurement policies and safeguards.
The Bank will also coordinate with the IFIs beyond individual projects, for example, by supporting joint IFI initiatives such as the Multilateral Development Bank Road Safety Initiative (see Section 3.2), and participating with other IFIs in the joint statement on Sustainable Transport in the Rio+20 conference. For the SEMED region, the Bank is part of the Deauville Partnership alongside a number of other IFIs working the region. Similarly, the Bank will coordinate closely with other IFIs in this region to ensure its engagement is complementary and the region can benefit from the relative strengths of each institution, including the EBRD.

EBRD cooperates closely with the EU, mobilising parallel funding under its different instruments (WBIF, NIF, EC Public Private Partnership Technical Preparation Programme, EU IPF and more recently EC SEMED Project Preparation Framework). The Bank will continue this collaboration with the EU and will focus on expanding joint operations where COOs become eligible for new funding sources.

4.5 Technical Cooperation Funds and Investment Grants

Technical Co-operation. The EBRD's public sector transport operations are heavy users of TC funding, with an estimated annual requirement of EUR 6-10 million of TC funds. TC funds are essential for the preparation and implementation of the Bank's transport projects and to unlock opportunities to achieve the Bank's transition objectives. In terms of geography, the Bank expects the use of TC funds for transport projects to be concentrated in the Western Balkans, ETCs and the SEMED region. While opportunities are limited in the transport sector, the Bank will also seek selectively to mobilise investment grants, particularly in countries where there are IMF concessionality requirements.

Since 2005, TC requirements for the Bank's transport projects have almost doubled in terms of both project numbers and funding needs, increasing from 12 TC projects (EUR 2.3 million) in 2005 to 18 TC projects (EUR 8.0 million) in 2012. Broadly TC funds support two distinct categories: i) project-based and ii) transition-related. The first category primarily focuses on supporting the client with the implementation of large scale infrastructure projects and/or their environmental and social assessments. These assignments are predominantly administered by the client and the bulk of these focus on contract supervision and management.

Going forward the funding of TC projects will be guided by the Bank's cost-sharing policy for TCs. For private sector clients, cost-sharing will be sought, with the exception of energy efficiency TCs. For public sector clients, use of loan proceeds will be sought for project-based TCs, such as design and supervision, where possible, in order to free up much needed donor support for transition-related and sustainability TCs.

Sustainable Transport. The Bank will prioritise the use of TC funding for sustainable transport, particularly for sustainability and energy efficiency policy development, energy audits to identify energy consumption patterns, and identification and preparation of energy efficiency investments. TC funds will also be utilised to support environmentally and socially sound development by focusing on environmental and social aspects of project implementation, including stakeholder engagement.

Reform and Restructuring. The most significant use of TC funds will continue to focus on the Bank's ability to use TCs as a key instrument to support policy dialogue and promote transition objectives generally through its public sector projects. These TCs are developed in parallel to the investment projects, and are targeted on specific areas of reform in order to utilise efficiently the grant resources. The Bank works closely with the beneficiaries of these TCs, such as transport agencies, operators, or the governments to develop the objectives and scope and ensure commitment to the results of these projects. Amongst others, reform TCs will address transition issues such as road sector reform in countries like Azerbaijan and Ukraine, as well as the Western Balkan and ETC countries, state railway company restructuring and commercialisation in the Balkans, advisory services for PPPs in countries like Kazakhstan where the Government is also willing to contribute to underline its commitment to the TC support provided, and enhancing business and investment planning in port authorities in countries like Croatia, which has a number of small ports in need of support with institutional strengthening. The Bank's ability to mobilise such TC support provides a unique opportunity to engage in policy dialogue in those countries where traditionally the reform process in the transport sector is lagging behind reform in other sectors.

Project Preparation and Implementation. A common use of TC funds historically in the transport sector has been to support implementation of Bank-funded projects, including construction supervision and support to Project Implementation Units ("PIUs"). Through the use of TC projects, the Bank has been able to ensure that its clients receive the essential support required to deliver complex public infrastructure projects. A key objective of this implementation support is the transfer of knowledge, best-practise and skills in both procurement and contract implementation. Whilst still a priority requirement to ensure successful and efficient project delivery, the Bank will continue to move towards encouraging loan funds to be used to finance implementation in particular.

Investment Grants. The transport sector is not a heavy user of investment grants, but there are circumstances where affordability considerations require grants to be sought and in regions, such as the ETCs, blending grants with EBRD loans to satisfy IMF concessionality requirements is essential for the Bank to operate in these markets, and pursue its transition agenda. To a lesser extent, the Bank will seek EU grants in pre-Accession countries in the Western Balkans and EU Neighbourhood Countries.

4.6 Strategic Performance Indicators

This section sets out the strategic performance framework under which the Bank will conduct its transport operations. In order to support the evaluation of the achievements of the Bank in delivering the Strategy, a series of SPIs have been identified. The SPIs have been developed to provide a quantifiable means of assessing whether certain strategic objectives have been met.

However, region-wide SPIs only go so far given different priorities in different countries; in fact the choice of such region-wide SPIs is unavoidably skewed to those objectives that are not only measurable but that have region-wide relevance. More specific transport sector objectives will be set in the context of individual country strategies, which are better able to reflect the particular transition gaps and circumstances in specific countries.

Given the natural annual fluctuations in the Bank's transport operations, the SPIs will be reviewed every five years whilst this Strategy is in place. Therefore the SPIs will be first reviewed five years after this document is approved by the EBRD's Board, and subsequently after every five years until such time as the Strategy is superseded. At this point in time, a final evaluation will take place during the process of preparation of the next Transport Strategy. In the meantime, the Board Documents for transport projects will detail those projects which are directly contributing to the fulfilment of the relevant SPI(s).

The SPIs for this Strategy are:

1. **Policy Dialogue Engagement**: by supporting sector reform and restructuring enable the transformation of 3-5 sovereign clients into commercially-oriented entities (or part of their operations into commercially-oriented ring-fenced activities), which can raise finance on a non-sovereign basis or contract-out operations to the private sector.

Through the Bank's on-going policy dialogue and support of the restructuring and commercialisation of rail operations, a state-owned railway company may reach the stage where it can ring-fence cashflows from profitable activities such as freight operations to raise financing without recourse to a sovereign guarantee. Similarly, the Bank's support for reform and restructuring of the road sector through its loan covenants may facilitate contracting-out of road maintenance to the private sector under performance-based maintenance contracts or the concessioning of road development/modernisation, operation and maintenance under public private partnership arrangements.

2. **Commercial Orientation**: At least 60 per cent of projects structured on a private or non-sovereign basis (calculated as an average of cumulative project numbers over a five year period.)

A key objective of this Strategy is to advance the transition process in the transport sector, by promoting the commercial orientation of the Bank's transport operations and increasing the role of the private sector. As described in Section 1.2 there has been an increase in private sector lending since 2005, and lending to state-owned enterprises on a commercial terms. Over past 5 years this ratio has ranged from 51% to 58%. This SPI therefore captures the need to increase the level of commercial lending, including non-sovereign projects with

SOEs. At the same time, however, it recognises the need to ensure that the Bank continues to support the transition process in countries where transition gaps remain, particularly in Early Transition Countries, or where the transition progress has had a difficult history and sovereign financing continues to be required to address these transition challenges. It needs to be recognised that the overall trend may be subject to fluctuations on an annual basis and for this reason the SPI is defined as a rolling 5-year average.

3. **Sustainability Focus**: Reduce CO2 emissions by a doubling of the Transport SEI contribution to 25% of Transport annual business volume over the next five year period (2013-2018).

Transport is a key sector under SEI 2 – over the period 2007 to 2012 the Bank provided EUR 870 million for energy efficiency investments to reduce CO2 emissions in the transport sector. This represents 13% of the annual business volume under the SEI programme during this period. This SPI therefore reflects the enhanced focus on low carbon transport as a core theme of this Strategy.

As the Strategy outlines, sustainability in the transport sector encompasses a broad range of impacts, including environmental, social and economic issues. Climate change mitigation and adaptation, integrated network development, pollution prevention, biodiversity protection, economic inclusion and gender equality, and road safety, are all important aspects of sustainable transport. Going forward the Bank *will build on its achievements by expanding its activities and initiatives to address the challenges in these areas* and will develop further its reporting mechanisms relating to sustainable transport. This is expected to include the introduction of a methodology to measure social, economic and environmental impacts in line with the work currently underway by the Multilateral Development Banks (MDBs) following the signing of the Rio+20 Joint Statement.

4. **Road Safety Focus:** Ensure that within five years all public sector road projects are subject to a road safety assessment that identifies the risks to be reduced and at least 50 per cent of such projects to include specific road safety components or initiatives to enhance the impact of the Bank's project on improving road safety in its COOs.

As noted above, in Eastern Europe and the former CIS, on average, 16.3-19 per 100,000 population die each year in road accidents. This compares with 11-12 per 100,000 in Western Europe (World Health Organisation (WHO)). These figures understate the issue considering the relatively low levels of car ownership in the region. The WHO estimates the direct and indirect costs of road accidents to account for between 1-3 per cent of GDP of European countries (WHO, European Status Report on Road Safety, 2008). Road safety is one of the single biggest issues of sustainable transport facing the region. However, this cannot be addressed by one institution alone, which is why the EBRD has joined forces with other MDBs in a decade of action to tackle this issue, as explained in Section 3 above. As part of its response, the Bank is now piloting road safety activities across a number of countries, and is actively looking for opportunities to develop road safety components in its road investments, where possible harnessing private sector resources. The objective is to build up the Bank's road safety activities over the next five years, with the target of achieving at least half of the Bank’s public sector road investments having road safety components by the fifth year, such as specific investment components in line with the conclusions of the Road Safety Audit, outreach activities with, private sector engagement, or Technical Cooperation projects on institutional strengthening and capacity building.

ANNEXES

Annex A - Evaluation

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Annex D - Transition Challenges

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Annex A - Evaluation

The following provides a summary of the key recommendations of the Bank's Evaluation Department's (EvD) Special Study of the Transport Operations Policy, 2005-2008 (BDS04-72 (Final)) and the way in which they are addressed in this Strategy.

Recommendation	**Response**
The Bank needs to more realistically align overall sector reform expectations with individual infrastructure project expectations and deliverables. Since transition-related objectives are, to a large extent, country- or region- specific, the scope and content of the TOP vis-à-vis the related sector section in the respective country strategies would benefit from a better realignment and consolidation. Similarly, the role of and need for TC and policy dialogue in fostering transition processes in this particular sector deserves clearer recognition in both the sector policy and individual country strategies.	This Strategy recognises the need to set realistic reform expectations and deliverables, while maintaining a level of aspiration for the transition process. TC and policy dialogue are clearly recognised as core tools for the Bank to advance transition in the transport sector (Section 4.5).
The Bank needs to place more emphasis on MDB/Donor cooperation. Whilst such cooperation on the corporate level is well heralded, this evaluation points to considerable scope for improvement at working levels and it should be monitored accordingly. EBRD's Resident Offices (ROs) are seen to be in the lead here, since they are closest at the intervention points. This RO role would need to be clearly enshrined in the forthcoming TOP and also lead to commensurate resource allocations, apart from the usual project generation and monitoring tasks.	IFI/donor coordination is central to the Bank's transport operations, both in terms of the investments and the reform agenda. IFI/donor co-financing and coordination are therefore central to the Bank's strategy (Section 3.4). Project teams are typically staffed by Sector and RO bankers, reflecting the key co-ordinating role RO staff can play with other IFIs on the ground.
In light of climate change implications, the new TOP should place more emphasis on environment and commensurate technologies. This includes the Bank's investments in private modes of transportation (e.g. cars). Also, the environmental and social impact assessments of major PPP concession roads should always include a public sector alternative. As the Bank moves south and east to non-EU countries with their own standards, the Bank could provide greater guidance on what is meant by "EU Environmental Standards". EBRD has an opportunity to add value and show leadership in this important sector.	*Sustainable transport*, encompassing climate change, environmental and social impacts, and road safety, has been identified as one of the key pillars of this strategy (Section 3.2). All transport operations are conducted in accordance with the Bank's Environmental and Social Policy (Section 3.2).

A more holistic or indeed 'integrated' approach needs to be adopted by the Bank in infrastructure (transport) projects during project preparation. The Evaluation Team is of the view that the TOP should adopt a more systemic approach to transport sector needs complementary to the project demand-driven paradigm. Closer and more effective cooperation and consultation with other MDBs and Donors – as proposed above – would be one way to facilitate a more integrated planning approach.	This Strategy recognises the need to focus transition impact of sovereign deals on key reforms to promote private sector development (Section 4.1). Effective cooperation and consultation with other IFIs/donors is an important objective of this strategy (4.4).
Accountability of sector policies needs strengthening. In order to elevate sector policies to the level of accountability instruments – with the forthcoming TOP in mind - they need to adopt a more programmatic approach rather than a 'one-size-fits-all' approach, circumscribing the existing portfolio, pipeline and envisaged investment opportunities.	This Strategy combines the need for accountability with the concomitant need for flexibility to respond to the dynamics of the changing environment in which the Bank will be required to operate over the life of the strategy.

Annex B - Transition Performance

Alongside assessing the transition impact of individual operations, the EBRD also periodically reviews the wider impact of its operations at the sector and country level. The Transition Impact Retrospective (TIR) assessed the transition impact of EBRD operations from 2005 to 2009, by reviewing the transition challenges facing the region, and assessing the impact of the Bank's operations against these challenges. The exercise considered a range of factors, including the project objectives, the implementation record, and the Bank's reform efforts. The results for the transport sector, by country, are shown in Figure 1.

A key result of the TIR was identifying that the greatest transition impact in the Bank's operations was achieved in the infrastructure sectors, including transport, particularly in South Eastern Europe, Russia, Tajikistan, and in the Central European and Baltic countries. More specifically, in the transport sector the TIR recognised that the Bank has placed significant emphasis on improving the institutions and policies that support the development of markets, such as institutional reform and regulatory development. This broadly reflects the earlier stage of transition in the period the TIR covered, where market structures and regulatory regimes were still being established. Changing the structure and extent of markets, in other words growing and enhancing competition in the market, is now a key objective for transport operations as the private sector plays an increasingly important role in the provision of transport infrastructure and services. Substantial transition impact has been achieved in the road and rail sub-sectors. Key examples of where the Bank has supported transition include the Bank's catalysing role in road PPP transactions, the development of road agencies and the improvement of the financial sustainability of the road sector, and the unbundling and corporatisation of state railway companies.

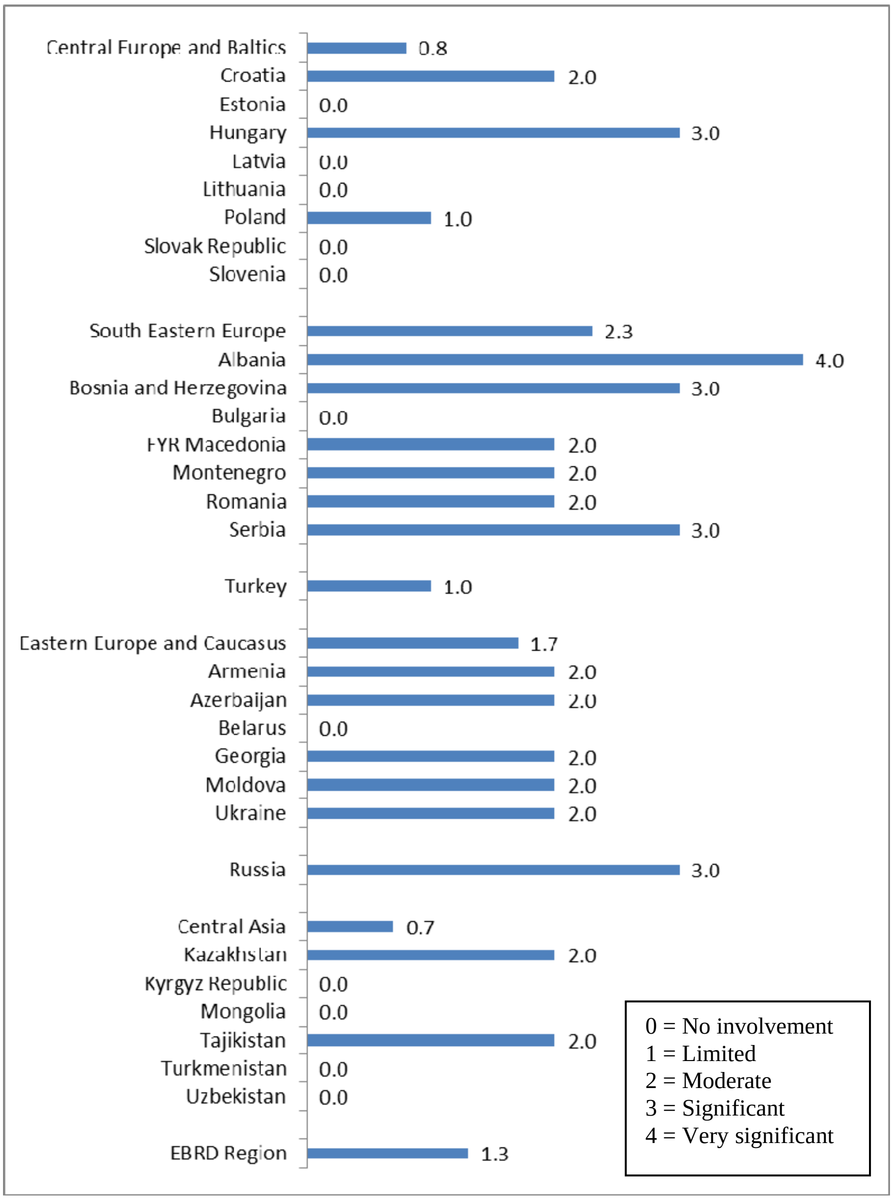
Figure 1 illustrates how Russia, the EBRD's largest market, is among the countries where the Bank has achieved the highest transition impact, based on the TIR assessment. This result is based on significant efforts to progress reforms in the Russia transport sector, particularly in the railway sector. The most significant impact was observed in transactions supporting leading large private sector rail and multimodal operators, with expected long-term effects of increased competition in the sector and improvements in corporate governance.

Significant transition impact has been achieved in the South Eastern Europe region, where the Bank has worked with countries to support reconstruction and modernisation of infrastructure, alongside wide-ranging reform programmes. Albania's transport sector, where the Bank is engaged in projects across many modes (road, airports, ports), stands out as having achieved the highest transition impact in region. The Bank played a leading role in Tirana International Airport's successful concession, and has had a deep involvement in road sector reform through policy dialogue and TC projects.

Among the CEB countries, the TIR assessment recognised Hungary as achieving significant transition impact largely due to the Bank's contribution to the adoption of the PPP structure for road investments, with considerable demonstration impact in the region. Certain countries, such as Poland, Latvia and Estonia achieved more modest ratings, reflecting a relatively advanced stage of transition, and the access to EU funding, which reduced the EBRD's additionality in these countries.

Across Eastern Europe and Caucasus, moderate transition impact was achieved in the TIR assessment. However transition in Central Asia has been challenging, with significant transition gaps remaining. The Bank's engagement is more limited in Central Asia, due to concessionality requirements, resulting in fewer opportunities for the EBRD's intervention. Kazakhstan is a partial exception, with greater transition impact being achieved during the TIR review period through substantial sovereign-financed projects predominantly in the road and rail sectors.

Figure 1 Transition Impact Retrospective 2009: Summary of Results achieved in the Transportation Sector



Annex C - Policy Dialogue Case Studies

Case Study 1 : Serbia | Policy Dialogue and Reform in the Railway Sector

The Bank's engagement in the rail sector in Serbia demonstrates how policy dialogue and technical cooperation, sustained over a number of projects, has supported the complex and lengthy reform process. This engagement also illustrates the Bank's approach of combining sector and country expertise.

Framework for Promoting Reform

The EBRD has been engaged in the Serbian rail sector since 2001, with the twin objectives of modernising rail assets and supporting the rail reform process. This engagement demonstrates how the Bank, in parallel to its investments, maintains a dialogue on complex but critical policy issues such as commercialisation, market liberalisation and sustainability. This dialogue frequently results in the preparation of targeted Technical Cooperation projects, which support Serbia's institutions in delivering their reform objectives.

The rail sector in Serbia suffered from severe under-maintenance over a prolonged period, resulting in a large infrastructure deficit which required significant investment. The Bank has made 5 loans to Serbian Railways, the state railway company, providing a total of EUR 412 million for rolling stock and infrastructure investments, in order for the railways to provide better quality services to the market.

Using its investments as a platform, the Bank has engaged in policy dialogue with the key actors in the reform process, including the Government of Serbia (Ministry of Infrastructure), Serbian Railways and the Railways Directorate (regulator). The Bank's engagement deepened in 2010, when the legislation for the restructuring of Serbian Railways was under preparation – the Bank funded a Strategic Rail Advisor to the Government of Serbia at its request, who worked with the government and the railways, providing strategic advice on the restructuring and wider reform process.

Increasing Efficiency

A common theme of the Bank's policy dialogue with Serbian Railways has been on increasing efficiency. Like most railways of the region, Serbian Railways has been structured as a vertically integrated entity, and faced a number of complex legacy issues which resulted in low productivity levels. Increasing efficiency meant addressing these difficult issues, including through labour and network rationalisation. The Bank has placed significant emphasis on measures to increase cost transparency. The Bank worked with Serbian Railways on separating internal accounts for infrastructure and operations, a precursor to legal separation in to separate companies, which is now underway. The cost work directly fed into the use of productivity ratios, as a measure of financial performance. Improving business planning also drives efficiency, and the Bank prepared a Technical Cooperation project with Serbian Railways to prepare strategic business plans for individual units – infrastructure, passenger and freight.

Transparent Financing

An important reform area for railways is the manner in which they are financed, more specifically moving towards a more commercial funding arrangement. Through its dialogue with the Ministry of Infrastructure, the Bank has supported the use of the Public Service Obligation (PSO) mechanism. The PSO is a contract between the state and the railway operator for loss-making services. This arrangement is more commercial as it allows the level of output to be set for a particular cost, and can incentivise good performance and penalise poor performance. The Bank has also engaged on the same issue in funding the maintenance and operation of infrastructure, and this lead to a Technical Cooperation project to prepare a template Multi-Annual Contract between the state and the future Infrastructure Manager.

Market Liberalisation

As a pre-Accession country, Serbia is working towards compliance with European legislation, including the directives pertaining to the rail sector. Introducing competition into the rail freight sector is one of the key reforms to achieve compliance, and this also closely aligns to the Bank's focus on private sector development. Much of the dialogue focused on the key steps in introducing third party operators – preparing the access charge regime and network statement, and the associated legislation. In parallel, the Bank has worked closely with the Railways Directorate, which will perform the economic regulatory role once the market has opened. This dialogue resulted in capacity-building Technical Cooperation project, advising the Railways Directorate on the processes and human resources required to adequately perform this function.

Sustainability

Substantial policy dialogue has taken place with Serbian Railways on energy efficiency, and this has been reinforced with targeted Technical Cooperation projects. Initially EBRD provided consultants to perform an energy efficiency audit, identifying the key targets to reduce energy consumption across the organisation. This work then fed into dialogue on the use of an Energy Management Information System, and a Technical Cooperation project is underway to scope this system. Serbian Railways now has a dedicated Sustainability Unit, focused on addressing energy efficiency and broader sustainability issues including environmental impacts.

Case Study 2 : Ukraine | Policy Dialogue and Reform in the Road Sector

The Bank's engagement in the road sector in Ukraine illustrates the evolutionary nature of its role in supporting transition in a particular country over time – in this case over a decade – through policy dialogue, a programme of sovereign lending and technical cooperation, all supported by a strong sector specialism and committed presence in the Kyiv Resident Office.

Framework for Promoting Reform

Co-operation between the Bank and the Government in the road sector started in 1996. Successful implementation of the road projects that followed and continued dialogue with the Ukrainian authorities and Ukravtodor, the state-owned road agency, has allowed the Bank to develop a programme of focused lending, which has given momentum and continuity to the reform process and increased the overall impact of the Bank's involvement. It has also provided much needed financing for the development of key European road corridors, promoting regional integration and inclusion.

The Bank has provided four loans to the road sector totalling EUR 625 million, with a second tranche of EUR 200 million ready to commit under the fourth project. The first three loans financed the rehabilitation of the M06 highway. The fourth project (Pan-European Corridors) will complete the rehabilitation of this landmark EBRD road programme linking Kyiv to the neighbouring EU and CIS countries and a number of other key sections of the national road network approaching Kyiv. All of these loans have been linked to key road sector reform measures. Substantial progress been achieved against key transition milestones supported by the Bank has in three main areas: road sector financing, institutional reform and promoting involvement of the private sector.

Road sector financing

Road sector financing has been substantially reformed over the last 10 years. The Bank was instrumental in supporting the introduction of an efficient system of road user charges. This was a major improvement on the previous turnover tax used to fund the sector, which was unrelated to road use. It also allowed the Bank to ensure adequate funds were allocated to the road sector overall and particularly for road maintenance. The Bank's continued dialogue with the authorities has resulted in on-going improvements in road sector funding. A major accomplishment, in particular over the past three years, has been the three-fold increase in EUR terms in the excise tax for petrol (increasing from an average of EUR 60 per tonne to an average of EUR 198 per tonne) and a two-fold increase in the excise tax for diesel (increasing from an average of EUR 33 per tonne to an average of EUR 72 per tonne). The Bank continues to work with Ukravtodor and the relevant ministries to promote further increases the fuel excise taxes to ensure that sustainable development of the road sector can be achieved and maintained.

Implementation of road sector restructuring

A number of key steps in the restructuring of Ukravtodor have also been achieved through on-going policy dialogue. Early restructuring steps involved the separation of Ukravtodor's funding and contracting functions, as well as improvement of its operational efficiency through the introduction of competitive tendering of contracts and privatisation of ancillary services. More recently, the focus has been on separation of the management, administration and funding of state and local roads, with the aim of decentralising responsibility for local roads to regional authorities. The Cabinet of Ministers' approval of an updated Road Sector Reform resolution paved the way for these changes to be introduced The first step was the preparation and enactment of the required legal amendments and resolutions, which were needed to underpin this restructuring process. The Law on Roads was subsequently approved by the Parliament and Cabinet of Ministers, was the key legislative change which detailed the local roads to be transferred to regional authorities. The required resolution covering the mechanism for the distribution of road user charges between the state and local public roads has recently been approved by a joint order of the Ministry of Finance and Ministry of Infrastructure. With this in place, the decentralisation of local roads has moved a step closer.

Private sector engagement

The Bank's dialogue on greater engagement of the private sector in the development and maintenance of roads in Ukraine has been in two key areas. First, in response to the Government's interest in considering using PPPs in the road sector, the Bank supported the mobilisation of consultants to develop the legal framework and identify a pilot project, which could be implemented on a PPP basis. While this work was successfully completed and the framework now exists to introduce PPPs, a change in government meant a change in priorities and PPPs were not pursued. Second, an area in which the Bank has provided significant support to Ukravtodor has been on out-sourcing of performance-based maintenance contracts to the private sector. Successful introduction of such contracts will be a ground-breaking achievement for Ukravtodor, as it would become one of the first state road administrations in the CIS region to implement this type of long-term maintenance contract. In Ukraine, this concept is considered an efficient solution and an effective way to develop the private sector – increasing competition in the provision of road maintenance as well as introducing efficiencies and cost savings. Ukravtodor - fully supported by the Government – is committed to the successful award of a pilot performance based maintenance contract for the M06 highway and to the rolling out such contracts on a broader scale. The Bank has worked closely with Ukravtodor in this important area and will continue to provide its full support to ensure this method of contracting is successfully introduced in Ukraine, as a potential precursor to re-consideration of the introduction PPPs in the road sector.

Annex D - Transition Challenges

Transition countries of the region are at widely varying stages of the transition process. To determine the remaining transition challenges, the Bank prepares the Assessment of Transition Challenges ("ATC"). The 2011 ATC contained detailed sector analyses, including for the transport sector focusing on the road and railway sectors, where countries were assessed on their progress towards well-functioning market economies. The benchmarks were defined across two dimensions – market structure, the balance between public and private in the market and the degree of competition, and market-supporting institutions and policies, the legislative, regulatory and policy framework for market functioning. The degree of the remaining transition challenges are rated as negligible, small, medium or large. The ATC complements the Transition Retrospective ("TIR") described in Annex B, which looks back at the progress made in the transition process over the period 2005-2009. In the railway and roadway sectors transition means the following broad steps have been undertaken:

Market structure

- Industry restructuring through accounting separation and functional unbundling. In railways, this typically means the separation of infrastructure from freight and passenger operations, and often the separation operations along business lines, and the divestment of ancillary services. In roads, this implies the separation of new construction from road maintenance, engineering and design.
- Private sector participation and competition for the market in construction, operations and maintenance, possibly through BOT-type concessions, management or service contracts or other types of public-private partnerships ("PPPs"). In railways, privatisation of freight operations or at least privatisation of ancillary services (e.g. network maintenance). Not all transport services are suitable for privatisation and also depend on the country context.
- Competition in selected markets (e.g. freight) following for the liberalisation of network access according to non-discriminatory principles and/or award of licenses to the private sector, allowing them to operate freight services. In the road sector, the rules and practices of open tendering of construction and maintenance contracts.

Market-supporting institutions

- Tariff reform towards more cost-based tariffs, reducing cross-subsidies and introducing transparency in the provision of state subsidies. In railways, freedom to establish commercial freight tariffs and the introduction of explicit arrangements for providing subsidies through Public Service Obligations ("PSO"). In roads, the key parameters are: (i) road maintenance expenditures are sufficient to maintain the quality of state roads and motorways; (ii) road user charges (i.e. the introduction of road user charges based on vehicle and fuel taxes) are enough to cover the costs of operational expenditures and possibly capital costs; and (iii) road user charges are in accordance with road use and, at the advanced stage, associated with negative externalities, such as pollution emissions and congestion.
- Development of an adequate legal and regulatory framework to facilitate industry restructuring (i.e. Railway and Road Acts).
- Separation of operating and policy setting functions. In roads, this implies the creation of a Road Agency, with decision making, resource allocation and management across road networks. In railways, this is implemented through the establishment of a rail regulator,

ideally independent, but at least characterised by high standards of accountability and transparency as well as the technical capacity to set tariffs and ensure fair access to infrastructure.

Figure 1: Transition Challenges for Road and Rail 2012

SCORING 1-4*	**Market Structure**			**Market Institutions**	
Central Europe and Baltics	**Roads**	**Railways**		**Roads**	**Railways**
Croatia	●●	●●●		●●●	●●●
Estonia	●●●	●●		●●●	●
Hungary	●●	●●		●	●●
Latvia	●●●	●●		●●●	●
Lithuania	●●●	●●●		●●●	●●
Poland	●●	●●		●●	●
Slovak Republic	●●●	●●		●●●	●●●
Slovenia	●●●	●●●		●●●	●●
South Eastern Europe					
Albania	●●●	●●●●		●●●	●●●●
Bosnia and Herzegovina	●●●	●●●		●●●	●●
Bulgaria	●●●	●●		●●●	●●●
FYR Macedonia	●●●	●●●		●●●	●●●
Montenegro	●●●	●●●		●●●●	●●●
Romania	●●	●●		●●●	●●
Serbia	●●●	●●●		●●●	●●
Turkey	●●●	●●●		●●●	●●●
Eastern Europe and Caucasus					
Armenia	●●●	●●●		●●●	●●●●
Azerbaijan	●●●	●●●		●●●	●●●●
Belarus	●●●●	●●●●		●●●●	●●●●
	Roads	Railways		Roads	Railways
Georgia	●●●●	●●●		●●●	●●●

SCORING 1-4*	Market Structure			Market Institutions	
Moldova	●●●	●●●●		●●●	●●●●
Ukraine	●●●	●●●		●●●	●●●●
Russia	●●●	●●		●●●	●●
Central Asia					
Kazakhstan	●●●	●●●		●●●	●●●
Kyrgyz Republic	●●●●	●●●●		●●●●	●●●●
Mongolia	●●●●	●●●		●●●●	●●●
Tajikistan	●●●●	●●●●		●●●●	●●●●
Turkmenistan	●●●●	●●●●		●●●●	●●●●
Uzbekistan	●●●●	●●●		●●●●	●●●
Southern and Eastern Mediterranean					
Egypt	●●●●	●●●●		●●●	●●●●
Jordan	●●●	●●●●		●●●	●●●●
Morocco	●●●	●●●●		●●●	●●●
Tunisia	●●●	●●●●		●●●●	●●●

*Where ● = negligible challenge and ●●●● = large challenge

Geographical Transition Challenges

Across the Central European and Baltic ("CEB") countries, which represent the most advanced part of the region in terms of transition overall, specific challenges remain in the transport sector. These challenges are largely focused on developing the private market for both transport infrastructure and services. However, in the rail sector, institutional reform in some cases has been insufficient and specific transition challenges remain to achieve financial sustainability of state railways in some CEB countries.

In the Western Balkan countries of South Eastern Europe significant resources have been invested in transport infrastructure rehabilitation and modernisation linked to reform. In some sectors, such as the Albanian road sector and Serbian rail sector, a broad range of transition measures have been adopted, many to achieve alignment with EU requirements. Case Study 1 illustrates the emphasis placed on policy dialogue and reform in the railway sector in Serbia. The institutional and policy-related transition challenges in the road and rail sub-sectors of SEE countries are therefore progressing well and remaining challenges are considerably reduced. Whilst there are notable exceptions, for example the Albanian rail sector where large transition gaps remain, the dominant transition challenges relate to private market development. In the two

SEE countries which are now EU Member States, Romania and Bulgaria, the key transition challenges centre on the need for private market development, including the market for intermodal and logistics services. However, challenges also remain in the railway sector, where the reforms which have taken place have not achieved a financially sustainable railway system and further restructuring and regulatory improvements are needed.

In Russia, comprehensive reforms are underway throughout the transport sector. These are complex processes which will take time to complete and significant transition challenges therefore remain. In the rail sector, for example, there is a need to strengthen the regulatory framework to support non-discriminatory tariffs and greater involvement of private operators to ensure that the full benefits of the structural reform programme are realised. In the port sector, challenges include the corporatisation of the landlord port authority, and supporting the development of concessions to raise private capital for development of port infrastructure. While there have been notable advancements in the preceding period in the roads and airport sectors, challenges also remain to extend the adoption of PPP structures for infrastructure provision, which could be more widely applied to develop regional infrastructure and other transport sub-sectors, such as the provision of rail infrastructure. Growth of the private provision of integrated transport solutions through further development of intermodal and logistics services will be another transition challenge going forward in Russia.

In Turkey, the transition challenges are highly focused on private sector development in infrastructure PPPs in the roads, airports and ports sectors, and development of the private market for transport services, such as intermodal and logistics. However, the Turkish rail sector is largely unreformed and represents a significant transition challenge which is yet to commence.

Despite the complex political situation, the transition process has advanced in Ukraine, and some of the more persistent challenges including the restructuring of the state railway company are slowly progressing. However, the fact that it has taken more than ten years to achieve corporatisation of the national railway company illustrates the time required to achieve some reform goals and the need to remain engaged through a series of projects sometimes over an extended period. Significant progress has also been made in terms of road sector reform, which is described in Case Study 2, although private sector participation is low and PPPs have yet to emerge despite earlier interest in road PPPs. In general, across the transport sector, there remain significant transition challenges to creating a favourable environment to encourage private sector participation.

Similarly in Kazakhstan, the remaining transition challenges in the road sector focus mainly on greater autonomy of operations and the need for increased private sector participation in the road sector through the introduction of PPPs and greater outsourcing of maintenance activities under Performance-based Maintenance Contracts. In the rail sector, reforms are advancing, but much remains be done to create the conditions for further private sector participation. For other transport modes, improving corporate governance and supporting the expansion of the private sector are key transition challenges.

In the Early Transition Countries, there are large transition challenges across all modes for the Bank to address (the road and rail ratings of individual countries can be seen in Annex D).

In the SEMED region transport infrastructure and services are dominated by state-ownership Private sector participation is limited and these countries typically lack independent regulation of the transport sector. The transition challenges include the need to deepen private sector participation in infrastructure, develop competitive markets for transport services, and support institutional development and commercialisation. In addition, the SEMED countries face significant issues relating to the economic participation of the younger demographic.

Annex E - Modal Challenges and Approach

Roads

Roads represent the primary infrastructure by which individuals reach markets and services, and provide the network for the distribution of goods. Roads make up a significant proportion of a country's infrastructure assets, demonstrating that a good quality road network is essential for the development of well-functioning modern economies by reducing transport times and costs, improving safety and accessibility to rural regions.

The Bank has invested more than EUR 4.9 billion in 72 key road projects at all levels of the network to develop a more efficient network. These include construction and rehabilitation of rural roads, support of PPP revenue generating projects in the most advanced transition countries and the introduction of performance based contracts in the Western Balkans. In all of them, the Bank has ensured compliance with the strict policy and procedures on procurement, environmental and social issues. Alongside these investments, the Bank has provided assistance to strengthen the capacity of road administrations and to implement more effective arrangements for commercialisation, maintenance and other related activities.

Challenges. Institutional reform of the road sector is taking place across the region, yet a substantial transition gap remains in many countries, particularly those at the earlier stages of transition. In these countries, separation of policy and management functions (road agencies) is yet to take place or, where road agencies exist, institutional development is still required to support these agencies in performing their role. This also includes enhancing business planning and asset management capabilities in the areas of procurement and contract management expertise.

Financial sustainability must be taken into account to ensure affordability of road maintenance throughout the intended economic life of the road network. Otherwise, the initial gains in improved accessibility, affordability, and safety will gradually be lost. Financial Sustainability is partly achieved when contracting out the management of road maintenance under long term contracts, including performance-based contracts which increase private sector risk and realise cost-savings. The incorporation of the 'user pays' principles is another tool to ensure financial affordability. However, this tolling offer barriers from a technical and political perspective. More practical measures include the introduction of vignettes for heavy goods vehicles, which represent the greatest burden on road infrastructure, alongside further price discrimination for vehicle types where tolls exist.

In terms of transition, well-structured PPPs capture the benefits of private sector participation in transport infrastructure, and can demonstrate the viability of private finance within the countries and the region. Many countries in the region are therefore considering these forms of private finance for road infrastructure, however there are relatively few countries in the region with successful examples. In order to prepare and implement PPPs successfully, it is necessary that governments adopt an adequate legal and regulatory framework and appreciate the need for experienced advisors.

Despite the positive evolution during the last decade, there is still a road infrastructure deficit to address in order to facilitate regional competitiveness and economic growth. This road deficit has already been highlighted in the Global Competitiveness Report, on a scale from one to seven, the quality of road infrastructure is rated as 3.2 in the region, compared to 5.3 in Western Europe. Furthermore, the demand for transport will continue to grow with demographic and economic development, globalisation and car ownership.

However, the heightened importance of sustainable development requires the Bank to prioritise key developments aligning the investment in road development with economic efficiency, regard for the environment and social inclusion. This is ensured through the consideration of drivers such as energy efficiency and climate change adaptation, but also through the identification of road safety as a major public health issue, which affects the region as a result of the rapid rate of motorisation and road expansion.

To help realise the full potential for modern roads to contribute to more accessible and affordable transport, the EBRD will support the emergence of private road transport operators and will encourage competitive transport markets.

Operational Approach. In the most advanced transition countries, while significant transition gaps remain, much of the legal basis of the sector reform has been established, and the countries are in the process of implementation. The Bank will therefore increase its selectivity, continuing to support sovereign infrastructure investments only where a clear rationale for incremental transition can be made. The Bank will then seek opportunities to mobilise private sector capital, through structures such as PPPs, and will support governments with the necessary legislative and institutional reforms to facilitate the use of private finance, using policy dialogue and TC projects in its approach.

In the early transition countries, institutional support is still required to support the separation of policy and management functions, as well as ensuring the financial sustainability of maintenance works through the introduction of the private sector. The availability of EBRD financing will continue to be flexible to meet the circumstances of the COOs, but predicated on the firm commitment to implement institutional reforms.

The Bank will balance economic, environmental and social components to develop sustainable systems. For example, the Bank will look for opportunities to finance key projects with energy efficiency benefits and to apply energy efficient technologies where possible. Where opportunities exist, the Bank will also support the market transition of road transport operators.

Railways

Historically, railways played a central role in the region's economies, with special importance in the former Soviet Union for geographic and demographic reasons. In the last two decades, railways have made the transition from the roles mandated by a centrally planned economy to new roles which depend on market demands and management competence. However, under-investment over the transition period has caused passenger and freight demand to decline and created the need for substantial capital investment to replace and modernise infrastructure assets.

The heightened importance of sustainable development and low carbon growth strengthens the need for bridging the rail infrastructure gap.

The Bank has responded to this challenge by embarking on significant rail infrastructure and rolling stock replacement programmes. To date, the Bank has financed 62 projects for a total investment of EUR 3.4 billion to bring infrastructure and rolling stock up to international standards of safety, security and environmental compliance. The Bank's portfolio includes major rehabilitation works in the Western Balkans, promotion of key Trans-European Corridors particularly Corridors X and VIII, and, where possible, support to private schemes in the sector (e.g. a PPP scheme for refurbishment and management of rail stations in the Czech Republic). The Bank has also financed the renewal of the ageing rolling stock by state owned rail companies and private freight operators in Russia and the Ukraine.

Challenges. Across the region, the stage and pace of reform varies by country, but all share the twin objectives of increasing efficiency, thereby relieving the cost burden on the state, and improving the quality of services being offered to the market.

Where the reform process is less advanced, and ownership and operation is retained by the public sector, the challenges centre on the need to improve the efficiency of railway management and the implementation of commercially-oriented contracts based on the principles of transparency and accountability. Where infrastructure and operations remain within a single entity, mainly in the rail sector, the Bank's generally supports vertical separation to increase efficiency. By separating fixed assets for operations, for example, the possibility to implement track access regimes to new operators is made possible. This is particularly interesting because it opens up the potential to allow new suburban rail operations to be introduced as well as private freight operations, which should improve efficiencies and provide more market-responsive services.

For those countries with a more advanced restructuring model, such as the EU member states which have separated rail infrastructure and operations in compliance with European directives, the role of the Bank in the public rail domain is more limited. However, even in these advanced transition countries, the Bank may still have a role to play in promoting financial sustainability of the railway sector. The recent crisis has pointed, in some countries, to the need for further restructuring to improve the market orientation and resilience of the state rail companies, including financial and labour restructuring.

Where liberalisation of the market has started, there are also opportunities for the Bank to continue to support commercialisation and privatisation of rail subsidiaries from the state railway companies. Public Private Partnerships ("PPPs") can relieve governments of the burden of financing railways investments, speed up railway construction and introduce the modern, efficient, and cost-effective operations that are needed for railways to be competitive.

Under the focus on sustainable development, railway plays a central role to create a multimodal, environmentally friendly, efficient and safe transport system. However, developing efficient railway systems with higher modal share requires covering the rail infrastructure deficit and improving rolling stock quality. Improvements may also be achieved by promoting international rail traffic management standards, including adoption of the European Rail Traffic Management System (ERTMS).

Railways, alongside inland waterways, are the most energy efficient and least polluting land transport mode, both for passenger and freight. However, there are still significant energy efficiency opportunities in existing railway systems to ensure their long term competitiveness. The Bank will support the modernisation and introduction of cost effective technologies and strategies such as regenerative braking, power generation in terminals or integrated energy management systems.

Beyond the traditional areas of rail sector financing of infrastructure and rolling stock, there are also opportunities to increase private sector participation in a number of niche areas, such as infrastructure and rolling stock maintenance, station commercial management or rail property development, such as commercial development in rail land assets often held by state railway companies in prime locations in the centre of cities.

Operational Approach. The Bank will continue to engage in the rail sector, working across both the public and private sectors, financing infrastructure rehabilitation, upgrade or new construction, rolling stock renewal, financial and labour restructuring, as well as related investments in infrastructure and rolling stock support services, energy efficiency and station development, with an increasing emphasis on the corridor approach to Trans-European Networks, Pan-European corridors, etc.

Through its investments, the Bank will support the ongoing reforms in the region, providing a flexible approach in order to meet the circumstances of individual countries, and co-financing and cooperating with other IFIs active in the region, and with the EU where convenient.

The availability of EBRD financing for public sector projects will continue to be predicated on the firm commitment of countries to implement the necessary reforms, for which the Bank will also engage in policy dialogue (for example, assisting in the enhancement of regulatory capacity to ensure non-discriminatory access to infrastructure, which underpins the development of competitive rail services markets). Given the different circumstances, the Bank will utilise financing instruments which are appropriate for the stage of transition, such as sovereign loans for vertically integrated railways, and corporate loans for profitable rail companies or their subsidiaries.

The Bank will strive to achieve a balance between supporting public and private actors, in the rail sector too. Where markets exist, such as the rolling stock leasing markets, the Bank will continue to seek opportunities for financing private companies, to promote private ownership, product and financial innovation, and enhance competition in the market.

Alongside the public and private sector, the Bank will support its clients' efforts to incorporate suitable technologies and the implementation of best practices with regards to energy efficiency.

Air Transport

The aviation sector, which encompasses a number of sub-sectors (spanning airlines, airports and air navigation services), is increasingly important to development in all regions, as many of the economic benefits generated by air travel such as development of tourism industry, mobilisation of foreign direct investment and so on are not substitutable by other modes. Given the strategic importance of the aviation sector in the terms of mobility and economic growth, the Bank has provided more than EUR 700 million in 37 projects to increase private sector participation and the outsourcing of airport services to promote modern air navigation systems and to modernise the fleet of private air carriers. The Bank has, for example, financed the development of PPPs to develop new airports in Tirana, St Petersburg, Yerevan and Tbilisi, attracting international investors and ensuring the transfer of skills and best practice to its COOs.

Challenges. In the airport subsector, transition is advancing though progress varies widely across the region. Many airports are natural monopolies, so the private sector can play a vital role in increasing cost-effectiveness through competition for the market. To date, airports have largely been separated from airlines and established as state-owned companies, but in countries at an earlier stage of transition, further commercialisation of airports is still necessary to increase efficiency, attract additional airline traffic, and ensure financial efficiency.

A first step in the reform process of further commercialisation requires enhancing the management capacity through improved business planning, corporate governance and information systems, including for energy management and safety standards. Beyond these structures, airports present a number of support activities such as ground-handling, in-flight catering and aircraft maintenance, and commercial opportunities such as retail and car parking, which are well suited to private sector, allowing airport companies to focus on their core business, while contracting-out support and commercial activities to the private sector.

In general, there is still need for further private sector participation in the airport management through a range of different schemes and models, such as PPPs, concessions, management contracts, divestitures, which ensure competition for the market and, through strategic investors and sponsors, transfer of skills. In parallel, strong economic regulation is needed in the airport sector, and the Bank can support capacity enhancement of civil aviation regulatory authorities.

The aviation sector has come under increased scrutiny due to its environmental impact; aviation produces around 2 per cent of the world's manmade emissions of GHG (IEA 2008) and on a per passenger-kilometre basis aircraft emit roughly the same level of emissions as a small petrol car with a single passenger (DEFRA 2007). The industry's challenge is striving to reduce its GHG emissions through Low Carbon Growth: innovative technologies, rehabilitation, modernisation and capacity enhancement of airports, operations and airlines. In this context, efficient airport development must integrate land accessibility in their design.

Additionally, the Bank will continue to support efficient Air Traffic Management, which provide more efficient procedures, shorter routes and significant emissions savings. Where not yet achieved, a key transition challenge is the creation of independent Air Navigation Services Providers ("ANSPs") which are separate from government, allowing them to focus on core air traffic control tasks. Efficient ANSPs must have tariffs which allow cost recovery, be compliant with international standards and be members of international organisations, such as

EUROCONTROL. The Bank also actively supports financing that contributes to the implementation of the Single European Sky, a central element of European air transport policy to meet future safety, capacity and efficiency needs at a European rather than at a national level.
The financing of aircraft acquisition offers fewer opportunities for the Bank. This subsector is often adequately served by commercial banks and the Bank´s participation is selective in supporting private airlines or those in the process of being privatised, which present clear transition benefits, including safety and environmental benefits (e.g. efficiency improvements, energy efficiency innovations, connections to remote or less developed areas). The Bank will also consider opportunities to finance providers of auxiliary airport services, such as maintenance companies.

Operational Approach. Given the importance of air transport services for economic development, the Bank will continue to finance airport infrastructure and, should opportunities arise, consider financing associated services, such as aircraft maintenance. In the airport sector, the Bank can support competitively selected strategic sponsors and private investors in airport investments such as PPP structures. Through these deals, the Bank will request the strictest environmental appraisal and will incorporate energy efficiency technologies where possible.

The Bank will also continue to finance ANSPs, which can offer potentially significant benefits in reducing aviation emissions through the optimisation of flight paths and selectively will consider fleet modernisation and expansion

The financing of aircraft acquisition and other airline investments will continue to be supported selectively, when very strong value added to improve environmental, energy efficiency and safety standards can be demonstrated.

Maritime Sector

Maritime transport and ports are essential components of international trade and goods movement. Maritime traffic has grown sharply in the region over the past decade, particularly containerised cargo, reflecting wider economic growth. The deep sea shipping sector has tended to be served by commercial banks in the region, with the Bank focusing on the regional short sea shipping markets. However, this has change in the current economic climate with opportunities in the dry bulk deep sea market emerging in countries such as Turkey and Russia to support local shipping companies acquire energy efficient fleets. The Bank has also supported development of efficient port facilities as key multimodal nodes to facilitate logistics flows.

In these areas, the Bank´s portfolio includes 47 projects to invest EUR 0.7 billion in fleet modernisation, capacity expansion and efficient port infrastructure in the region, as well as supporting successful port privatisation, greenfield projects under concession and reform of port authorities.

Challenges. The sector has undergone significant structural changes since the transition process commenced; ownership and management of shipping companies lies largely with the private sector, but some companies remain relatively uncompetitive because of an aging fleet profile. The Bank’s role in supporting the needs of the sector through financing fleet renewal is therefore critical in promoting competition, energy efficiency and the long term viability in the sector.

Beyond fleet modernisation, inadequate business practices and poor corporate governance also restricts access to finance, and in the long term hinders their competitiveness. The regional short sea market is characterised by many small to medium size operators who are in need of financing, modern business practices, alongside technical and commercial expertise to operate more efficient and sustainable services.

Considering the port infrastructure, under-investment in the port sector over the past decade has meant capacity has failed to keep up with rising demand, resulting in bottlenecks which act as a constraint on transition and broader economic development. It is therefore necessary to invest on key safe, clean and efficient port infrastructure developments to meet the rising demand.

Besides the capacity expansion, sustainable development requires that completion of the transition reform process in the port sector is completed in order to ensure economically efficient operations. A key transition milestone, the separation of port infrastructure management from government, has largely been achieved across the region with the formation of port authorities. However, the process of restructuring, corporatisation and commercialisation of the port authorities is at varying stages across the region. The Bank supports this reform process, focusing on improving cost recovery through tariff reform, and institutional development so the port authority can effectively perform its role as the coordinator of port activities.

Once a port authority is established there are a number of different options and private structures for the organisation of port activities, and this is an opportunity for the Bank to engage in policy dialogue with governments. The most common forms are the services port, tool port and landlord port, and each offers different roles for the public and private sectors. The most prevalent mode of private participation is the landlord model. The Bank endorses this approach elsewhere in the region, given that services ports include a very limited private participation and should only be considered at an early stage of transition to gain confidence before transferring or investing in assets.

Although international maritime transport is the most energy efficient mode of mass transport, it carries 90 per cent of world trade and it is therefore a major contributor to global CO_2 emissions (2.7 per cent in 2007), among other environmental impacts. Progress has been made during the last decade to develop a more environmentally friendly sector: technologies and strategies to mitigate the environmental impact are well known, but have not been applied to the same extent everywhere because of different market failures. As maritime transport is predicted to continue growing significantly in line with world trade, it is necessary to adopt a global approach for further improvements in energy efficiency and emission reduction, as well as the strictest environmental performance. Additionally, pressure on ports to limit all sorts of pollution will increase further and this may increase the number of ports that will be forced to undertake environmental programmes and shift to a new location away from congested city areas.

Ports may raise particular concerns in relation to possible future sea level rise or storm surges. The Bank will therefore ensure that the project is climate resilient through appropriate design and operating measures.

Inland waterway transport is an under-utilised low carbon mode in the region, and therefore presents an opportunity for development. It offers a low-cost and low-emissions mode of transport, which supports cross-border trade, but it currently suffers from under-developed infrastructure, poor maintenance, absence of charging regimes, fuel subsidies favouring other transport modes and a lack of awareness. While economically viable opportunities may be limited, the Bank supports the development of inland waterways in the region where viable financing structures can be identified.

While there have been some successes, the shipbuilding sector in the region faces a contracting global market share, primarily due to weak governmental commitment to restructuring and privatising the industry, and the growth of rival facilities elsewhere in the world. Where opportunities emerge, the Bank supports the restructuring, privatisation and modernisation of state-owned shipyards, with the objective of eliminating state subsidies and enhancing competitiveness.

Operational Approach The Bank will continue supporting efficient structures in the maritime sector as the most sustainable alternative to facilitate trade and economic development. In this context, the Bank's strategy is to support projects which enhance the level of private sector participation along the spectrum of shipping, port activities and shipbuilding, and may consider investing alongside strategic partners in cases where there is a clear and acceptable exit strategy.

The Bank will also utilise debt instruments to support both new fleet and conversion and retrofitting of existing vessels of shipping and inland water operators. Alongside the investments, the Bank will support the corporate development of shipping clients, focusing on the transparency of ownership, good corporate governance and sound business practices, including the deployment of technologies and strategies to increase energy efficiency as business development drivers beyond the project-based environment and social requirements.

The Bank will continue to work in the port sector in the region, financing both public and private projects. The Bank can provide publically owned port authorities with finance for infrastructure rehabilitation and modernisation, with a focus on the commercialisation of port infrastructure, while engaging in policy dialogue with governments on the strategy to increase private sector participation. In the private sector, the Bank will utilise a range of financing instruments, including hybrid instruments and IFI cooperation, to raise the necessary amounts of finance for port privatisation and greenfield projects, often concessions, as well as modernisation and investments which bring commercial, environmental and technical best practices which are financially efficient.

While opportunities are limited, the Bank will also provide financing for inland waterway, shipbuilding and repair companies, particularly when these operations support restructuring and privatisation to improve efficiency and promote best practice.

Intermodal transport and Logistics

The world's economies are becoming increasingly interconnected. As a result, advanced logistics systems can have a significant effect on the competitiveness of enterprises and trading economies. The development of seamless intermodal systems play a key role in permitting the most appropriate mode of transport to be used for different elements of the transport chain, combining the flexibility of road operations with the linehaul efficiency of rail transport – and the ability of sea transport to move large quantities of freight over extended distances.

The logistics market in the region has grown substantially in recent years, with the need for integrated services covering multimodal transport, storage and management of freight to streamline freight movements and lower transportation costs for industry.

The Bank has been engaged in the logistics sector for several years, financing innovative private multi-modal operators in the larger markets of Russia and Turkey to expand and modernise their fleet, as well as developing warehousing facilities in Serbia, to name a few examples. Under this strategy, the Bank will enhance its support to the logistics sector across the region.

Challenges. The benefits of a well-planned intermodal system which facilitates the use of several modes are seen in various stages of the supply chain. In general, intermodal strategies make the transport sector more efficient and reliable, they reduce the transport costs and increase competitiveness of regional markets. Growth in the logistics sector is therefore closely linked to the development of intermodal nodes on the network, the most important being seaports and logistic platforms, and integration of these nodes into road and rail networks.

The region has a relatively under-developed intermodal nodes network: the World Bank's Logistics Performance Index (2012 Update), which has systematically ranked 156 countries since 2007 across a range of criteria measuring the quality and quantity of factors affecting logistics efficiency, shows that the countries of the EBRD region still lag behind global competitors. Improved logistics performance is highly correlated with trade expansion, export-led growth, attractiveness of FDI, all of which contribute to overall economic growth. For the 2012 LPI, only five countries in the EBRD region rank in the top 40 worldwide (Turkey at number 27, followed by Poland at 30, Slovenia 34, Bulgaria at 36, and Hungary at 40), with Ukraine (66), Kazakhstan (86) and Russia (98) ranking in the bottom half worldwide. Therefore there is significant development potential.

The Bank has the opportunity to support the development of this new market in the region. This is not constrained to third party logistics providers, integrated logistics operators such as courier companies which carry out the full cycle including transportation, storage, inventory, packaging etc., but also second-party logistics providers, carriers and storage providers, which own transport and storage assets such as road haulage operators, and first-party logistics providers, senders and receivers of cargo. The Bank will therefore support private operators, thereby increasing competition and promoting more widespread private ownership in the freight transport sector.

Like all modes of freight transport in the region, road haulage was greatly impacted by the financial crisis and ensuing economic downturn, volumes are now increasing as economies in the region stabilise or return to growth. The long term trend for road freight however is steady growth As economies prosper and become more consumer-oriented, the demand for road freight increases.

Multimodal transport and the logistics industry that normally arranges it sometimes suffer from a lack of policy attention, because each of the modes involved is the responsibility of a different agency. There is need of encouraging both the necessary investments, trade facilitation measures and regulatory changes to set forward the path for freight logistics innovation in the region and much-needed freight transport services and specialisation. This includes policy dialogue on free-trade zones around ports or inland transportation hubs, coordination of rail and sea tariffs, and investment planning to support networks which efficiently integrate the individual modes.

Development of integrated networks and logistics operators sets out the basis of the sustainable development: the benefits extend beyond transport efficiency to environmental respect, safer operations and social inclusion, where networks capitalise on the benefits of individual modes to reduce distances travelled and thereby reduce transport costs, times and emissions.

Operational Approach. The Bank supports the integration and optimisation of freight networks services, where the relative strengths of each mode are exploited, in order to streamline operations, reduce fuel costs and emissions, and improve the quality of service offered to the market.

The Bank will continue to seek opportunities to finance the intermodal and logistics sector with an emphasis on private sector projects. Under this Strategy, the Bank will enhance its support to the logistics subsector across the region, including the development of associated infrastructure such as intermodal terminals and warehousing facilities, but also fleet modernisation to operate competitive, cost-efficient and flexible transport services at several levels, from international shippers to post services or road haulage operators, which are able to adapt to the needs of industry.

The Bank will consider opportunities to finance the public postal services companies, where there is a clear commitment to implement reforms from the government. With a few exceptions, public postal services are loss-making across the region, with significant and complex restructuring and reforms required. Where opportunities emerge, the Bank will support the private postal services market, such as parcel delivery companies.

Improving logistics has the potential to lower energy consumption through optimised networks, but the Bank's efforts will go beyond this to support the adoption of international energy efficiency standards for operations, fleet and buildings. The Bank will therefore seek opportunities to finance investments to improve the energy efficiency of road freight services, through lower emission trucks, and more efficient infrastructure.

In parallel the Bank will engage the governments of the region in policy dialogue on development the investment climate to support growth in the sector, including development of regional intermodal systems and nodes, integrated planning and the use of intelligent technologies through policy dialogue.

Annex F - World Bank Logistics Performance Index ("LPI")

2012 Update - Extract

LPI Rank	Country	LPI Score	Customs	Infrastructure	International shipments	Logistics competence	Tracking & tracing	Timeliness
30	Poland	3.43	3.3	3.1	3.47	3.3	3.32	4.04
34	Slovenia	3.29	3.05	3.24	3.34	3.25	3.2	3.6
36	Bulgaria	3.21	2.97	3.2	3.25	3.1	3.16	3.56
40	Hungary	3.17	2.82	3.14	2.99	3.18	3.52	3.41
41	Tunisia	3.17	3.12	2.88	2.88	3.12	3.25	3.75
42	Croatia	3.16	3.06	3.35	2.95	2.92	3.2	3.54
44	Czech Republic	3.14	2.95	2.96	3.01	3.34	3.17	3.4
50	Morocco	3.03	2.64	3.14	3.01	2.89	3.01	3.51
51	Slovak Republic	3.03	2.88	2.99	2.84	3.07	2.84	3.57
54	Romania	3	2.65	2.51	2.99	2.83	3.1	3.82
55	Bosnia and Herzegovina	2.99	2.65	2.86	3	2.93	2.81	3.61
57	Egypt, Arab Rep.	2.98	2.6	3.07	3	2.95	2.86	3.39
58	Lithuania	2.95	2.73	2.58	2.97	2.91	2.73	3.7
65	Estonia	2.86	2.51	2.79	2.82	2.82	3	3.23
66	Ukraine	2.85	2.41	2.69	2.72	2.85	3.15	3.31
75	Serbia	2.8	2.39	2.62	2.76	2.8	3.07	3.14
76	Latvia	2.78	2.71	2.52	2.72	2.64	2.97	3.08
77	Georgia	2.77	2.9	2.85	2.68	2.78	2.59	2.86
78	Albania	2.77	2.43	2.43	2.84	2.65	2.65	3.58
86	Kazakhstan	2.69	2.58	2.6	2.67	2.75	2.83	2.73
91	Belarus	2.61	2.24	2.78	2.58	2.65	2.58	2.87
95	Russian Federation	2.58	2.04	2.45	2.59	2.65	2.76	3.02
99	Macedonia, FYR	2.56	2.24	2.6	2.66	2.66	2.41	2.79
100	Armenia	2.56	2.27	2.38	2.65	2.4	2.57	3.07
116	Azerbaijan	2.48	1.92	2.42	2.43	2.14	2.75	3.23
117	Uzbekistan	2.46	2.25	2.25	2.38	2.39	2.53	2.96
120	Montenegro	2.45	2.31	2.3	2.22	2.35	2.62	2.89
130	Kyrgyz Republic	2.35	2.45	2.49	2	2.25	2.31	2.69
132	Moldova	2.33	2.17	2.44	2.08	2.15	2.44	2.74
136	Tajikistan	2.28	2.43	2.03	2.33	2.22	2.13	2.51
140	Mongolia	2.25	1.98	2.22	2.13	1.88	2.29	2.99

The overall score of the Logistics Performance Index reflects the perception of a country's logistics services based on the efficiency of the customs clearance process, the quality of trade-and transport-related infrastructure, the ease of arranging competitively priced shipments, the quality of logistics services, the ability to track and trace consignments, and the frequency with which shipments reach the consignee within the scheduled time. The index ranges from 1 to 5, with a higher score representing better performance. Data are from Logistics Performance Index surveys conducted by the World Bank in partnership with academic and international institutions and private companies and individuals engaged in international logistics. Respondents evaluate eight markets on six core dimensions on a scale from 1 (worst) to 5 (best). The markets are chosen based on the most important export and import markets of the respondent's country, random selection, and, for landlocked countries, neighbouring countries that connect them with international markets. Scores for the six areas are averaged across all respondents and aggregated into a single score using principal components analysis. Details of the survey methodology and index construction methodology are in Arvis and others' Connecting to Compete 2010: Trade Logistics in the Global Economy (2010).

Annex G - Geographical Approach

SEMED. The Bank is commencing operations in four countries in the SEMED region – Egypt, Morocco, Jordan and Tunisia. This is a diverse group of countries, in terms of population, industry, economic situation and many other factors. However in the transport sector, these countries share certain characteristics. Generally the sector remains dominated by state-owned companies, particularly in the road and rail sectors, where infrastructure and operations remain integrated. Port and aviation infrastructure sectors have private sector participation to varying degrees. For example, the port sectors of Morocco and Tunisia are open to competition, with concessions awarded for terminal construction and operation, and Enfidha Airport in Tunisia is one of the few examples of a PPP in the aviation sector. The private transport services market is fragmented, with typically small road haulage companies, national bus operators, logistics companies and shipping lines. These countries also typically lack independent regulation of the transport sector.

From this perspective, the transition challenges in SEMED are similar to those of the Bank's traditional region – a need to deepen private sector participation in infrastructure, develop competitive markets for transport services, and support institutional development and commercialisation. Alongside transition challenges, the SEMED countries face significant issues relating to the economic participation of the younger demographic. The Middle East and North Africa (MENA), which includes all the SEMED countries, has the highest rate of youth unemployment in the world (World Bank MENA Regional Strategy 2011).

The transport strategy for SEMED will promote private-sector led growth where possible, through private sector participation and market development, as well as supporting social inclusion. For transport infrastructure projects, the Bank's preferred type of financing is on a non-sovereign basis, whether through commercial loans to SOEs or concession structures such as PPPs. However, selective sovereign financing may be appropriate to further the Bank's transition mandate and address funding gaps given the prevalence of the state in the transport sector. The private sector preference reflects both the Bank's overall approach in the SEMED region and the scarcity of public funding for infrastructure in the SEMED countries. The Bank will seek opportunities to work alongside its IFI partners in the region, in order to leverage the funding, benefits and experience of each IFI, and coordinate on key sector reform issues.

Central Europe and Baltic States (including Croatia). Compared to the region as a whole, transport networks are more developed, and transition gaps overall generally smaller, in these countries which are the most advanced in the transition process. However, many of these countries still retain 'medium' transition challenges in the transport sector compared to the 'small' challenges seen in many other sectors of the economy, demonstrating the complexity and persistence of the transition process in the transport sector. There may also be variations by sector, with significant challenges remaining particularly in the railway sector in this region.

The Bank's approach will be to target its resources on private sector projects, including PPPs and concessions in the road, port and airport sectors, which often have high capital costs that the market cannot finance fully. Participation of the Bank will depend on market conditions, but is expected to be required in the coming strategy period to finance PPPs and concessions in this region. The Bank is also following the progress of these countries in achieving longer term reform objectives in the rail sector, which envisages full or partial privatisation most commonly of the state freight operator. Should opportunities arise, the Bank will consider financing privatisation of rail operators in this region. It may also consider providing selective sovereign support based on a substantial programme of reform aimed at achieving financial sustainability of the railway network.

The Bank has a built a significant portfolio in the transport sector in Croatia, financing a broad range of projects, particularly in roads, ports and air navigation services. With EU membership expected in 2013, the Bank's sovereign operations in Croatia are expected to reduce as other sources of EU funding become available. The Bank will continue selectively to provide sovereign financing, for example supporting the remaining rail reform measures, however the emphasis will shift towards to private sector operations in line with rest of the region.

South-Eastern Europe. Despite substantial investment in transport infrastructure in the past decade, a significant infrastructure deficit remains in the countries of South Eastern Europe. Much of the investment to date has focused on the key European road and rail corridors as well as nodes (railways, ports and airports) and the focus is expanding to regional transport. Low carbon transport is moving up the policy agenda of these countries, in line with the need for harmonisation with EU standards and directives, with increased emphasis on rail and inland waterway transport, although investment in the latter to date has been limited, and local and regional roads.

In the non-EU Member States, while significant transition gaps remain, much of the legal basis of the sector reform programmes has been established, and the countries are in the process of implementing the required institutional changes. The Bank will increase its selectivity, continuing to support sovereign infrastructure investments only where there is a clear transition rationale or a strong focus on energy efficiency. The Bank will also continue to co-finance with other IFIs, particularly the EIB and to a lesser degree with EU-IPA funds, and will coordinate with the EU's South Eastern Europe Transport Observatory ("SEETO").

To support preparation and implementation of public sector projects, and sector reforms, the Bank will continue to utilise TC funds, particularly through the Western Balkans Investment Framework ("WBIF") for eligible countries and bi-lateral funds.

In Romania and Bulgaria, which although EU Member States, face significant challenges to achieve financial sustainability in the railway sector, the Bank may consider sovereign-based financing which supports major restructuring of rail companies in poor financial condition.

The region has made limited progress with concessions, with few examples of successfully executed PPPs. However, governments are keen to utilise this form of financing to reduce government debt, particularly in the prevailing economic climate. The Bank will seek opportunities for private sector projects in this region, including PPPs and privatisation projects, financing transport services providers, and non-sovereign projects with SOEs structured on a

commercial basis. Where possible, the Bank will work with strategic investors to introduce best practice technical, financial and operational standards in transport services.
The Bank will also seek opportunities to support the transport services market, such as logistics, which is highly fragmented due to the small market size of individual countries in this region.

Turkey. The engagement of the EBRD in Turkey's transport sector, since the commencement of operations in 2010, has focused on the private sector. The transport market in Turkey is large and relatively developed. The government has ambitious plans for new road and high speed rail links, airport and port developments, as well as logistics centres, much of which can be financed by the private sector directly or under PPP schemes.

Turkey is able to access substantial funding from multilateral, bilateral, and commercial sources both local and international. The Bank will therefore focus on projects where it is additional and can promote transition. This includes large infrastructure PPPs in the roads and airport sectors, which cannot be financed entirely by the market and require participation of the IFIs active in the country. The Bank has a key role to play in supporting the adoption of international standards for PPPs in Turkey, which have yet to be rolled out successfully in all sectors. The Bank may provide selective sovereign support for restructuring of the railway sector, alongside other IFIs, provided that a substantial programme of reform is put in place.

The Bank will also build on its early successes in the Turkey, by focusing on intermodal, logistics and shipping, expanding the market, and supporting energy efficiency through replacement of older assets. The port sector also presents opportunities for EBRD financing of expansion of recently privatised ports, with potential concession with ports which currently remain under ownership of the state and private port development.

Eastern Europe and the Caucasus. This is a diverse part of the region where the Bank is facing specific issues in each country, although in general these countries have transport infrastructure which urgently needs rehabilitation and modernisation, and under-developed transport service markets. Significant challenges exist in Moldova, both in terms of the large infrastructure deficit and the early stage of transition. The Bank will finance sovereign infrastructure projects that support key sector reforms. The policy dialogue in Moldova will focus on institutional reform and commercialisation across all modes, with a view to increasing private sector participation where feasible.

In Belarus, where a 'calibrated' country strategy is currently in place, the Bank will focus on private sector projects, and for transport infrastructure projects where it will support bi-lateral assistance to the government to develop PPPs.

The Bank's operations in Ukraine are subject to a higher level of selectivity currently due to the Bank's level of exposure to Ukraine. In the short term, the Bank will limit engagement in large sovereign transactions, and generally apply a higher degree of selectivity for projects based on transition impact potential, additionality and sound banking. There are many challenges in the transport sector which the EBRD can address through sovereign and non-sovereign projects with state-owned entities and private sector projects, including regulatory reform, rail restructuring, private rail market development, expansion of the intermodal and logistics sectors, modernisation of port and airports, and energy efficiency improvements. The extent to which

the Bank can address these challenges will be depend on the government's commitment to reform.
In the Caucasus, the Bank will aim to increase its support for non-sovereign projects with SOEs, and to develop private sector projects, alongside supporting market reforms through sovereign projects. In general, across Eastern Europe and the Caucasus, the Bank will use TC projects to support implementation of infrastructure projects and targeted areas of reform.

Russia. The Bank's operations in Russia are also subject to a higher level of selectivity currently due to the Bank's level of exposure to Russia. The Russian market is the largest in the EBRD region, and the Bank has been involved in key transition developments in the transport sector, including reform of the rail sector, development of the private freight operator market, and institutional development of the state port authority. The Bank has played and continues to play a leading role in the preparation of concessions in the aviation and road sectors in Russia. In response to the financial crisis, the Bank also supported both operators and infrastructure providers which suffered from limited access to funding, by assisting in balance sheet restructuring and financing key investments.

The transport investment needs in Russia remain vast, given the scale of the country and the need to modernise infrastructure and further develop market-responsive transport services. The Russian transport strategy, which extends until 2030, envisages a shift from modernisation to development over the next three to four years. The expansion of the network covers all modes, including an emphasis on investments to support increasing trade and transit, such as intermodal facilities and international corridors.

The Bank will support the development of the transport services market, by financing private sector operators, including rail freight and multimodal operators, leasing companies, shipping lines and road freight companies. When supporting these companies in replacing or expanding their fleets, the Bank will seek to finance assets with improved energy efficiency as well as the adoption of standards which lower energy consumption from operations. The Bank will also seek opportunities to finance private providers of infrastructure, such as intermodal and logistics facilities, or privately owned industrial rail lines.

The Bank will support infrastructure investments with financially sustainable state-owned entities which are committed to restructuring and commercialisation of their activities. Infrastructure priorities will be sought, where the investments unlock and induce demand, alongside projects which improve the quality of transport services. The Bank will continue to support commercialisation of subsidiary companies within the state-owned, Russian Railways Group, supporting the privatisation process of such companies. The Bank will continue to support infrastructure projects which utilise private sources of capital, such as concessions in the road, aviation and port sectors.

Kazakhstan. The cost of transportation in Kazakhstan, as is the case across Central Asia, is relatively high which affects the competitiveness of goods. The Bank will continue to finance the investment programmes of the national railway company and its subsidiaries on a non-sovereign basis to improve infrastructure and services and support further restructuring of the rail sector. The Bank will also consider selective investment in the rehabilitation and development of key regional road corridors on a sovereign basis, where these projects support further reforms in the sector. Opportunities in other modes will be more limited, including aviation, ports, shipping and logistics, and the Bank will seek opportunities to support reform-oriented state-owned companies and reputable private sector companies, alongside engaging with the government on the development of PPPs.

Central Asia ETCs. The ETC countries in Central Asia represent the largest transition challenge in the region, with reforms at an early stage in the transport sector. The transport networks are in generally poor condition, restricting access for rural communities and resulting in high transportation costs for the economy. In these countries, the Bank's approach is to finance infrastructure projects and support fundamental sector reforms. In the road sector, the Bank will focus on increasing funding for maintenance, creation and institutional strengthening of road agencies, and supporting the development of a private road maintenance market. For railways, the core objective is institutional reform and commercialisation to improve efficiency and financial sustainability. The Bank will also seeks opportunities to finance other modes, including in the ports and aviation sectors in order to raise the quality of infrastructure and services and support market reforms.

It is anticipated that the Bank will finance sovereign transactions in the Central Asian ETC countries, as few state-owned entities are sufficiently creditworthy independently to support debt, and there is a very limited private sector. There may be opportunities to finance the port and aviation sectors on a commercial basis through non-sovereign loans to SOEs, which the Bank will support. Due to concessionality requirements, the Bank will co-finance its sovereign projects in this region with sources of grant finance, including from other IFIs and bilateral sources.