

The World Bank

The Organization for Economic Co-operation and Development (OECD)

The Bank-Netherlands Water Partnership

MARKET DEVELOPMENT STUDY

Strategies for Domestic Inputs

in the

Water Utility Management Markets

of

Eastern-Central Europe and Central Asia

Стратегии участия частного сектора
в управлении предприятиями ВКХ
в странах Центральной и Восточной Европы
и Средней Азии

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EXECUTIVE SUMMARY (Draft Version: pre workshop)

1.0 Introduction

This market development study evaluates the opportunities for greater domestic inputs in community water services, especially through public-private-partnerships, of the Eastern-Central Europe and Central Asia (ECA) region.

While the people of the ECA region have undergone dramatic political, economic and social changes during the last 15 years, this has not yet translated into universally effective and efficient water services. Despite continued local, national and international efforts, many millions of residents, especially in rural and poor areas, remain without hygienic or reliable water supply and sanitation. This is incompatible with commitments to meet the millennium development goals and diminishes efforts for greater democratisation, economic recovery and standards-of-living.

This study is based on “grass-roots” inputs, with 65 ECA respondents (35 experts and 30 participants) to a market survey on the community water services markets in their respective communities and countries. Two case studies of private ECA companies engaged in water utility management (only one complete to date) calibrate and provide a more detailed evaluation of the ECA wide results. With these valuable insights, a study team for the Organization for Economic Cooperation and Development and the World Bank, with funding from the Bank Netherlands Water Partnership, report on key market deficiencies and, accordingly, present strategies for domestic solutions towards better water utility management for the people of the ECA region.

The overall goal is to evaluate the potential for improvements in water utility management through greater domestic inputs of expertise and capital, and how this potential can be realized within the ECA region. A complementary study assesses the potential for greater “international” inputs, including in public-private-partnership models, in the ECA water utility management markets.

2.0 Market Setting

The ECA region covers an immense area with great diversity in geography, cultures, religions and societies, and with 500 million inhabitants. While the future political-economic prospects differ in each country, most of the 29 ECA countries have not yet resumed previous levels of economic activity or standards-of-living.

Starting with the fall of the “iron curtain”, the ECA region continues to be in the midst of a significant socio – political - economic transition with repercussions at the local, regional and global levels. The business setting continues to develop in parallel with the ongoing governmental and institutional reforms and can, in some circumstances, be unpredictable or even unstable. However, reform and stability is possible, as demonstrated by the 8 ECA countries which joined the European Union in 2004.

3.0 Water & Wastewater Market Overview

A clear need prevails in many communities of the ECA region for **improved water utility management capacities** and **increased investments** to attain universal and reliable coverage (about 80% of ECA residents connected to piped water supply and about 40% connected to sewage evacuation systems). Many water utilities and their respective communities are caught in a self-perpetuating “unsustainable cycle”, characterized by ineffective service, insufficient revenues and, as a result, inadequate investments for system maintenance, upgrade or expansion.

The private sector, both international and domestic, are seen as potential instruments for improvements through greater application of expertise and capital. Yet, the domestic inputs to date have been minimal, e.g. about 8% of water services market in Russia, and international inputs appear stable in a tentative market.

The ECA region represents a potential marketplace of about 570 million equivalent inhabitants, including commercial and industrial activities, with a revenue potential grossly estimated at **US\$ 30 billion per year** (perhaps a fourfold increase over current levels). The World Bank estimates investments totalling US\$ 100 billion are necessary for water & sanitation infrastructure over the next 10 years in the ECA region. Yet, local revenue sources are often inadequate and the local finance sectors are generally not developed or focused on water sector lending.

4. Domestic Perspectives

The questionnaire respondents send clear messages regarding **eight key limitations** to domestic inputs (or lack thereof) in the ECA water utility management markets.

Country Setting	Continuing transitions in the political, economic and social systems renders many parts of ECA as unstable business environments, with excessive “non-project” risk
Water Sector	Adaptation from previous regimes to newly independent states has resulted in vague legislation and limited ministry capacities.
Market Structures	Many ECA markets are entrenched in the traditional “water utility” model without accurate knowledge, legal basis or mechanisms to consider alternative solutions, ala mobilization of the private sector.
Domestic Market	Market attractiveness is reduced by the limited size, profitability and local “willingness” towards efficient water services
Procurement	Markets have an image of being biased to established, large and/or international companies. Pre-qualification and bidding procedures are not viewed as open or transparent.
Execution	Projects are often unviable due to unrealistic performance standards
Domestic Expertise	Domestic companies offer expertise in some key technical and administrative areas, but not in management and operations; they prefer only low-level PPP inputs over the short-term.
Domestic Capital	Domestic companies are not capable of private investments over the short- to medium-term.

“Experts” (water sector ministries, utility owners & professional associations) are more optimistic about the capabilities of domestic companies and more enthusiastic about the short-term prospects for PPP than “participants” (utilities and private companies).

Overall, domestic companies report caution about future PPP inputs, with a positive consensus formed only regarding service contracts. Yet, various company types are more optimistic – witness all operators and two-thirds of consultants are eager to secure service contracts (as opposed to only one-third of public utilities). Utilities and consultants are wary of high-level PPP, but operators are clearly keen for all PPP forms, except divestiture.

The more impoverished ECA regions especially the Balkans, followed by the CIS and EU Candidate states, present more limitations than the EU states. But companies from EU candidate states are more enthusiastic than other ECA areas with over 70% keen for management and BOT contracts.

International market participants generally echo the key limitations of the ECA water markets. Some domestic company strengths, such as market familiarity, lower price structures and expertise in specific technical & administrative matters, may present opportunities for complementary cooperation with international companies

5. Case Studies

The Case Study in Piaseczno, Poland presents a long-term example of a private operator engaged in a service contract forged with the Municipality at the onset of the transitional period (1993) and continuing for 10 years, before being upgraded to a 10-year “lease” in 2003.

In response to the transfer of assets to the municipal level across Poland, the Municipality took advantage of the flexibility in the Polish legislative regime to outsource operations, rather than form a new utility. While project preparation, procurement, transparency and risk allocation do not approach standard IFI practices, the local parties appear to have had neither the capacity nor the resources to proceed according to “best practices” during a period of high volatility and uncertainty in the water sector.

Key factors are the generally flexible and solution oriented approach of the public and private participants during a volatile period; risk allocation and transfer of responsibility to the private partner have improved over time. However, more attention to open and transparent procurement is now necessary to meet EU standards.

A suitable second case study (ideally in a less prosperous part of ECA – *suggestions please!*) has not yet been identified.

6. Market Development Opportunities

With the input from domestic market respondents, the study team developed market “opening” strategies aimed at, on the demand side, eliminating barriers to domestic participation, and, on the supply side, fostering the capacities of the domestic pool.

No Action	No significant change is likely in the water markets with the current levels of inputs.
Sound Business Setting	Further attention to country/ regional factors (democratisation, economic development, ethics/ corruption, etc.) are key to establish a suitable business environment. Risk guarantees are necessary to cover non-project risk for a more attractive market in the short-term.
Flexible Market Structures	Creation of water markets “open” to both public and private inputs requires an some key reforms, which may include: <ul style="list-style-type: none"> • A national PPP committee & clearing house • Informational campaign/ PPP demonstration projects • Legislative reforms • Stakeholder contracts (performance standards, referendums) • Focus on core activities
Procurement	Creating an “attractive” market may involve: <ul style="list-style-type: none"> • Establish rules of engagement with 3rd party enforcement • Ensure open bidding with pre-qualification • Adjust pre-qualification criteria to address perceived biases • Adopt more qualitative bidding (eliminate “low bid” wins)
Project Execution	A more attractive market includes viable projects: <ul style="list-style-type: none"> • Realistic contracts and performance standards • 3rd party involved as “honest broker”
Market Sphere	A key to greater domestic inputs is an extension of the market sphere: <ul style="list-style-type: none"> • Service area groupings: urban-rural, affluent-poor • Finance instruments focused on poor and rural areas/ utilities
Grow Domestic Expertise	To develop further domestic companies require more experience: <ul style="list-style-type: none"> • PPP exploratory and transitional period • Projects matching domestic company strengths and size • Service provider groupings (public-private, domestic-foreign)
Build Domestic Financing	Development of capacity for private capital is a long-term process: <ul style="list-style-type: none"> • Incorporate – develop the local banking sector • Local incentives through matching funds by third parties (IFIs) • Investment guarantees to safeguard private capital

7. Conclusions

The key messages from within ECA regarding the possibility of greater domestic inputs for water utility management are:

Market Deficiencies

1. The **need for improved community water services** persists in the ECA region, more urgently in the rural and poor areas, especially in impoverished countries.
2. **Market limitations persist at the national, sector and local levels** and act to dissuade greater participation by domestic companies. Barriers tend to present the greatest obstacles to market entry in the poorer ECA countries.
3. Domestic companies currently have **modest levels of experience and expertise**, but are confident of their ability to perform in service and management contracts.
4. Domestic companies provide **no short- or medium-term capacity for capital infusion** into the market.

Market Strategies

5. Strategies are available to eliminate or decrease barriers and **create a more attractive and accessible market** to domestic companies.
6. Options exist to create more market opportunities and, thereby, **grow domestic company capacities in water utility management** towards greater levels of private sector responsibility.
7. Measures exist to gradually **grow the local finance market** and to develop, over the long-term, capital inputs by local companies.
8. **Complementary strategies**, mobilizing both domestic and international inputs of expertise and capital, may offer the best hope for water service improvements to the entire ECA region.

8. Recommendations: Strategic Action Plan

To foster more accessible, transparent, effective and efficient water utility management markets in ECA, **five key action measures** are recommended for consideration by local, national and international entities, as they develop water service initiatives in specific ECA communities and countries:

1. Support country efforts to foster a stable and predictable business setting
2. Undertake reforms, spearheaded by a national committee, for a more attractive and accessible water market, open to public and private mechanisms for water utility management,
3. Expand the domestic market sphere
4. Develop the capacities of domestic companies for expertise (short- to medium-term) and capital inputs (long-term)
5. Promote greater synergies between all market segments and participants: national and international, public and private.

КРАТКИЙ ОБЗОР (Проект для обсуждения на семинаре)

1. Введение

Целью настоящего исследования развития рынка услуг коммунального водоснабжения и канализации в странах Восточной и Центральной Европы и Центральной Азии (ЕЦА) является оценка перспектив более существенного вклада в развитие отрасли местных компаний и организаций, особенно путем создания партнерств между государственным и частным сектором.

В течение последних 15 лет страны и народы ЕЦА пережили глубокие изменения в политической, экономической и социальной сферах. Однако эти изменения до сих пор не привели к созданию в регионе в полной мере эффективного водохозяйственного сектора. Несмотря на продолжающиеся усилия, предпринимаемые на местном, национальном и международном уровнях, многие миллионы людей, особенно в сельской местности и бедных районах, по-прежнему остаются без надежной или удовлетворительной с точки зрения гигиены системы водоснабжения и канализации. Такое положение вещей противоречит заявленным целям развития тысячелетия и затрудняет продвижение в направлении большей демократизации, экономического подъема и повышения уровня жизни.

Настоящее исследование основано на данных, полученных на «низовом» уровне, в том числе на ответах, полученных от 65 респондентов в странах ЕЦА (35 экспертов и 30 участников) во время проведения опроса, посвященного функционированию рынка водохозяйственных услуг в соответствующих странах и населенных пунктах. Помимо этого, были изучены конкретные примеры деятельности двух частных компаний в странах ЕЦА, занимающихся водоснабжением (к настоящему моменту это исследование закончено лишь в отношении одной из них), что также позволяет сделать более подробный анализ общих результатов по региону. В результате были получены очень ценные данные, и на их основе группа экспертов, работающих для Организации экономического сотрудничества и развития и Всемирного банка, с финансовым участием Водного партнерства Всемирного банка и правительства Нидерландов, подготовила доклад о ключевых факторах, препятствующих развитию рынка. Этот документ также содержит описание стратегий совершенствования услуг по водоснабжению и водоотведению для населения стран ЕЦА, основанных на внутренних ресурсах.

2. Экономические условия

Регион ЕЦА представляет собой огромную территорию с 500-миллионным населением. Он характеризуется большим географическим, культурным, религиозным и общественным разнообразием. Притом, что конкретные страны региона имеют разные политико-экономические перспективы, можно сказать, что большинству из 29 стран ЕЦА еще не удалось достичь прежнего уровня экономической активности или уровня жизни.

В период, начавшийся с падения «железного занавеса», страны региона продолжают переживать процесс серьезнейших социальных, политических и экономических изменений, последствия которых ощущаются не только на местном или региональном, но также и на глобальном уровне. Экономические условия продолжают развиваться параллельно с непрекращающимися правительственными и институциональными реформами, и при некоторых обстоятельствах это развитие может оказаться непредсказуемым или даже нестабильным. Тем не менее, проведение успешных реформ и обеспечение стабильности возможны, что подтверждается примером восьми стран ЕЦА, принятых в 2004 году в члены Европейского Союза.

3. Обзор рынка услуг в области водоснабжения и канализации

Во многих населенных пунктах в странах ЕЦА налицо очевидная необходимость в **укреплении потенциала управления предприятиями водного хозяйства и увеличении объема инвестиций**, которые позволят добиться того, чтобы все население этих стран смогло пользоваться надежной системой водоснабжения (в настоящее время только 80% жителей стран ЕЦА имеют дома водопровод и около 40% могут пользоваться канализацией). Многие предприятия водоснабжения и водоотведения и обслуживаемые ими населенные пункты оказались в своеобразном замкнутом «цикле неустойчивости», который характеризуется неэффективной работой коммунальных предприятий, низкой прибылью и, как следствие, недостатком инвестиций, направленных на поддержание системы коммунального хозяйства, ее модернизацию или расширение.

Считается, что участие частных компаний, местных и иностранных, способно привести к существенному улучшению существующего положения дел, в первую очередь за счет привлечения капитала и использования своих знаний, опыта и подходов. Тем не менее, вклад местных компаний в развитие водохозяйственного сектора до настоящего времени остается минимальным - так, в России они предоставляют услуги водоснабжения и водоотведения лишь примерно 8% городского населения. Что касается деятельности иностранных компаний, то на «пробных» рынках она представляется стабильной.

Водохозяйственный сектор региона ЕЦА представляет собой достаточно емкий рынок, эквивалентный 570-миллионному населению, включая коммерческую и промышленную деятельность, с потенциалом роста до примерно **30 миллиардов долларов США в год** (что в три-четыре раза превышает нынешний уровень). По оценке Всемирного банка, в ближайшие 10 лет совокупные инвестиции в инфраструктуру водоснабжения и канализации в регионе ЕЦА должны составить около 100 миллиардов долларов США, однако местные источники доходов часто оказываются недостаточными, а местные финансовые институты, как правило, еще слабо развиты, либо мало занимаются кредитованием водохозяйственного сектора.

4. Перспективы участия отечественных компаний

Информация, полученная в результате опроса респондентов, четко указывает на восемь ключевых факторов, объясняющих недостаточность или отсутствие вклада местных компаний в развитие рынка водоснабжения в странах ЕЦА.

Общэкономические условия	Из-за продолжающихся изменений в политической, экономической и социальной системах во многих частях региона ЕЦА сохраняются нестабильные условия хозяйственной деятельности и чрезмерные «внепроектные» риски
Водохозяйственный сектор	Недоработанное законодательство и ограниченный потенциал министерств являются результатом перехода от прежних режимов к новым независимым государствам.
Рыночные структуры	На многих рынках ЕЦА прочно укоренилась традиционная «коммунальная» модель хозяйствования; там не хватает знаний, правовых условий и практических механизмов, которые сделали бы возможной реализацию альтернативных решений, например, привлечение частного сектора.
Внутренние рынки	На привлекательность внутренних рынков негативно влияют их ограниченные размеры и доходность, а также существующее на местном уровне нежелание повышать эффективность водохозяйственного сектора.
Распределение контрактов	Широко распространено мнение о том, что местные рынки тяготеют к привлечению уже существующих крупных и/или иностранных компаний. Считается, что отборочные критерии и процедура проведения конкурсов не являются открытыми или прозрачными.
Реализация	Реализуемые проекты часто оказываются нежизнеспособными в виду нереалистичных показателей эффективности.
Квалификация на местном уровне	Местные компании способны обеспечить достаточный уровень квалификации в некоторых ключевых технических и административных вопросах, но не в вопросах управления и эксплуатационной деятельности.
Местный капитал	Отечественные компании не способны обеспечить инвестиции, за исключением кратко- и среднесрочных.

“Эксперты” (представители министерств, отвечающих за водоснабжение и водоотведение, владельцы предприятий водоснабжения и представители отраслевых ассоциаций) более оптимистично относятся к потенциалу местных компаний и гораздо более высоко оценивают краткосрочные перспективы партнерства государственных и частных компаний, нежели «участники» (представители коммунальных предприятий и частных компаний).

В целом, местные компании проявляют осторожность в оценке перспектив партнерства государственного и частного секторов. Положительно оцениваются только перспективы, касающиеся контрактов на оказание услуг. С другой стороны,

другие компании проявляют гораздо больше оптимизма – так все операторы и две трети консалтинговых компаний хотели бы получить контракты на оказание услуг (среди государственных коммунальных предприятий таких только одна треть). Коммунальные предприятия и консалтинговые компании с осторожностью относятся к слишком глубокому партнерству государственного и частного секторов, но операторы приветствуют любые формы такого партнерства, за исключением отчуждения собственности.

В наиболее бедных регионах ЕЦА, в первую очередь на Балканах, и в меньшей степени в странах СНГ и государствах-кандидатах в члены ЕС, ограничивающих факторов больше, чем в странах ЕС. Тем не менее, компании в государствах-кандидатах в члены ЕС проявляют гораздо больше энтузиазма, чем в остальных регионах ЕЦА – более 70% положительно относятся к контрактам на управление и контрактам типа BOT (строительство-эксплуатация-передача).

Иностранные участники рынка, как правило, осознают ключевые ограничивающие факторы, существующие в водохозяйственном секторе стран ЕЦА. Некоторые сильные стороны местных компаний, такие как знание рынка, более низкие цены и знакомство с конкретными техническими и административными вопросами, создают возможности для взаимодополняющего сотрудничества с иностранными компаниями.

5. Конкретные примеры

В городе Пясечно, Польша, есть пример долгосрочного выполнения частным оператором контракта на оказание услуг, заключенного с муниципалитетом в начале периода реформ (1993) и действовавшего в течение десяти лет, после чего в 2003 г. он был переоформлен в 10-летнюю «аренду».

Когда по всей Польше активы переводились на муниципальный уровень, этот муниципалитет воспользовался гибкостью польского законодательства для того, чтобы передать водохозяйственное обслуживание внешнему подрядчику, а не образовывать новое коммунальное предприятие. Разумеется, подготовка этого проекта, получение контракта оператором, прозрачность процесса и распределение рисков далеки от стандартных процедур, которым следуют международные финансовые институты, но очевидно, что у действующих лиц этой истории не было ни возможностей, ни ресурсов для того, чтобы в период высокой экономической нестабильности и неопределенности в отрасли водоснабжения поступать в соответствии с «образцовыми методами».

Ключевым является подход, принятый муниципалитетом и частной компанией в период нестабильности – в целом, он отличался гибкостью и был направлен на то, чтобы найти подходящее решение. Механизмы распределения рисков и переноса ответственности на партнера-частную компанию за это время значительно усовершенствовались. Тем не менее, для обеспечения соответствия стандартам, принятым в ЕС, сейчас необходимо уделять больше внимания открытости и прозрачности распределения таких контрактов.

К настоящему времени нам не удалось подобрать еще один подходящий пример, и в этой связи мы будем приветствовать ваши предложения. Желательно, чтобы такой пример относился к стране ЕЦА, менее развитой в экономическом отношении.

6. Перспективы развития рынка

На основе информации, полученной от респондентов на местном уровне, экспертная группа разработала стратегии «открытия рынка», которые со стороны спроса направлены на уничтожение барьеров, препятствующих большему участию в отрасли местных компаний, а со стороны предложения – на укрепление потенциала и взаимодействия местных компаний и ресурсов.

Бездействие	При существующем уровне участия значительные изменения в водохозяйственном секторе представляются маловероятными.
Благоприятные условия для ведения бизнеса	Для того чтобы условия ведения бизнеса были благоприятными, в первую очередь необходимо – на уровне стран и региона в целом – уделять внимание таким факторам как демократизация, экономическое развитие, деловая этика/коррупция и т. п. В краткосрочной перспективе нужны гарантии защиты от «внепроектных» рисков – это сделает рынки более привлекательными.
Гибкие рыночные структуры	Для создания рынка услуг в области водоснабжения, который бы был «открытым» как для государственных, так и для частных компаний, требуется проведение некоторых ключевых реформ. Они могут включать: <ul style="list-style-type: none"> • Создание национальных комитетов и клиринговых центров по партнерству государственного и частного секторов • Информационные кампании/Демонстрационные проекты, совместно реализуемые государственными и частными компаниями • Законодательные реформы • Развитие контактов между заинтересованными группами (отраслевые стандарты, референдумы) • Концентрацию на основной деятельности
Распределение контрактов	Для создания «привлекательного» рынка могут потребоваться следующие меры: <ul style="list-style-type: none"> • Установление правил взаимодействия, выполнение которых контролировала бы третья сторона • Обеспечение открытости конкурсов и соблюдение критериев предварительного отбора • Разработка таких критериев отбора, которые бы не давали оснований для подозрений в пристрастности • Применение критериев «качества» для выявления победителя (недопущение получения контракта стороной, предложившей наименьшую цену за счет ухудшения качества услуг)

Выполнение проектов	<p>Более привлекательный рынок подразумевает жизнеспособные проекты:</p> <ul style="list-style-type: none"> • Реалистичные контракты и показатели эффективности • Привлечение третьей стороны в качестве «честного брокера»
Рыночная сфера	<p>Ключевым фактором обеспечения большего вклада в развитие отрасли со стороны местных компаний является расширение рыночной сферы:</p> <ul style="list-style-type: none"> • Группировка зон обслуживания: городские - сельские, богатые – бедные районы • Концентрация финансовых инструментов на развитии предприятий водоснабжения в бедных районах и в сельской местности
Повышение квалификации на местном уровне	<p>Дальнейшее укрепление потенциала местных компаний требует большего опыта:</p> <ul style="list-style-type: none"> • Партнерство государственного и частного сектора – изучение возможностей и переходный период • Проекты должны соответствовать размеру местных компаний и их сильным сторонам • Группировка поставщиков услуг (государственные - частные, местные - иностранные)
Укрепление местного потенциала в сфере финансирования	<p>Развитие потенциала участия частного капитала является долгосрочным процессом:</p> <ul style="list-style-type: none"> • Создание/развитие местного банковского сектора • Сочетание местных инициатив с финансированием со стороны третьих организаций (международные финансовые институты) • Гарантии инвестиций для защиты частного капитала

7. Выводы

Ключевые выводы, полученные в результате проведенного исследования стран ЕЦА в отношении возможности более существенного вклада местных организаций в развитие коммунального водоснабжения и управления им, сводятся к следующему:

Слабые стороны местных рынков

9. В регионе ЕЦА сохраняется необходимость в повышении уровня коммунального водоснабжения и водоотведения, в первую очередь в сельской местности и бедных районах, особенно в беднейших странах региона.
10. На рынках продолжают сохраняться ограничивающие факторы – как на национальном, так и на отраслевом и местном уровнях. В результате этого местные частные компании неохотно идут на более активное участие в деятельности отрасли. Наибольшие барьеры к вхождению компаний на рынок существуют в бедных странах региона.

11. В настоящее время местные компании обладают достаточно скромным опытом и уровнем квалификации. Тем не менее, они выражают уверенность в своей способности успешно выполнять контракты на оказание услуг и управление.
12. У местных частных компаний отсутствует возможность привлечения в отрасль краткосрочных или среднесрочных капиталовложений.

Рыночные стратегии

13. Существуют стратегии, которые позволят устранить или уменьшить существующие барьеры и создать рынок, который был бы более привлекательным и доступным для местных компаний.
14. Существуют способы создания более благоприятных рыночных условий и, следовательно, укрепления потенциала местных частных компаний в области управления системой водоснабжения с целью повышения их ответственности.
15. Существуют подходы, направленные на постепенный рост местных финансовых рынков и развитие, в долгосрочной перспективе, способности местных частных компаний обеспечивать отрасль капиталовложениями.
16. Взаимодополняющие стратегии, направленные на привлечение квалификации и капитала местных и иностранных компаний, являются лучшим способом добиться улучшений в водохозяйственном секторе во всем регионе ЕЦА.

8. Рекомендации: стратегический план действий

Для создания в ЕЦА более доступных, прозрачных, рациональных и эффективных рынков услуг водоснабжения и водоотведения, на рассмотрение местных, национальных и международных организаций, занимающихся развитием отраслевых инициатив в конкретных районах и странах ЕЦА, выносятся пять ключевых рекомендаций:

6. Поддерживать усилия, предпринимаемые странами региона для создания стабильных и предсказуемых условий ведения бизнеса;
7. Приступить к реформам, руководить которыми будет национальный комитет и которые будут направлены на создание более привлекательного и доступного рынка услуг водоснабжения и водоотведения, открытого для государственных и частных компаний, способных осуществлять управление коммунальным хозяйством;
8. Способствовать расширению внутренних рынков;
9. Укреплять потенциал местных частных компаний в плане повышения квалификации (в кратко- и среднесрочной перспективе) и увеличения капиталовложений в отрасль (в долгосрочной перспективе),
10. Содействовать более активному взаимодействию всех сегментов и участников рынка: национальных и международных, государственных и частных.

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B1. Questionnaire Assessment

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B.2 Questionnaire and Instructions

Annex C: Distribution and Results of “Participants” Survey

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LIST OF ABBREVIATIONS

ECA	Europe and Central Asia (the “region” comprising the former East Block and Soviet Union)
EU	European Union
GOs	Government Organizations
MDGs	Millennium Development Goals, established during the Johannesburg Summit of the United Nations
NGOs	Non-Government Organizations
IFIs	International Financing Institutions
OECD	Organization for Economic Cooperation and Development
PPP	Public-Private-Partnership
PSP	Private Sector Participation

Note: While many terms exist to convey the notion of private sector involvement in water utility management , the term PPP shall be used in this report.

1.0 INTRODUCTION

1.1 Program Background

Following the fall of the Berlin Wall in 1989 and the ensuing socio-political reforms in the Eastern Europe and Central Asia (ECA) region, the marketplace for community water services also experienced dramatic changes.

The domestic water sectors were sporadically reformed in parallel with the overall political and institutional changes of each newly formed country. New or reshaped water ministries strove to define and fulfil their missions. Utilities struggled to maintain service and solubility during austere times. An infusion of international inputs, ranging from the financing & donor community to private companies, also attempted to address the needs of the vast market.

According to ever more liberalized economies and legislation, a variety of domestic entities and companies asserted themselves to establish a role in an evolving water utility management market. Many former state water agencies were re-branded as private companies. New domestic companies emerged in various markets: operators, engineering firms, technical service companies, etc.

Yet, after more than 15 years of activity and evolution in this “new” water market, domestic companies were playing a minor, if any, role. As such the IFI & Donor community posed key questions regarding inputs by domestic companies in water utility management, especially as part of the mobilization to attain the Millennium Development Goals:

- Are domestic participants limited in access to the ECA market?
- Can domestic companies contribute as water utility managers?

To find answers to these questions, The World Bank and the Organization for Economic Cooperation and Development (OECD) teamed together to evaluate this change in the ECA water market. The joint program started as a regional part of a larger global consultation by the World Bank and the International Finance Corporation with the private sector, donor community and local stakeholders, regarding municipal water supply and wastewater.

The program for the ECA region was structured with the following objectives:

1. to engage the private sector, financing community (donors/ international financing institutions - IFIs) and stakeholders to share experiences on market activities and strategies
2. to discuss ways to maximize the flow of investment capital and technical know-how to the region.

To date, the program has included two **forums** (Paris 2002, Vienna 2003), which facilitated productive exchanges between donors, international financing institutions (IFIs), private companies and stakeholders on factors (positive & negative) affecting future strategies in the ECA market for private water utility management^{1,2}.

Another part of the program consists of two **market development studies** to address the feasibility of improving the capacity and scope of private inputs, from the domestic private sector, led by the OECD (*this report*), and the international private sector, led by The World Bank (a companion report).

1.2 Purpose of the “Domestic” Market Development Study

This *Market Development Study* is an objective assessment of the ECA marketplace for community water & wastewater services to establish the feasibility of enhancing inputs by “domestic” entities for the benefit of the ECA region.

Goals of the “Domestic” Market Development Study

1. Assess the ECA water market, focusing on **capabilities for utility management** by the full range of domestic companies
2. Conduct a forum for change (with public, private & financing stakeholders)
3. Develop a Strategic Action Plan to:
 - a. **Decrease – eliminate limitations to access in the ECA market** by the full range of domestic companies and organizations active in water utility management
 - b. **grow the market for domestic inputs** to include primary and secondary cities, rural areas and poor populations

1.3 Study Approach and Methods

The OECD and the World Bank’s Europe and Central Asia Sector Unit assembled a team from October 2003 through October 2004 to conduct this market development study:

- **Team Leader:** P. Borkey of the OECD
- **Team Leader:** A. Rohde of the World Bank’s ECA group
- **Water Supply Expert:** C. Schmandt, Water & Environment Consultant

In preparation of the *Market Development Study*, the Study Team incorporated and relied on a combination of procedures and information sources.

Survey - Questionnaire	The Study Team conducted an open survey of “domestic” (ECA) companies via a questionnaire to directly solicit views, comments and suggestions from <ol style="list-style-type: none"> 1. “experts” (Annex B). 2. “participants” (Annex C).
Case Studies	The Study Team conducted two in-depth Case Studies to assess the experiences of “newcomers” to the marketplace (Annex D).
Workshop	The Study Team conducted a workshop on the interim survey results in Moscow on 20-21 September 2004 (Annex E).
Forums	The Study Team benefited from the OECD & World Bank forums on PPP in the ECA region (Paris, April 2002 & Vienna, July 2003).
References	The Study Team utilized and relied on various reference materials, as referenced in the endnotes.

2.0 MARKET SETTING

2.1 Natural Environment

The Eastern Europe and Central Asia region covers a vast area spanning from the Carpathian mountains of Central Europe to the steppes of Central Asia and from the Baltic, Mediterranean and Black Seas in the east to the Arctic and Pacific Oceans in the North and West. This enormous area is diverse in topography, morphology and climate resulting in a wide variety of ecologies (tundra, alpine, forest, plains - steppe, wetlands, semi-desert, desert, etc.).

Many parts of the ECA region are rich in natural resources, including minerals, fertile soils, forests and, of great interest in today's economy, oil reserves.

The ECA region has water rich and water poor areas

Despite mighty river systems, such as the Danube, Volga, Ob' and Yenisey, and great inland waters, such as the Caspian and Aral Seas and Lake Bajkal, water availability varies widely throughout the region according to natural factors and phenomenon.

Human impacts on the natural environment are apparent throughout the region according to urbanization, industrial & mining activities, agriculture, infrastructure (hydropower, transportation), etc. The human manipulation of hydrology and waterways has, in some cases – witness the Aral Sea – significantly altered the ecology, in addition to the balance between water rich and water poor areas.

2.2 Peoples and Cultures

The ECA region is host to a wide variety of cultures, ethnicities, religions and languages, reflective of the regional and continental histories. While such diversity provides great cultural wealth and tradition, some areas experience longstanding tensions between various ethnic or religious populations. Throughout most of the ECA region, the various peoples coexist peacefully; yet, in some areas, the cross-cultural tensions have flared during the last decade into isolated violence, armed conflict, even war.

500 million people require water supply & sanitation services for their livelihood

The total population of the ECA region is about 500 million with the most populous countries including Turkey and the Russian Federation³. While large major metropolitan areas ("primary cities" greater than 500,000 inhabitants – see Annex A) are prevalent, such as Warsaw, Moscow, Kiev, Baku, Tashkent and Novosibirsk, much of the ECA population is settled in smaller cities, towns and villages (so called "secondary cities") and in rural areas. Migration from the countryside to cities, spurred by the political transitions of the early 1990s, is gradually leading to a more urban demographic.

Urban Population as Percent (%) of Total⁴

- Central Asia: 47 %
- Balkans: 51 %
- Eastern Europe: 63 %
- Baltic States: 66 %
- Central Europe: 62 %

The population is generally younger than Western European standards, in part due to higher population growth and in part due to lower living standards / life expectancies. The dramatic societal and economic changes since the early 1990s have resulted in a decrease of life expectancies in many countries⁵.

2.3 Countries and Governments

The fall of the “Iron Curtain,” symbolized by the collapse of the Berlin Wall in November 1989, dramatically ushered in a dynamic, yet uncertain political era for the entire ECA region. The broad rejection of centrally dominant state institutions in favour of more “democratic” governments and market oriented economies, significantly altered the power and societal structures prevalent since 1945 and the end of World War II.

The dissolution of the Soviet Union and “Eastern Block” was accompanied by a rise in cultural - nationalism with the result that many “new” countries were carved out of formerly expansive regimes. The ECA region includes 29 countries in 6 geographic areas.

Balkans

Albania
Bosnia and Herzegovina
Croatia
Macedonia, the Former Yugoslav Republic of
Montenegro
Serbia
(Kosovo under United Nations administration)

Central Asia

Kazakhstan
Kyrgyz Republic
Tajikistan
Turkmenistan
Uzbekistan

Baltic States

Estonia
Latvia
Lithuania

Central Europe

Czech Republic
Hungary
Poland
Slovakia
Slovenia

Caucasus

Armenia
Azerbaijan
Georgia

Eastern Europe

Belarus
Bulgaria
Moldova
Romania
Russian Federation
Turkey
Ukraine

Figure 1: The Countries of the Europe and Central Asia (ECA) Region

At the **national level**, many political transitions occurred peacefully, such as the disbanding of the Soviet Union and the reunification of East & West Germany. In other cases, the changes in government were instigated or resisted by inter ethnic-religious-nationalistic violence, civil unrest, assassinations and, even armed conflict, such as the civil war during the break-up of Yugoslavia.

The political transitions of decentralization, institutional reform and democratisation are long-term processes

The political adjustments and power struggles are still ongoing in some parts of ECA, in some cases violently - witness the assassination of Serbia’s Prime Minister in March of 2003 and the ethnic riots in Serbia & Kosovo of March 2004 - but peacefully in others, such as the “rose revolution” in Georgia of December 2003.

According to the rise of new governments, many countries have or are reforming the legislative and judicial systems, a lengthy process to revamp government & judicial institutions, procedures and laws. A major challenge to government reform is the prevalence of corruption, a human predilection aggravated in uncertain political and economic environments. Organized crime, which gained strength and influence during the “law & order” vacuum of the political transitions, challenges the rule of law in many countries.

At the **community level**, the wide-spread elimination of central planning structures has triggered a process of decentralization, transferring greater autonomy coupled with more responsibility to local and municipal governments. Accordingly, the local governments are increasingly more accountable to the local population for public services, such as education, transportation, power, but also water supply and wastewater. In many cases, levels of responsibility have outpaced local government-institutions capacities in these areas, resulting in financial and know-how gaps.

2.4 Economies and Incomes

The transition from state-dictated to more market-oriented economies has proven a long-term process and yielded significant challenges.

The shift to a “market-oriented” economy introduced even more austere times

Domestic industrial capacity was generally devastated after the political transitions, as the state-owned industries were dismantled, resulting in unemployment (in many countries as high as 30-50%), loss of tax revenue and a general decline in wealth. Gradually, some industry is being privatised, but the process is slow. Foreign investment, benefiting from a cheaper labour pool, has offset this trend to some extent.

Much of the workforce is engaged in agricultural activities, with the former state-run farms divided into small plots, primarily for family farms. However, the future economic prospects of many countries rest on vital natural resources, such as oil in Russia and Central Asia. Natural resource exports, for example, boosted economic growth in the Commonwealth of Independent States (CIS) in 2003 to 5.6 percent, the third highest level among the world’s emerging economies⁶.

The previous free-trade zones and trade agreements were eliminated with the dissolution of the East Block, Soviet Union, and Yugoslavia, aggravating regional commerce and exchange of goods, formerly the basis of much economic activity. Yet, new regional trade pacts and accession of 8 ECA countries to the European Union has begun to spur economies.

The foundations of the various economies, public infrastructure and services for transportation, power, communication, solid waste, water, sewerage, have in large part been victim of under-investment, both prior to and after the political transition coupled with poor operations and maintenance practices over the last decades. Accordingly, the reliability and quality of public services often has a negative impact on economic development potential of a country or region.

With fewer jobs and pension systems dismantled, household incomes generally fell throughout the ECA region. Some families rely on subsistence farming or support from the Diaspora for survival. Poverty levels have increased and standards of living decreased, especially in areas most plagued by political instability and civil unrest. Poor populations are located in both urban and rural areas. Many primary and secondary cities have “impromptu” neighbourhoods inhabited primarily by recent migrants from the countryside with no official status nor municipal services or infrastructure.

The income levels in some ECA countries, primarily Central European and the Baltic States, have recently begun to approach Western European standards. For the remainder, however, income levels have stagnated, if not decreased in real terms over the past 15 years, with Gross Domestic Product still below the pre-transition levels. For instance, about two thirds (69%) of the ECA countries are considered “Lower Middle & Low Income” countries according to The World Bank’s country income categories (see Annex A and below).

Table 1: Country Incomes in ECA⁷

Income Category	ECA Countries (29)	Percent of Total (%)
High (non OECD)	1	3 %
Upper Middle	8	28 %
Lower Middle	12	41 %
Low	8	28 %

All the low and lower middle category countries are located in Central Asia, the Balkans, and Eastern Europe, while the Baltic and Central Europe areas include only countries with upper middle and high income categories. On average annual GDP-PPP in Central Europe is 4 times that in Central Asia.

Gross Domestic Product - Purchasing Power Parity (Average per Geographic Area)

- Central Asia: Intl.\$ **2,982** per year
- Balkans: Intl.\$ **3,659** per year
- Eastern Europe: Intl.\$ **5,850** per year
- Baltic States: Intl.\$ **8,072** per year
- Central Europe: Intl.\$**12,814** per year

2.5 International Relations

The dissolution of the “Eastern” superpower, the Soviet Union with its Eastern Block satellites, and a regional power, Yugoslavia, has reduced the geo-political clout of the region over the last 15 years. Yet, the thawing of the Cold War attitudes between East and West, has resulted in greater contact with and access to neighbouring regions, especially Western Europe, and the rest of the world, along cultural and commercial lines, with benefits for all sides.

Eight ECA countries joined the European Union in 2004

The overall openness of the ECA region is signal by the ratification of new trade agreements with the international community and with other ECA countries.

A major step is the accession of eight Baltic and Central European Countries into the European Union in May 2004, according to the respective success of political, legislative and economic reforms in Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia and Slovenia.

3.0 WATER & WASTEWATER MARKET OVERVIEW

3.1 Marketplace

3.1.1 Size and Segments

The ECA market for water & wastewater services represents a population of about 480 million, with roughly 63 % (300 million) located in urban settings and about 37% (180 million) in rural settings⁸, plus the associated business and industrial activities. Country standards for public health / sanitation and environmental quality generally require piped water supply and sewerage services for urban dwellers and, increasingly, for rural inhabitants.

<i>Table 2: Market Segments in ECA:</i> Estimated Demand for Community Water & Wastewater Services			
Segment	Inhabitants	Commerce & Industry, equivalent	TOTAL Equivalent Population
Primary Cities (> 500,000 inhabitants)	100 million	± 30 million	± 130 million
Secondary Cities (500,000 – 10,000 inhabitants)	200 million	± 40 million	± 240 million
Sub Total: Urban Areas	300 million	70 million	370 million
Rural Areas (< 10,000 inhabitants)	180 million	±20 million	±200 million
TOTAL	480 million	90 million	570 million

The immediate market for the water & wastewater services to urban areas is estimated at an equivalent population of 570 million inhabitants, when considering industrial and commercial activities.

3.1.2 Coverage

Overall market coverage in the ECA region extends to an average of about 80% of the population (about 385 million people) for piped water supply and about 40% (about 190 million) for sewerage services⁹. Wastewater evacuation systems, often combined with storm water evacuation, often do not include wastewater treatment facilities, especially in secondary cities and rural areas.

Community water & wastewater services are concentrated in primary cities, with secondary cities and then rural areas having lower areas of coverage. However, significant sections of primary and secondary cities (new settlements, poor neighbourhoods, etc.) remain without satisfactory or, in some cases, any water services.

3.1.3 Value

The following table presents a gross estimate of the ECA annual market value (assuming 100% market coverage, water consumption at 200 litres per capita per day and a price of US\$ 0.50 per cubic meter for water supply and US\$ 0.25 per cubic meter for sewerage).

<i>Table 3: Annual Market Value in ECA</i>			
Estimated Value of Community Water & Wastewater Services			
Segment	Total Population (including commerce & industry)	Service Needs (cubic meters per year)	Value (US\$)
Primary Cities (> 500,000 inhabitants)	± 130 million	± 10 billion	± 7 billion
Secondary Cities (500,000 – 10,000 inhabitants)	± 240 million	± 18 billion	± 13 billion
Sub Total: Urban Areas	370 million	28 billion	20 billion.
Rural Areas (< 10,000 inhabitants)	±200 million	± 15 billion	± 11billion
TOTAL	570 million	43 billion	31 billion

The OECD & World Bank estimate investments totalling about US\$ 100 billion are necessary over the next decade [2002-2011] to meet the water supply and sanitation infrastructure requirements of the ECA region¹⁰. Based on the current worldwide average of 5% private sector involvement in the water & sewerage market, this represents a private sector market value of US\$ 5 billion.

3.2 Water Sector

3.2.1 Institutional Structure

Parallel to the wider political changes, many of the newly created federal governments in the ECA region are undertaking a comprehensive process of adapting the prior institutional structures and regulatory regimes of the water sector. A common model for water sector reform is the European Union's Water Framework Directive, espousing an "integrated" and "river basin" approach to water resources management (irrigation, drainage, flood control, hydro-power, etc.), in general, and for community water & wastewater services, in particular (the focus of this study).

With numerous new or revised government ministries and agencies, new capacities are required in standards & regulations, tariff policies, operational & administrative oversight, etc. This process is ongoing and, especially in poorer countries, presents challenges to assemble a qualified and experienced government administration. The transformation translates into a dynamic on-the-ground setting in some ECA countries, as many regulations and standards are replaced or introduced.

3.2.2 Structures for Competition

The states of the ECA region typically allocate the key responsibilities for community water and wastewater services in a monopoly fashion, without opportunity for competition a standard approach throughout the world for “common good” and capital intensive resources, such as water.

The current organization of the market mirrors the overall political and economic shift in the ECA region away from centralized mechanisms to greater autonomy and accountability for community / municipal governments and utilities.

Table 4: Allocation of Main Functions and Responsibilities for Community Water & Wastewater Services
(a “Generalized” Model of the ECA Water Marketplace)

Primary Functions	Responsibility (Pre – Political Transitions)	Responsibility (Post - Political Transitions)
SECTOR OVERSIGHT		
• Regulations & Standards	Central Government	Central Government
• Tariffs	Central Government	Local Gov. with approval by Central Gov.
• Control & Enforcement	Central Government	Central & Local Government
SUPPLY		
Ownership		
• Water Resources	Central Government	Central Government (no private ownership)
• Assets (infrastructure)	Central Government	Local Government
• Service Organization (utility)	Central Government	Local Government
Community Service		
• Operations & Maintenance	Utility	Utility via Service Agreement with Local Government
• Operational Revenue	Utility via Customer Tariffs with cross-subsidization	Utility via Customer Tariffs plus some cross-subsidization
• Asset Management & Development	Central Government	Utility & Owner (Local Government)
• Asset Financing	Central Government	Utility & Owner (Local Gov.)
DEMAND		
• Inhabitants of Service Area	Payment of Tariff, based on “social” value	Payment of Tariff, based on “social” or “commercial” value
(Note: This generalized overview for the ECA region is presented as a basis for evaluation with the understanding that variations exist country-by-country in the organization of the water sector).		

STATE ROLE: Resources Owner & Regulator

The **central government** is typically both the owner and regulator of water resources. Therefore, central governments generally assign the main responsibilities to different agencies to determine and control:

- Use of all water resources (water rights, extraction / discharge, authority for community service)
- Public health, environmental quality and customer advocacy in community service (service standards & regulations; administrative, financial & operational requirements)

In this arrangement, the government performs two key responsibilities to fulfil its mandate of “**safeguarding common resources in the public interest.**” Critics of this arrangement claim a conflict of interest between the roles of owner and regulator of the same resources.

COMMUNITY ROLE: Utility Owner & Asset Development

The **local government** is generally granted, through enabling legislation (from the central government) the rights to provide community water & wastewater service. These rights are typically dedicated exclusively per each city, town or village (local government, typically a municipality).

Normally, the local government establishes a public service company / utility to operate and manage the particular community services, often formalized through a service agreement. Yet, the local government maintains overall management control over the utility company as owner. In particular, the leadership position(s) of a utility are often subject to political appointment, rather than exclusively merit-based selection.

As owner of the utility and all physical assets, the local government assumes responsibility for the renewal, replacement or expansion of the public service infrastructure, which formerly rested with the central planning structures. This transfer of asset development responsibilities has presented great challenges, requiring new expertise and capabilities at the local level, especially to secure financing for infrastructure works.

UTILITY ROLE: Community Service, Cost Recovery & Asset Management

The **public utility company** assumes the obligations and rights for community water supply and wastewater evacuation. In many cases, especially in smaller towns where financial resources are scarcer, the utility is granted responsibility for a wide spectrum of other community services, such as solid waste, streets, parks, public market places, cemeteries, etc.

The utilities are responsible for the technical operation & maintenance of the water supply / wastewater systems, financial administration (billings & collections) and overall company management. A key duty is the recovery of funds from the customers using the service, typically through tariffs and connection fees, to recover operations costs and finance asset development investments. Customer bases have generally been slow to accept the transition from a “social” to a “cost recovery” tariff, upon the disappearance of central government finances and subsidies, especially considering the austere economic conditions and poor water service levels.

3.2.3 Tariff Policy and Demand Management

Tariff structures are generally proposed at the local level, but reviewed and approved at the state level, either directly through a government agency or an independent commission. At the local level, the new democratic procedures can result in electoral pressures on the local officials proposing changes to water tariff policy, possibly undermining the possibility to raise capital for necessary improvements.

A dilemma in ECA (and the world): is water a “social right” or a “market product”

Tariff policies throughout the ECA region generally vary between two basic approaches:

- **“social pricing”**, which considers water services as a birth right of each citizen, to be provided at affordable levels and without profit by the state
- **“market pricing”**, which considers water as a product, to be priced according to the costs and investment incurred to provide community service

Accordingly, water supply is either metered at the customer connection, enabling demand management through consumption based billing, or not (block rates). The resolution of this basic issue in each country and each community has a significant impact on the financial viability of water utilities and, in turn, the quality of services.

3.2.4 Finance

On a worldwide basis, the World Panel on Financing Global Water Infrastructure estimates a doubling of investment is necessary in developing countries to reduce by half the number of people without sustainable access to safe drinking water¹¹.

Yet, in many ECA countries, funds for asset renewal, replacement or expansion are not readily available. Customer revenues are often only sufficient to cover operations costs, at best. “Unsustainable” utilities and cash-strapped local governments (low tax revenues) do not qualify for credit from local banking institutions, nor could they afford the debt service. Moreover, many ECA countries, especially the poor, only have emerging financing and banking sectors, without capabilities to finance long-term, capital intensive projects.

Therefore, most ECA communities either make do with the existing infrastructure systems or seek assistance from external sources for investment monies: central government (usually also cash strapped), foreign donors, non-government organizations (especially in rural areas) or international financing institutions.

3.3 Community Service

3.3.1 Service Levels

At the operational level, water & wastewater services generally do not meet EU standards in many communities, often with associated risks to public health and environmental quality and impacts to standards-of-living and economic activities. While, primary and secondary cities typically have established albeit dilapidated water supply and sewerage systems, rural areas, often have no or minimal infrastructure systems.

Service levels, especially in poorer countries, can be unsatisfactory, characterized by:

- **Inefficient water supply** (incompliance with quality standards, intermittent supply, incomplete service areas, excessive losses, etc.)
- **Ineffective wastewater service** (incompliance with effluent standards or no treatment at all, overflows in rain events, incomplete service areas, etc.)
- **Insufficient human capacity** (lack of training or experience in utility management, customer service and asset management/ development)

Poor service levels and dissatisfied customers trigger the “unsustainable” cycle

Beyond potential public health and environmental quality impacts, unreliable water services aggravate the economic health of the utility and decreases the attractiveness of the entire community. Poor service tends to alienate the customer base, which, in turn, is less likely to pay for services, resulting in lower revenues for the utility, thereby limiting the available capital to make needed improvements (see figure below).

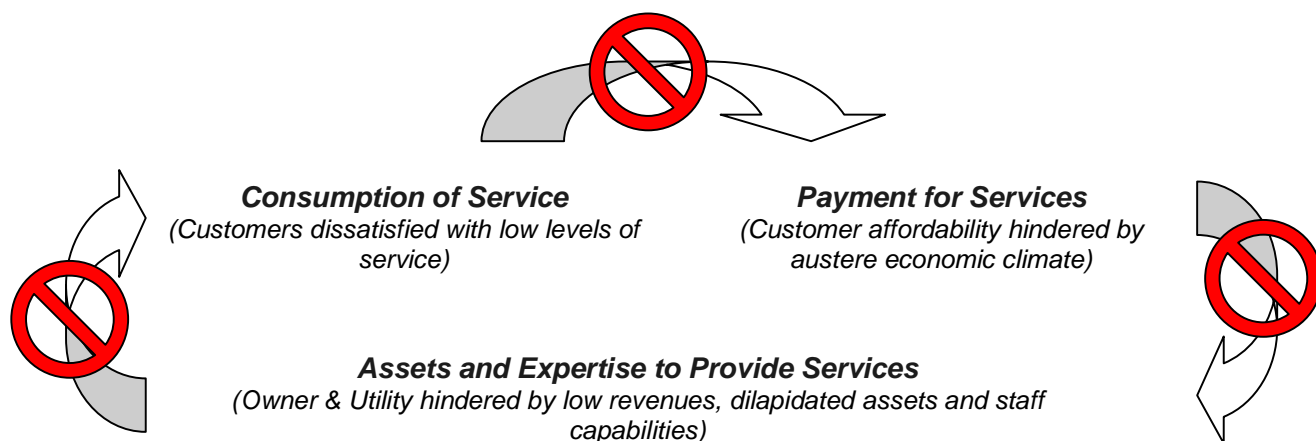


Figure 1: The “Sustainability Cycle” is broken in many water utilities of the ECA region

3.3.2 Service Providers

With the abolishment of centrally controlled and subsidized water sector structures, the provision of community water and wastewater services required a different approach, striving towards the “new principles” of local autonomy, sustainability and accountability. Yet, the path to a “more decentralized and market-oriented” service model was uncertain, aggravated by limited experience and training opportunities.

Needed: Operational & Investment Capital and Staff Expertise

Some water utilities have adapted to the new challenges and attained full operational cost recovery – some even with sufficient funds to finance infrastructure projects. However, most public water and wastewater service providers continue as remnants of the past era, based on a more subsidized and social approach to water sector services, with many changes necessary to become sustainable and efficient organizations. Many water utilities, especially in the poorer ECA countries, remain trapped in an “unsustainable” cycle, without the financial or human resources to escape.

According to unsustainable operations, cross subsidization is common in many ECA countries, with budget shortfalls covered through state disbursements, bartering or simply non-payment of obligations (such as for electricity). Utility finances are often not transparent with a lack of cost accounting and an unclear mix of services.

Chronic under-investment over decades, before and after the political transitions, has rendered many water utility assets and infrastructure dilapidated and limited the ability of water utilities to provide a valuable (safe, sufficient, reliable) service. The challenge of upgrading water utility assets has been compounded by the process of decentralization; the responsibility of asset development and financing has been transferred to the local governments (as owner) and the utilities. Yet, these entities had little or no previous experience in this area at the time of transfer.

3.3.3 Customer Base

In some ECA countries, much of the customer base is unemployed or with earnings below the poverty level, as detailed in the previous chapter. This has a profound impact on customer affordability for water services, especially in poorer countries. Some areas have a historically poor payment culture for common good type resources, both before and after the political transitions.

Consume as possible, but do not consistently pay for poor services

In areas without water metering and demand management, customer consumption habits can be extreme for non-drinking water uses (garden irrigation, car & street washing, household plumbing spillage, etc.), while billing levels and collection rates remain low. Such consumption and payment patterns exacerbate the “unsustainable” cycle, reducing overall levels-of-service (lower system pressure or less water available for other customers) without providing financial resources to cover the associated costs.

3.3.4 Private Sector Inputs

The private sector often fulfils a traditional role in the ECA water market place as a contractor (construction, supplier, etc.) or consultant (technical, management, etc.) to water utilities and their owners for specific projects or assignments.

A variety of domestic and foreign companies provide services in this manner. The indigenous private sector includes the remnants of the central planning agencies, converted to private companies during the political transitions, and newly formed companies (engineering, general contractors, etc.). The international private companies represent the entire range of companies active in the water sector of the “industrialized” world.

Private sector provides traditional & non-traditional inputs

Public-Private Partnership type arrangements, in which a private sector company assumes responsibility for selected aspects or even all of a water utility’s obligations and rights (see Annex A), have been introduced in the ECA marketplace since the political transitions. During the last 15 years all PPP contract forms have been applied somewhere in the ECA region:

- Service Contract
- Management Contract
- BOT (Build-Operate-Transfer), BOOT (Build-Own-Operate-Transfer), etc.
- Lease
- Concession
- Divestiture

However, community water service owners, utilities or customer bases are not always open to new arrangements or competition, limited by legal restrictions to the public service utilities/ companies or local-national attitudes against the introduction of a “market” approach to a “social-common” resource. For example, private inputs in water utility management comprise about 8% of the total market.

Since the cost of project development is high and overall knowledge of PPP is generally still low, most PPP initiatives are associated with the international donor and financing community (see below). Likewise, most private companies engaged in PPP contract arrangements are foreign companies.

3.4 International Activities

3.4.1 Donor and Financing Community

In the wake of the political transitions, the international donor and financing community commenced or intensified their activities in the ECA water sector (in addition to the power, transportation, finance and other sectors) to forward their missions of decreasing poverty and promoting sustainable development in support of political and social stability. For example, the World Bank's mission is a world free of poverty through assistance to the poorest people and countries towards stable, sustainable and equitable growth¹².

Sustainable community water services are key parts of donor & IFI missions

An effective, efficient and transparent water sector is a key part of the strategy for Government Organizations (GOs), Non Government Organizations (NGOs) and International Financing Institutions (IFIs) to attain their goals in the ECA region. Accordingly, international donors and financing institutions have provided funding (technical assistance, grants, loans, etc.) over the last decade to address the assets and capacity gaps in the public service providers of the ECA region.

Many Western European countries have bilateral investment mechanisms to promote investment and capacity building in developing countries, including the ECA region. The European Union, for example, has established financing instruments to assist candidate countries (the Central European and Baltic states) in their reform efforts and investments to qualify for accession, such as PHARE and ISPA (500 million per year until 2006). The TACIS program provides support to the Commonwealth of Independent States.

An investment gap to attain the Millennium Development Goals

More recently in 2002, at the Johannesburg Earth Summit, all 191 United Nations member states pledged to attain the Millennium Development Goals (MDG) by 2015, including to "reduce by half the proportion of people without sustainable access to safe drinking water."¹³ Much of the ECA population qualifies as part of the MDG target group. Therefore, even greater investment amounts are necessary.

However, the international donor community is reducing their commitments and investment flows to developing countries by 50%, in part as a result of the global recession starting in 2001 and in part according to improving conditions in some ECA countries¹⁴. This trend is contrary to attaining both the MDG and the donor community missions. A key question remains how to close this substantial investment gap.

Strategy for more capacity building and investment: Public-Private Partnership

To encourage additional investment and capacity building, and to spread the risk of water sector "redevelopment", many donor and financing entities encouraged, even actively promoted PPP in their activities in the ECA region since the political transitions. This goal of this strategy is to further increase investment and service efficiency in the water sector and, thereby, accelerate the process of meeting the water & sewerage needs of the ECA population.

Since the political transitions, donors and IFIs have undertaken more than 290 projects in ECA, with about 90 in PPP structures and 26 in twinning (of a “developed” with a “developing” utility - mostly in Baltic countries with Scandinavian assistance) arrangements¹⁵. Many of the PPP contracts have been implemented in larger urban areas. The World Bank portfolio, for example, includes PPP projects in the community water services of the ECA region, accounting for 17% in terms of projects and 8% in terms of investments during 1990-2000¹⁶.

However, to date the private sector accounts for about 5% of the total investments in the water sector during 1990-2000, and the cumulative investment in water & sanitation has slowed during the past 4 years¹⁷. This is neither sufficient to close the investment gap necessary to meet the MDGs in the ECA region nor attain donor and IFI missions.

3.4.2 International Companies

When the ECA water marketplace was initially “opened” in the early 1990s, a veritable “gold rush” ensued, as international companies bought up local companies or established satellite offices to assert market presence. The lure of the private sector (expertise for utility capacity building to attain sustainability, capital infusions for infrastructure investment) in combination with the ECA marketplace (large, untapped market of 500 million inhabitants right in close proximity to Western Europe) was irresistible to both sides.

ECA marketplace: defining the global competition for community water services

The international participants initially included companies from all over the industrialized world vying for traditional or PPP type contracts offered by international donors and IFIs. In particular, the ECA region presented a new market for competition between various types of service providers. Established water utilities and operators, dominant in the water utility management market for decades, vied with market newcomers – consultants, contractors, non-water utilities who have increasingly gained experiences through more global activities and more dynamic contract types.

An evolving participant profile for an evolving market

After a decade, regarding PPP contracts, the field had evolved into “a limited number of large Private Sector companies whose main interests are in doing lease and concession contracts. The extensive tradition of huge French multi-national water companies are known in the market, but also the newer British companies, with a fresh experience on privatisation. Newly formed consultant operators, who are particularly keen to do management contracts, have increased the number of private sector participants.”¹⁸

Rethinking the ECA marketplace

Following the global recession of 2001, many international companies retreated or changed strategies in the ECA region (or even globally), in part based on particular company experiences (procurement, execution, etc.) in the region, but also based on overall country factors and more critical attitudes regarding company risk & security. In addition, during the last few years the number of new PPP contracts diminished (see donor & IFI activities above), with some contending that the major urban markets suitable for PPP were already saturated.

Many companies, especially newcomers, voiced concerns about engrained procedures and mechanisms in the ECA region favouring the status quo. Were this trend to continue, Public-Private-Partnership, one potential pathway for water sector investments and improvements, would be diminished, contrary to the interests of the ECA region itself and the international donor and financing community.

4.0 DOMESTIC PERSPECTIVES

4.1 Dialogue with Domestic “Experts” and “Participants”

4.1.1 Overview

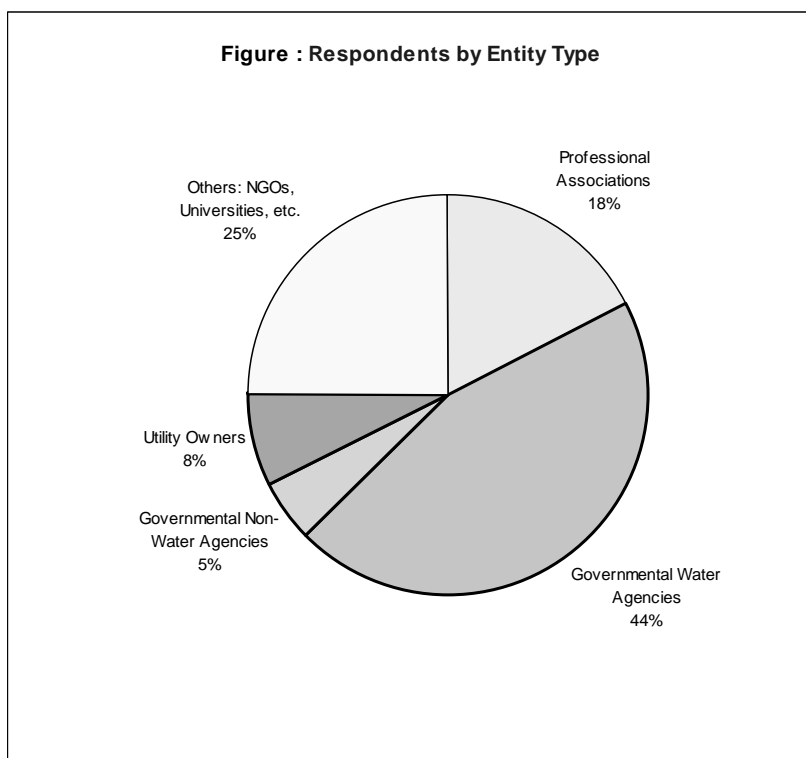
The views of domestic (from within ECA) entities, as gained through questionnaires, case studies and a workshop, focus on eight major themes, as summarized below.

<i>Table 7: Summary of Domestic Views on the ECA Water Marketplace</i>		
FACTORS (PROBLEMS)	CONCERNS (CAUSES)	SUGGESTIONS (SOLUTIONS)
A. Country Setting		
1. Non-Project Risk in business environment	<ul style="list-style-type: none"> • Dysfunctional economies • Political volatility • Corruption • Social strife 	<ul style="list-style-type: none"> • Guarantees by IFIs/ Donors to cover non-project risk • Parallel measures to support wider regional development
B. Water Sector		
1. Institutional Framework	<ul style="list-style-type: none"> • Developing legislation • Inefficient institutions 	<ul style="list-style-type: none"> • Parallel institutional reform • Better project preparation
C. Market Structures for Water Utility Management		
1. Market Understanding of Alternative Models	<ul style="list-style-type: none"> • Accurate knowledge of PPP advantages & disadvantages 	<ul style="list-style-type: none"> • Education Campaign • Pilot Program
2. Legal basis for PPP	<ul style="list-style-type: none"> • Enabling legislation • Tariff policy • Asset ownership 	<ul style="list-style-type: none"> • Legislative reforms
3. Role of Owner & Utility	<ul style="list-style-type: none"> • Political influence • Monopoly bias 	<ul style="list-style-type: none"> • Referendums • Stakeholder contracts • Merit-based staff selection
4. Scope of Utilities	<ul style="list-style-type: none"> • Public services beyond water 	<ul style="list-style-type: none"> • Un-bundle Utilities
D. Domestic Market for Water Utility Management		
1. Market Attractiveness	<ul style="list-style-type: none"> • Limited by size, accessibility, profitability & non-project risk 	<ul style="list-style-type: none"> • Create domestic opportunities • Reforms for PPP suitability
2. Market Acceptance	<ul style="list-style-type: none"> • “theoretical” acceptance, but lacking local “willingness” 	<ul style="list-style-type: none"> • Information Campaign • Stakeholder contracts
E. Procurement		
1. Pre-Qualification	<ul style="list-style-type: none"> • Bias to large, water sector & international companies 	<ul style="list-style-type: none"> • Adapt PQ criteria for more accessible market
2. Bidding	<ul style="list-style-type: none"> • Excessive focus on price 	<ul style="list-style-type: none"> • Adopt more qualitative process
3. Contracts	<ul style="list-style-type: none"> • Unfamiliar forms 	<ul style="list-style-type: none"> • Create national standards
4. Ethics	<ul style="list-style-type: none"> • Non-merit type influences 	<ul style="list-style-type: none"> • Set, monitor & enforce rules
F. Execution		
1. Project Team	<ul style="list-style-type: none"> • Onsite conflicts 	<ul style="list-style-type: none"> • 3rd Party as honest broker
2. Contract	<ul style="list-style-type: none"> • High performance standards 	<ul style="list-style-type: none"> • Better project preparation
G. Domestic Companies: Expertise		
1. Capacities	<ul style="list-style-type: none"> • Limited advantages over utilities & international firms 	<ul style="list-style-type: none"> • Projects to “grow” domestic sector
H. Domestic Companies: Capital		
1. Private Capital	<ul style="list-style-type: none"> • No immediate capacities 	<ul style="list-style-type: none"> • Develop local banking sector

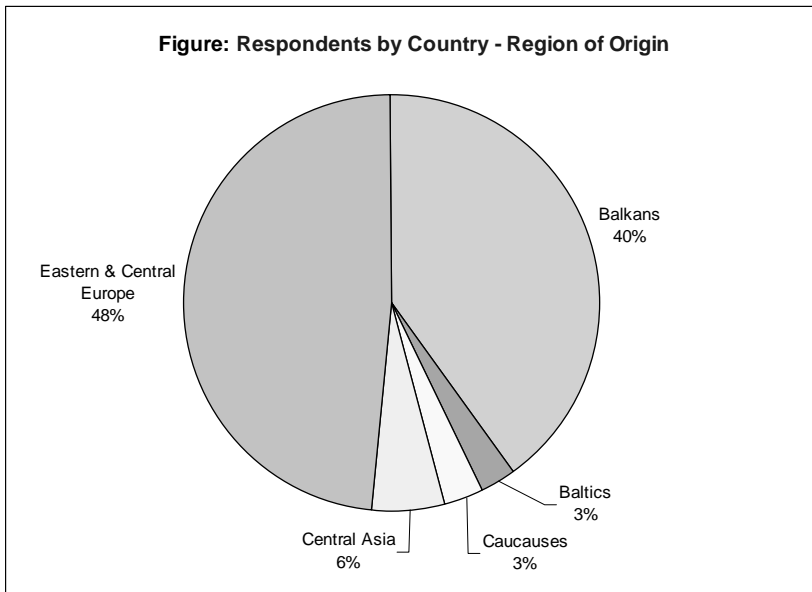
4.1.2 Profile of Respondents to “Expert” Questionnaire

The survey of domestic water sector “experts” (ministry officials, utility owners, professional associations, universities) consisted of the distribution of a questionnaire to a total of 219 entities in the ECA region. The questionnaire, distribution list and evaluation of the responses are presented in Annex B.

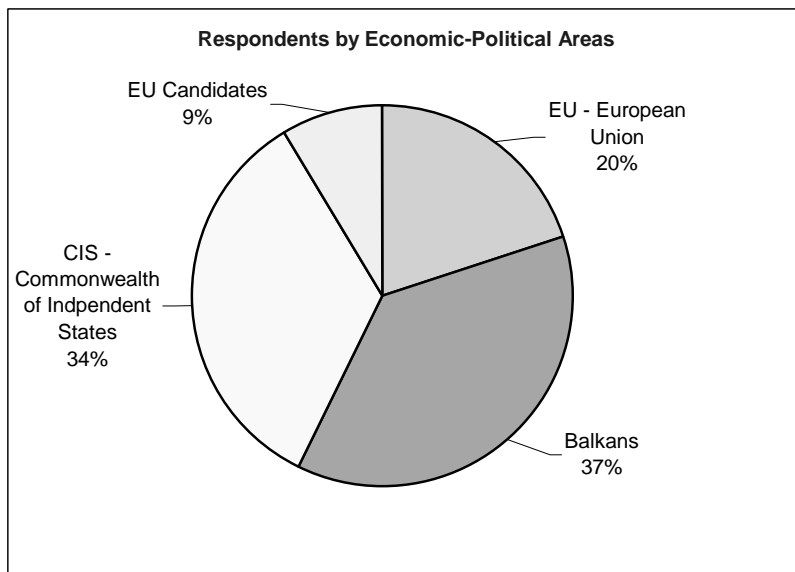
A total response rate of 18% was attained, with participation by 35 experts representing 21 countries.



Most of the “experts” are from government ranks.



Most of the “experts” are from Eastern-Central Europe and the Balkans.

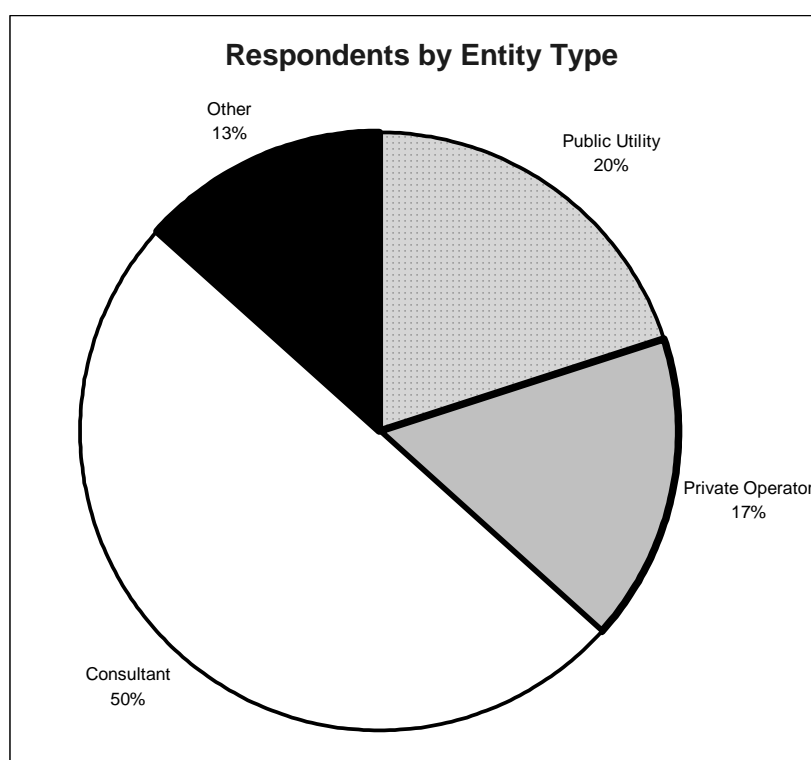


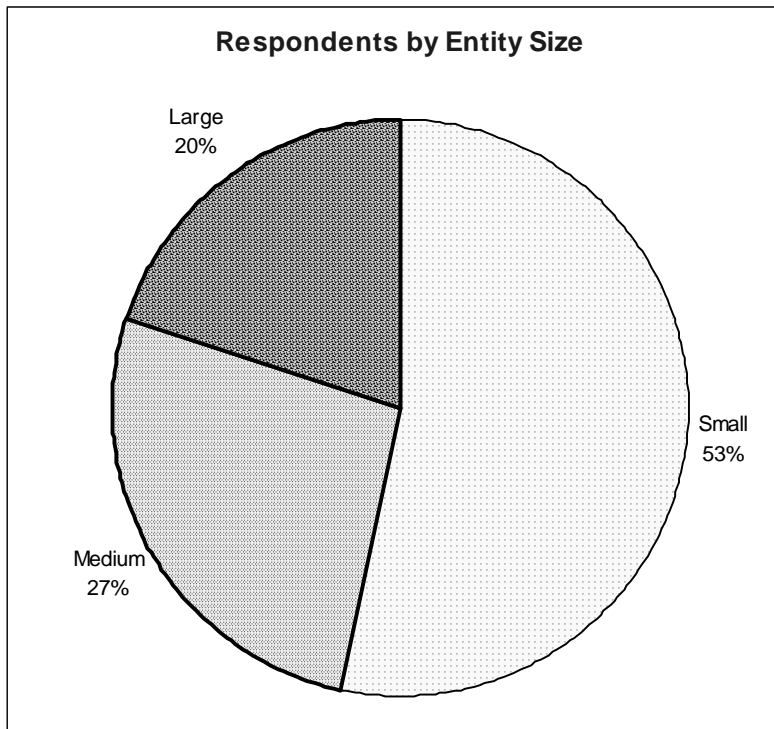
The CIS and Balkans have the greatest representation of the experts.

4.1.3 Profile of Respondents to “Participants” Questionnaire

The survey of domestic “participants” (companies currently or potentially involved in community water services) consisted of the distribution of a questionnaire on the water utility market to a total of 239 companies based in the ECA region. The questionnaire, distribution list and evaluation of the responses are presented in Annex C. A total response rate of 13% was attained, with participation by 30 companies representing 13 countries.

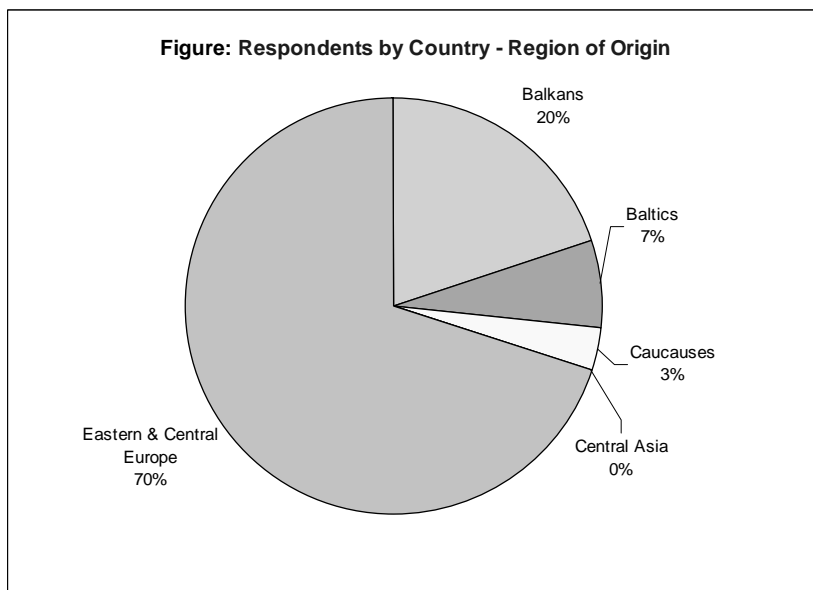
More than 80 percent report the water sector is the most important area of activity and income, mostly in technical or capacity building areas. Only 10% have no water sector experience.



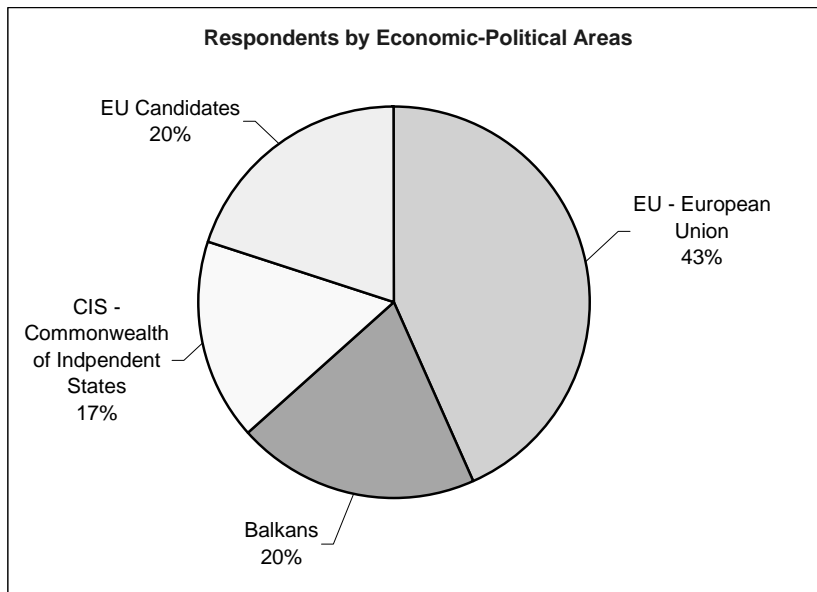


The majority of respondents are small companies.

- Small : less than 25 employees and Euro 1 million turnover
- Medium: between 25-100 employees & Euro 1 million – 4 million turnover
- Large: more than 100 employees and Euro 4 million turnover



Most of the "participants" are from Eastern-Central Europe.



Most “participants” are from the European Union, followed by EU candidates and the Balkans.

EU candidate companies report the most PPP experience (BOT, Management/ Administrative/ Technical Service Contracts).

4.2 Country Setting

The national setting is a key factor in the community water services market. Respondents confirm the importance of political, economic and social stability as cornerstones of a suitable environment for water sector activities.

The new EU countries are generally at the forefront of the ECA region with a greater likelihood that conditions conducive to sustainable community services are present. Respondents from the CIS, EU Candidate countries and the Balkans register the most country setting “limitations” to water services activities. However, there are exceptions. For example, respondents from EU states indicate the greatest concern with corruption.

<i>Table 4: Views on Sovereign Factors</i>	
CONCERNS – BARRIERS	POTENTIAL SOLUTIONS
Demand:	
Political Factors	Inclusive Democratisation Measures
Political volatility during reforms & democratisation process	
Economic Factors	Parallel Economic Development
Dysfunctional economic cycles: high unemployment & low wages tend to result in low collections on water fees	
Social Factors	Community Level Projects
Strife between various groups (as cited by respondents in the Balkans)	
Ethical – Legal Factors	Parallel Measures to Address Ethics
Corruption (cited low in CIS, but high in EU states) & Transparency	
Rule of Law (a concern in all ECA, especially in the Balkans & EU Candidate states)	
Supply:	
Country Perceptions & Risk	
Some regions are viewed as a more suitable (EU) or less suitable (CIS, EU candidate, Balkans) environment for business, including community water services.	Thorough Project Preparation
Private sector participants usually carry project risk as well as the non-project risk related to the country setting	Risk Guarantees
	<ul style="list-style-type: none"> • To address, allocate and manage risk • For non – project related risk: political, economic, social, etc., e.g. MIGA, National funds, etc.

4.3 Water Sector

Domestic respondents cite the developing nature of the water sector as a key concern throughout the ECA region. Following the dramatic political and regime changes of the late 1980s and early 1990s, parallel reforms took place in the water sector, to develop or harmonize water institutions and legislation. The reform process often resulted in on-the-ground ambiguities while new legislation was adopted and inefficiencies as new ministries developed institutional capacities.

<i>Table 5: Views on the ECA Water Sector</i>	
CONCERNS – BARRIERS	POTENTIAL SOLUTIONS
Demand:	
Institutional Framework	Parallel institutional reform measures
Inefficiency of government bodies, as cited by the ministries (“experts”) themselves	<ul style="list-style-type: none"> • To spur (and finance) capacity building and efficiency improvements in Ministries • To complete legislative reform
Developing legislation & agencies (changing standards, requirements, etc.), cited especially in Balkans & EU Candidate states	
Supply:	
Project Risk	Thorough project preparation
Private sector participants usually carry project risk plus non-project risk related to an “immature” sector: changes in regulations for compliance, agencies, etc.)	<ul style="list-style-type: none"> • including a risk allocation and management strategy

4.4 Market Structures for Water Utility Management

The traditional “community water – public service utility” model appears most prevalent in ECA, but public-private-partnership alternatives are generally acceptable to local populations, according to survey respondents. Yet, biases and structural obstacles persist. The key is to ensure full understanding and a legal basis for PPP models, such that communities can select the most appropriate solution to meet their needs from a full palette of options (whether a traditional utility or outsourcing to domestic companies).

Table 6: Views on Alternative Market Structures	
CONCERNS – BARRIERS	POTENTIAL SOLUTIONS
Demand:	
Market Understanding of PPP	Information – Education Campaign
Many market participants do not fully understand PPP (PSP, Privatisation, BOT, etc.) and the associated opportunities; though local acceptance is common	<ul style="list-style-type: none"> To explain and dispel myths of PPP options Target water sector agencies, utility owners, water companies and customers (workshops, pilot programs, etc.)
Facilitating Legislation	Legislative Reforms
“Enabling” legislation often limits water services exclusively to public utilities (monopoly structure– no private inputs permitted); cited especially in Balkans & CIS	<ul style="list-style-type: none"> To provide a legal basis for public AND/OR private options to supply water services, with appropriate safeguards for the community
Tariff policy continues to permit fees on a social (affordable to the poorest poor) rather than a commercial (cost recovery) basis	<ul style="list-style-type: none"> For Tariff procedures based on sustainability, including a viable mechanism for social cases
Asset ownership limited to public utilities – no private ownership allowed; cited in Balkans	<ul style="list-style-type: none"> To better define roles of private and public entities (especially for higher-level PPP)
Role of Utility Owner	Community Referendums
Political decisions, influenced by the reigning political party and re-election pressures, stifle tariff development and perpetuate the “un-sustainable” cycle of water companies	<ul style="list-style-type: none"> To circumvent the political arena
Water utility management staff is often vulnerable to political appointment; less in CIS	<ul style="list-style-type: none"> Stakeholder Contracts with Performance Standards To ensure community, utility & owner commitment throughout a project and remove tariff risk from private companies
Scope of Utilities	Merit Selection Procedures
Utility responsibilities often extend beyond water & wastewater services (solid waste, streets, public spaces, etc.); often not compatible with the capacities of domestic enterprises, especially in Balkans and EU candidate countries	<ul style="list-style-type: none"> For fair and transparent hiring – remove replacement risk from private companies
Supply:	
Market Openness	
Obstacles to market activities due to monopoly structures or bias	Legislative reforms and Education Campaign

4.5 Domestic Market for Water Utility Management

Domestic companies report the ECA markets for water utility management vary in efficiency and attractiveness. While the EU and CIS markets often appear more suitable for domestic inputs, this is often not so in Balkans and EU Candidate countries.

<i>Table 7: Views on the Domestic Market for Water Utility Management</i>	
CONCERNS – BARRIERS	POTENTIAL SOLUTIONS
Demand:	
Market Efficiency & Need	Establish Finance Mechanisms
Urban areas receive the best level of water services in ECA, though service in secondary cities is ranked better than in primary cities	<ul style="list-style-type: none"> Especially for Rural & Poor Areas (ISPA & PHARE have been successful instruments for the accession countries)
Rural and poor areas are the most ill-served, indicating the greatest need for improvement	<ul style="list-style-type: none"> Domestic companies are ready to work in rural areas, less so in poor areas
Market Size	Establish New Market Areas
Too few and infrequent projects – not a viable and reliable income source; cited especially in Balkans	<ul style="list-style-type: none"> Group urban with rural areas, established with new service areas, villages into regions, etc.
Market Openness	Revise Pre-Qualification & Selection Criteria
Perception of being closed to non-water sector enterprises	(See “procurement” section below)
Profitability	Tariff & Stakeholder Commitments
Poor economics & finances – lower profits; cited in Balkans and EU candidates	(See “market structures” section above)
Political Will	Stakeholder Commitments
Perception of insufficient Political Willingness at national and local levels to implement reforms for a PPP-friendly setting	(See “market structures” section above)
Utility Will	Stakeholder Commitments
Perception that public utilities and their owners are reluctant to take difficult steps towards efficiency (modern techniques, staff reductions, reorganization); except in EU countries	(See “market structures” section above)
Perception that public utilities are biased against inputs by “domestic” companies; cited most in Balkans	Information – Education Campaign
	(See “market structures” section above)
Community Will	Stakeholder Commitments
Customer base with historically low payment levels is not willing to take the necessary steps (higher tariffs, metering) to achieve a sustainable water service via any model	(See “market structures” section above)
Supply:	
Non-project company risk: financial & willingness; cited in Balkans & EU candidates	Tariff & Stakeholder Commitments
Young market – “over saturated” by capable companies both domestic & international	(See “market structures” section above)
Overwhelming confirmation of need for reform – to create a more PPP friendly market for domestic companies	Engage in comprehensive, PPP driven reform process

4.6 Procurement

Survey respondents express an overall lack of confidence in the bidding and selection processes in the ECA region. Pure domestic projects may lack open and transparent bidding procedures, especially due to regulatory ambiguities during the initial political transitions, while international projects may have biases for international companies and strive for the most economical solutions.

<i>Table 8: Views on Procurement</i>	
CONCERNS – BARRIERS	POTENTIAL SOLUTIONS
Demand:	
National government agencies often have limited or ambiguous role in procurement at local levels	Establish National Board to address PPP Issues <ul style="list-style-type: none"> • Address PPP at a national level • Provide central information on key issues in procurement, regulations, legal basis, etc. • Support and build domestic capacities in PPP, benefiting from international experience & expertise
IFIs and Donors have defined procurement procedures, drawing on world-wide experience	
Pre-qualification	Select and justify criteria specific to project needs: <ul style="list-style-type: none"> • company turnover, minimum number of staff, value of projects, financial resources, etc. • number of similar projects, staff qualifications • location of company headquarters/ registration
Criteria which tends to favour:	
<ul style="list-style-type: none"> • Large companies 	
<ul style="list-style-type: none"> • Established companies from the water sector, cited by EU Candidates • International, cited by all except EU states 	
Bidding	Eliminate “Low-bid wins” policy: <ul style="list-style-type: none"> • Reform selection process to emphasize quality of services & company value over project cost Reduce burdens among all competitors: <ul style="list-style-type: none"> • Use standardized pre-qualification and bidding forms
Excessive focus on financial rather than qualitative factors	
Costs of bidding: time and money to prepare proposals	Create National Standards (PPP committee) <ul style="list-style-type: none"> • Use (prepare) national-regional level standard documents for procurement, contracts, etc. • Meet international and domestic language requirements
Contracts	
Unfamiliar – non-standard forms; cited in Balkans & EU Candidates	Establish & Enforce strict rules of engagement <ul style="list-style-type: none"> • Define “acceptable” types of interaction permitted between competitors (and agents, home governments, etc.) with the “selection committee” Monitoring & Enforcement by a Third Party <ul style="list-style-type: none"> • Such as an NGO or an IFI
Ethics & Transparency	
Non-merit type of influences in the selection process: (Political influence?, Bribery?, Collusion?)	
Supply:	Introduce/ Retain open bidding with pre-qualification <ul style="list-style-type: none"> • Eliminate invitation only or direct-negotiation • Adopt parallel local language documentation
Perception that the market is biased or “closed”; cited less in CIS	

4.7 Execution

Respondents indicated the following reservations with contract implementation:

<i>Table 9: Views on Contract Implementation</i>	
CONCERNS – BARRIERS	POTENTIAL SOLUTIONS
Demand:	
Dysfunctional Project Team	Stakeholder Contracts – Commitments
Company Risk: Lack of “willingness” of all stakeholders – national, owner, utility, customers	Engage 3rd Party (IFIs) as honest broker: <ul style="list-style-type: none"> • Mediator between parties • Use special relationship to convince/ apply pressure at local & national levels • Promote institutional reforms
Contract Form	Thorough Project Preparation
Performance standards based on unrealistic expectations; cited in all of ECA and especially in Balkans & EU Candidate	<ul style="list-style-type: none"> • to understand the setting, context, challenges and opportunities
Supply:	
Project and non-Project risk	Thorough Project Preparation
	<ul style="list-style-type: none"> • fully understand the local context • clearly define and allocate responsibilities • prepare risk allocation & management strategy

4.8 Domestic Companies – Expertise

Respondents from within ECA indicate a confidence in the capacities of domestic companies to provide suitable inputs for water utility management. The “experts” are generally enthusiastic for all types of PPP inputs, while the “participants” are more cautious, most preferring to engage only in service and management contracts.

Table 10: Views on Domestic Companies - Expertise	
CONCERNS – BARRIERS	POTENTIAL SOLUTIONS
Demand:	
Utility Efficiency & Need	Establish Finance Mechanisms
Many effective utilities in ECA, most cited in EU states; Perception that unsustainable utilities are incapable of self-improvement	<ul style="list-style-type: none"> Especially for unsustainable utilities
Supply:	
Advantages over Utilities	Provide PPP Exploratory - Transition Period
<ul style="list-style-type: none"> Infrastructure project development: design, procurement, etc. Repairs and proactive maintenance of system infrastructure Human resources and staff development Customer service & management System/ service area planning: master plan/ capital investment plan Cited most in Balkans, least in EU – because of condition of utilities?	<ul style="list-style-type: none"> Technical Assistance & Performance Standards: give existing utility & community “last chance” to commercialise (with inputs from domestic companies in areas of strength) Require bids from Utility on any PPP inputs (provide bidding assistance if necessary)
Advantages over International Companies	“Grow” the Pool of Domestic Companies
<ul style="list-style-type: none"> Technical/ engineering capabilities Familiarity with the local community & water sector Coordination with local officials, customer base, etc. Better Performance – Quality Better value: best combination of price & performance Willingness to provide services in remote or rustic locations – less so to poor areas Lower Price 	<ul style="list-style-type: none"> Structure projects matching the areas of strength of domestic companies Develop smaller projects to suit domestic company size and financial-execution capabilities Provide projects or project components dedicated to domestic- national companies; cited in the Balkans and EU candidate countries Cluster domestic with international companies, each in accountable roles
...and disadvantages	Incorporate Project Safeguards
<ul style="list-style-type: none"> Access to Capital Limited experience/ capacity in private water utility management Exposure to local economy & currency Corruption (most concern by EU states) Abuse of Monopoly Most disadvantages cited by EU Candidates	<ul style="list-style-type: none"> Involvement of local/ national finance & banking sector, to develop capacity 3rd party project monitoring Establish customer representation groups
Readiness for PPP	Use Service and Management Contracts
ECA companies are ready for low-level PSP in next 5 years; companies in EU Candidate countries cite interest in high-level PSP.	<ul style="list-style-type: none"> Use an incremental approach to introduce/ spread PPP into markets

4.9 Domestic Companies – Capital

Respondents from within ECA indicate an inability and lack of desire to provide capital as part of their responsibilities in water utility management. Domestic companies will not provide an immediate source of capital for community water services.

<i>Table 11: Views on Domestic Companies - Capital</i>	
CONCERNS – BARRIERS	POTENTIAL SOLUTIONS
Demand:	
Private Sector Capital is desired as part of strategy to rectify community water sector deficiencies and attain Millennium Development Goals	Develop Local Finance & Banking Sectors
Supply:	
Domestic companies are not willing/ able to provide own capital for project investments/ improvements; most prefer low-level PPP	Provide Local Incentives <ul style="list-style-type: none"> • matching funds per referendums • matching funds per public or private investments

4.10 Assessment

4.10.1 Experts and Participants

The two types of respondents present generally comparable results.

The major differences are in the assessment of the current situation and future opportunities. Experts view the existing levels of service more successful in primary and secondary cities, than participants. Further, experts are more confident in the capabilities of domestic companies and, accordingly, are more optimistic about the future of PPP in their respective markets, not just low-level PPP, but also high level PPP.

4.10.2 International and Domestic Companies

International companies generally concur with domestic companies on all key limitations to the ECA community water markets.

	Domestic Perspective	International
Country Setting	Unsuitable business environment with excessive non-project risk in many parts of ECA	Consensus
Water Sector	Developing, often unclear regulatory regime with lagging institutional capacities	Consensus
Market Structures	Limited acceptance of private inputs ...and limited success of public utilities	Consensus
Domestic Market for Water Utility Management	Is too Small, inaccessible and unprofitable	Consensus
Procurement	Low level of confidence due to procedures & transparency	Consensus
Execution	Project planning & expectations inconsistent with project execution	Consensus
Expertise	Modest capabilities (ready for service contracts ...operators for high-level PPP) <ul style="list-style-type: none"> • Ready to work in remote locations 	Comprehensive and proven capabilities ...from a variety of company types <ul style="list-style-type: none"> • Ready to work in remote and poor locations
Capital	No capacity or desire for inputs	Consensus

5.0 CASE STUDIES

Two case studies were conducted to evaluate the feasibility and performance of “domestic” market participants in utility management roles. The Case Study in Piaseczno, Poland presents an example of the local development of public-private-partnership during a volatile period.

	CASE STUDY 1: Domestic, Private Operator in Poland	CASE STUDY 2: Private Operator in ?
PROJECT	Piaseczno Water Supply & Wastewater	
Type	1993-2002 Service Contract: WS & WW operations 2003 – 2012 Lease: WS & WW operations	
Location	Piaseczno, Poland	
Population	52,000	
Private Partner	Aquarius & Co	
Public Partner	Municipality of Piaseczno	
Finance Partner	Municipality of Piaseczno with funds through ISPA, Phare and National funds	

5.1 Water Utility Management by a Domestic Operator in Poland

The Case Study in Piaseczno, Poland presents a long-term example of a private operator engaged in a service contract forged with the Municipality at the onset of the transitional period (1993) and continuing for 10 years, before being upgraded to a 10-year “lease” in 2003.

In response to the transfer of assets to the municipal level across Poland, the Municipality took advantage of the flexibility in the Polish legislative regime to outsource operations, rather than form a new utility. While project preparation, procurement, transparency and risk allocation do not approach standard IFI practices, the local parties appear to have had neither the capacity nor the resources to proceed according to “best practices” during a period of high volatility and uncertainty in the water sector.

Key factors are the generally flexible and solution oriented approach of the public and private participants during a volatile period; risk allocation and transfer of responsibility to the private partner have improved over time. However, more attention to open and transparent procurement is now necessary to meet EU standards.

5.2 Water Utility Management by ? in ?

A suitable second case study (ideally in a less prosperous part of ECA) has not yet been identified.

5.3 Summary: Water Utility Management Options

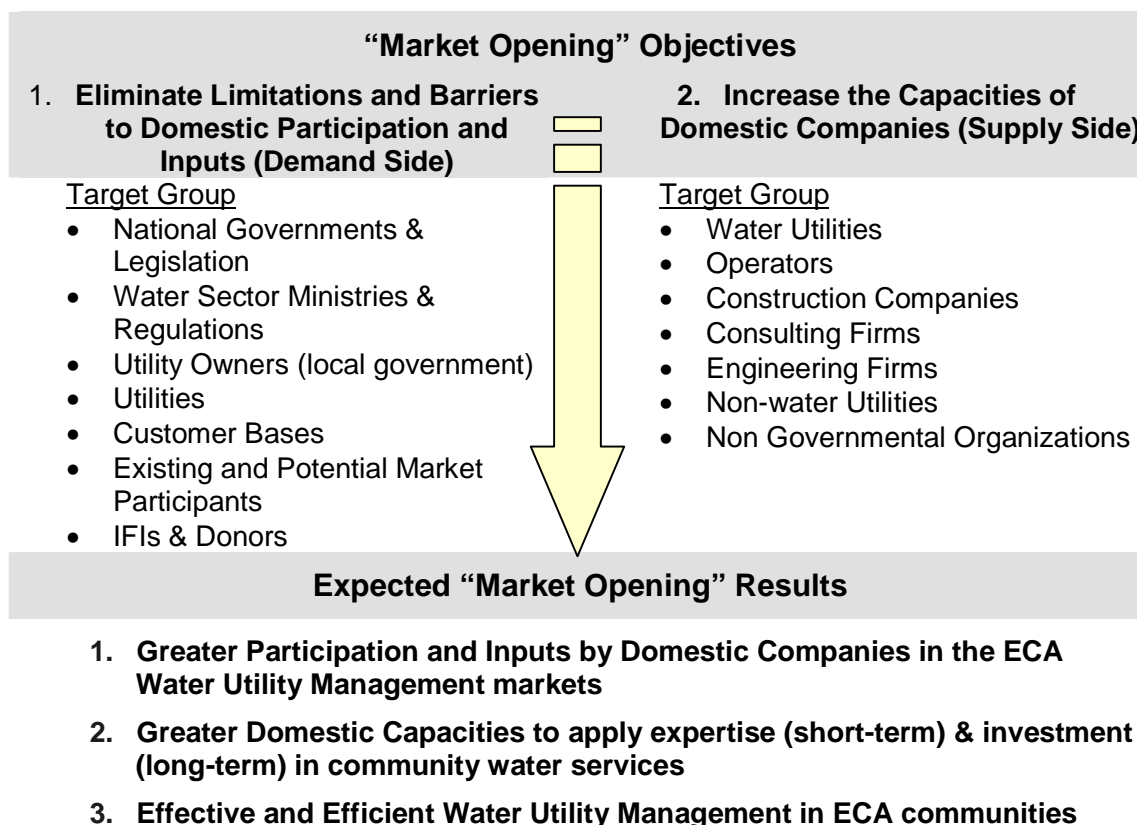
The case study in Poland demonstrates that a domestic company can enter and survive in the local water utility management market. Moreover, it shows the ability of a municipality to establish a private water utility management market

However, this example also highlights the need to evolve beyond the vague and unclear procedures and contracts of a transition period to ensure full acceptance and integrity of the PPP model.

6.0 MARKET DEVELOPMENT OPPORTUNITES

6.1 Objectives

The market development aspect of this study focuses on strategies to further mobilise domestic companies in the process to maximise the expertise and capital available to the ECA water utility management markets.



6.2 Development of Strategies

The market opening strategies presented in this chapter are based primarily on suggestions obtained from the respondents to the market survey and *during the associated workshop*, with interpretation and inputs from the Study Team.

Each strategy consists of several options to address the key market limitations identified by the survey respondents and bridge the gap to the “market opening” results. As each country, region and community has unique circumstances, no universal solution applies for the ECA region as a whole. Rather, local market participants must select options and devise strategies based on compatibility and applicability with the local context.

The feasibility of the options and strategies are evaluated through an identification of potential associated risks and risk mitigation measures.

6.3 Strategy: No Action

The first strategy focuses on maintaining the “existing” level of domestic inputs in the ECA water market, to estimate how the community water market will likely continue to function, without any course corrections or adaptations.

Feasibility Assessment: <u>No Action</u>		
CORRECTIVE MEASURE	Associated Risk	Possible Risk Mitigation
1. None – continue per current strategies	<p>A. Country Setting: domestic companies and utilities remain exposed to non-project/ country risk</p> <p>B. Water Sector: many water agencies remain ineffective, especially as regards PPP</p> <p>C. Water Utility Management Models: application of PPP remains vulnerable to misunderstandings, legal barriers, monopoly structures, political influence, etc.</p> <p>D. Domestic Market for Water Utility Management: remains dominated by</p> <ul style="list-style-type: none"> • water utilities in the public sector • international companies in the private sector <p>E. Pool of Domestic Companies: Opportunities for domestic companies remain sparse, resulting in little improvement in capacities or experience</p> <p>F. Competition: participation in the water market remains low, as confidence lags in procurement</p> <p>G. Implementation: continued risk to project discrepancies</p>	<ul style="list-style-type: none"> • Current levels of democratic, economic and social developments in ECA countries • Current levels of strengthening & aid in the water sector (from domestic and international sources)
LIKELY RESULTS:		
<p>1. Greater Participation and Inputs by Domestic Companies in ECA water markets? NOT LIKELY. Current levels of non-project risk and low confidence in procurement will negatively affect market attractiveness. Current levels of misunderstanding and structural barriers will limit the application of PPP</p> <p>2. Greater Domestic Capacities in Expertise (short-term) & Capital (long-term)? NOT LIKELY. Domestic companies will generally remain trapped in a vicious cycle of lacking experience to compete and qualify for projects. The prospect of domestic companies providing investment capital will remain very low.</p> <p>3. Effective and Efficient Water Utility Management Markets in all ECA communities? NOT LIKELY. Current levels of service are likely to remain unchanged, with continued disadvantages, especially to rural areas and the poor. Many water utilities will remain unsustainable, without prospect for improvement.</p>		

Domestic entities are unlikely, alone - under the current country settings and economic levels, to reverse the current cycles of service inefficiency and low coverage over the short to medium term. The ECA population, overall, would likely not experience any significant improvements in community water & wastewater services, neither in levels of service nor in areas of coverage. While the poor benefit in theory from low tariff levels, many poor communities are not connected to water or wastewater service networks and, therefore, do not actually gain from this benefit.

IFIs and donors would continue to provide inputs, in forms of technical assistance, grants, loans, etc., and continue at a similar rate towards attainment of the Millennium Development Goals. The domestic private sector would not be significantly mobilized in this essential quest. The international community of water sector companies would continue to selectively participate in the stable and secure niches of the ECA region, but possibly not enter into the markets for secondary cities, rural areas or poor populations.

Without reliable and effective water services, among others, opportunities for economic development would continue to limit many ECA communities, possibly jeopardizing progress towards democratisation and market economies in various ECA countries.

6.4 Strategy: Sound Business Setting

This strategy focuses on the fundamental factors responsible for a stable society and business environment. Key precursors to good community water services typically include a country setting with functional governments, a viable economic base offering employment to the vast majority of the working population, an impartial judicial system to enforce the rule of law and non-violent coexistence of all community groups. The ability to affect these macro-areas from the water sector alone is unrealistic. Yet, a reliable water supply is a key ingredient and measure of standards-of- living, economic development and community well-being.

Feasibility Assessment: <u>Basic Setting</u>		
CORRECTIVE MEASURES	Associated Risk	Possible Risk Mitigation
1. Continued Country-wide reforms towards democratisation, economic development, rule of law and peaceful coexistence	<ul style="list-style-type: none"> Macro-level changes are necessarily long term processes – with short-term fluctuations - which may be outpaced by sector or community progress 	<ul style="list-style-type: none"> Sound Project Preparation to fully understand macro-level conditions and the local context
2. Risk Guarantees for “non-project” - country risk	<ul style="list-style-type: none"> Additional project costs, to already economically deprived populations (the price for greater security and market attractiveness) 	<ul style="list-style-type: none"> Coverage of Costs by Others: (IFIs, Donors, National Funds?)
3. Pro-Ethics & Anti-Corruption Campaign	<ul style="list-style-type: none"> Resistance by entrenched parties and institutions 	<ul style="list-style-type: none"> Perseverance with replacement of weak links.
LIKELY RESULTS:		
<ol style="list-style-type: none"> Greater Participation and Inputs by Domestic Companies in the ECA water markets? GRADUALLY. Over time improvement in macro-factors and reduced exposure to non-project risk will contribute to a more conducive and attractive environment for business activities, in general, and community water services, in particular. Greater Domestic Capacities in expertise (short-term) & capital (long-term)? GRADUALLY. (same as above). Effective and Efficient Water Utility Management Markets in all ECA communities? GRADUALLY. (same as above). 		

According to the survey respondents, some ECA areas face greater challenges than others in providing a sound “country setting”, e.g. the Balkans report greater social volatility; the CIS and EU Candidate countries offer less suitable business conditions. Yet, all parts of ECA have room for improvement. For example, the new EU states registered the highest concern with corruption across the entire ECA area.

With the realization of these types of measures (many activities indeed underway at the country and water sector level according to the long-term process for institutional, political and economic changes in many ECA countries and communities) a gradual improvement in domestic and international inputs can be expected over the long-term.

However, the short term risks in ineffective water service and coverage can be expected to persist.

Several water industry standards provide guidance on how to address the fundamental elements necessary for development of private sector inputs in the water sector:

- The World Bank’s “Toolkit for Private Participation in Water & Sanitation” stresses the importance of government structures, policies and regulatory frameworks in the development of initiatives¹⁹.
- The Asian Development Bank has developed “Best Practices” to promote external investment in infrastructure²⁰. (The milestones checklist is summarized below, as a tool to apply and track progress towards application of PPP models).

Best Practice Milestones – Asian Development Bank
1. State-owned reform unit, specialized in privatisation
2. Scoping Study of the water utility
3. Costs & Benefits of separating natural monopoly businesses
4. Risk assessment and ranking with mitigation strategies
5. Determine most suitable PPP option – groundwork for privatisation tenders
6. Review legal framework for reorganization of water utilities (address necessary revisions)
7. Support for local Capital Market reforms
8. Prepare water resource management strategy; assess feasibility of tradable water rights
9. Assess data on non-revenue water and scope for revenue increases
10. Review Tariff Structures and financial statements
11. Assemble financial model of Utility, focusing on bulk and retail systems
12. Review bulk supply mechanism and develop schedule to meet international standards
13. Implement sound commercial tariff structures, billings and collections
14. Define scope of market, investment obligations and quality/ performance targets
15. Implement and independent regulatory authority for overall review
16. Commission advisors to prepare project preparation and tender documents

6.5 Strategy: Flexible Market Structures

This strategy targets the establishment of ECA water markets capable of effective and efficient community water services, regardless of the model for water utility management. Key precursors to a water market “open” to the most appropriate solution, whether public or private, include an enabling legislative framework, supportive water sector plus open and engaged market participants.

Feasibility Assessment: <u>Market Flexible to All Models</u>		
CORRECTIVE MEASURES	Associated Risk	Possible Risk Mitigation
1. National PPP Working Group & Clearing House (to foster sector-wide PPP reforms, capacity building, standards, start-up assistance)	<ul style="list-style-type: none"> Local acceptance Sustainability Accountability 	<ul style="list-style-type: none"> External Support to cover costs Performance targets
2. Information & Educational Campaign including demonstration projects	<ul style="list-style-type: none"> Resistance of ministries, utility owners, utilities, local population, etc. 	<ul style="list-style-type: none"> Demonstration projects to convince sceptics
3. Legislative and Sector Reforms to provide a legal basis for public and private models (service, tariff, assets, etc.)	<ul style="list-style-type: none"> Resistance to established public monopoly structures for social or political reasons 	<ul style="list-style-type: none"> community safeguards social policies
4. Stakeholder Contracts & Performance Standards (for public partner commitment)	<ul style="list-style-type: none"> Reluctance to PPP models and performance requirements 	<ul style="list-style-type: none"> Parallel training & threshold incentives
5. Community Referendums (ensure local support and reduce political influence)	<ul style="list-style-type: none"> Reluctance to involvement Reluctance to yield influence 	<ul style="list-style-type: none"> Parallel training & threshold incentives
6. Merit Selection of Utility Staff (reduce political influence)	<ul style="list-style-type: none"> Reluctance to yield influence 	<ul style="list-style-type: none"> Parallel training & incentives
7. Focus on Core Activities: “Un-bundle” Water from Non-Water Services OR cluster Water with Non-Water companies	<ul style="list-style-type: none"> Reluctance to yield domain 	<ul style="list-style-type: none"> Parallel training & incentives
LIKELY RESULTS:		
<p>1. Greater Participation and Inputs by Domestic Companies in ECA water markets? YES. Current levels of misunderstanding and structural barriers will be lifted, enabling greater application of PPP.</p> <p>2. Greater Domestic Capacities in expertise (short-term) & capital (long-term)? GRADUALLY. These measures will set the foundation and ensure the possibility for greater domestic inputs as well as to ensure engagement of other key market participants. Additional measures are necessary to “grow” domestic expertise (see below).</p> <p>3. Effective and Efficient Water Utility Management Markets in all ECA communities? GRADUALLY. These measures are key steps towards water service sustainability, whether through public or private mechanisms.</p>		

National PPP Working Group & Clearing House

This type of unit can play a leading role in the establishment of an environment conducive to PPP in each country (or region). A key weakness throughout ECA is that PPP has a project-specific existence and experience, but without a full-time proponent.

Such a unit can be formed from existing water ministry staff (as one possibility) without creating an extensive new bureaucracy. The purpose of the unit would be twofold:

1. to foster a sound basis for sustainable community water services
2. to promote an open framework for public or private models of water utility management

The PPP committees could function as a working group with local counterparts, with many tasks focused on sector-wide PPP reforms and capacity building.

- Catalyst role for PPP related reforms, as in sector legislation, etc. towards meeting the millennium development goals; establishment of country “business plan” for application of PPP
- Establishment & dissemination of standard bidding documents, contracts, stakeholder contracts (don’t reinvent the wheel) and in the country language (user-friendly)
- 3rd party assistance during project preparation, bidding and contract negotiation
- Coordination center for various national and international PPP efforts, possibly with funding from external and/ or national entities

Information & Educational Campaign targeting all market participants

An sector wide campaign is necessary to openly present the case for sustainable water services, through either public or private mechanisms, as best meets community needs.

A national working group (see above) could undertake such a campaign to target key market participants: ministries, utility owners, utilities, local population, and private companies. Workshops and informational meetings can provide basic information on the advantages and mechanisms of PPP, to dispel myths which sustain biases.

In especially sceptical markets, demonstration PPP projects can be prepared and implemented to illustrate the mechanisms and procedures.

Legislative and Sector Reforms (service, tariff, assets, etc.)

In many ECA countries basic reforms to legal framework are necessary to ensure a legal and commercial basis for public & private models. This will enable communities to seek solutions best suited to their unique situation, whether through public or private models.

Private companies require the legal right to provide community water and wastewater services, often restricted exclusively to a municipal utility. This monopoly structure must be loosened down to the local level.

Sustainable community water services is a goal of public or private water utility management. Yet, legislation and mechanisms regarding tariff policy often circumvent this principle based on a philosophy of water as a “social” right. Private companies are hesitant to enter a market in which a break even point, not to mention profit, is unsure.

While consideration of social cases and the poor is essential in water pricing, a more targeted approach is necessary; though the poor are the intended benefactors of low prices, they are often disconnected from water infrastructure in un-established neighbourhoods. Elements such as water stamps or progressive rates must be considered as part of the process to revamp tariff policy to ensure a sustainable revenue flow, regardless of whether under a public or private model.

For higher forms of PPP, such as BOT and divestiture, legislation reforms may be necessary to ensure private ownership of assets.

Stakeholder Contracts & Performance Standards (including Referendums)

A detriment to private company involvement in water markets is the lack of community or political willingness – and the inability to predict or enforce this local commitment. Stakeholder contracts can be utilized to ensure local participation according to performance requirements defined at the outset of the project.

Stakeholder contracts can cover a wide variety of issues:

- Tariff Policy reforms (adoption of social policy) or tariffs (tie to country economic performance, unemployment levels, etc.)
- Technical: extent of customer metering, etc.
- Organizational: staff levels, utility restructuring, etc.
- Community Referendum (ballot commitments for income levies or bonds; to circumvent political influence on tariff policy)

With staged or phased thresholds, projects can be suspended in case of lack of local fulfilment of terms.

Merit Selection of Utility Staff

A detriment to private sector involvement is the potential volatility in utility management. Directors and key managers may serve at the discretion of the government in power. A non-merit based change, mid-stream in a project presents significant risk. Establishment of transparent and merit-based staff selection procedures can eliminate this political influence.

Focus on Core Activities

Many municipal utilities retain responsibility for a plethora of community services, extending beyond water & sanitation to solid waste, streets, parks, market places, cemeteries, etc. Many private water sector companies have no capacities nor interest in pursuing such “dynamic” projects.

Possible solutions are to “un-bundle” water from non-water services prior to consideration of PPP models. Otherwise, another option is to structure projects, which group water with non-water sector companies.

6.6 Strategy: Open and Transparent Procurement

Transparency is a key concern of domestic participants during the entire span of a project, from procurement through implementation and for all participants (not only private sector competitors, but the local stakeholders as well). Several corrective measures are suggested by survey respondents to achieve more inclusive procedures.

Feasibility Assessment: <u>Open Procurement</u>		
CORRECTIVE MEASURE	Associated Risk	Possible Risk Mitigation
1. Introduce/ retain open bidding with pre-qualification	<ul style="list-style-type: none"> • Alienation of current participants 	<ul style="list-style-type: none"> • Replacement of weak links
2. Adjust and Justify PQ criteria for less biased appearance in procedures	<ul style="list-style-type: none"> • Less qualified applicants • Excessive number of applicants • Lessened ability of IFIs/ Donors to differentiate between qualified and unqualified applicants 	<ul style="list-style-type: none"> • Identification of precise Pre-qualification criteria necessary for each project • Strike appropriate balance
3. More Qualitative rather than Quantitative Bid Selection	<ul style="list-style-type: none"> • Less competitive bidding – higher prices 	<ul style="list-style-type: none"> • Appropriate balance of technical & cost
4. Lessen the Bidding Burden Standardization of tender documents, contracts, etc. (in local language)	<ul style="list-style-type: none"> • standardized forms deter individual approach and encourage “mass” submissions 	<ul style="list-style-type: none"> • Include separate sections to address unique aspects of project: methodology, local context, etc
5. Establish & Enforce Rules of Engagement	<ul style="list-style-type: none"> • Limited ability for control & enforcement 	<ul style="list-style-type: none"> • Introduce external project “controller”
6. Monitoring & Enforcement by a Third Party	<ul style="list-style-type: none"> • Added project costs • Additional layer of possible corruption 	<ul style="list-style-type: none"> • Consolidate under National PPP working group
LIKELY RESULTS:		
<p>Greater Participation and Inputs by Domestic Companies in ECA Water markets? YES. Confidence in procurement will improve market attractiveness and spu participation.</p> <p>Greater Domestic Capacities in expertise (short-term) & capital (long-term)? YES. With greater confidence in procurement, domestic companies are more likely to enter the market and, thereby, gain experience. Capital capacities of domestic companies are not likely to be improved.</p> <p>Effective and Efficient Water Utility Management Markets in all ECA communities? YES. With more inputs by domestic companies, levels of service and sustainability are likely to improve over the short to medium term.</p>		

Introduce/ retain open bidding with pre-qualification

Invitation only or direct-negotiation procedures are not compatible with an open and transparent market.

Adjust and Justify the Pre-qualification Criteria

Many criteria present an impression of bias to survey respondents, especially when no clear explanation of pertinence to the project is presented in tender documents. Attention is necessary to find the appropriate balance between weeding out unqualified candidates vs. closing off market interest.

Potential Criteria Bias in favour of...	Criteria to be Adjusted and/or Justified
Large companies	<ul style="list-style-type: none"> • company turnover • minimum number of staff • value of projects • financial resources
Established water sector companies	<ul style="list-style-type: none"> • number of similar projects • staff qualifications
International companies	<ul style="list-style-type: none"> • location of company headquarters/ registration

In turn, the key deliberation for clients (municipalities, IFIs, donors, etc.) is whether these criteria provide sufficient discrimination to select the “most qualified” applicant, yet provide a “window of opportunity” to potential market newcomers.

More Qualitative rather than Quantitative Bid Selection

Survey respondents express frustration with an “over emphasis” on the bid financial amount and an “under emphasis” on the qualitative aspects, during bid evaluation. In particular, the elimination of the “low bid wins” policy is favoured.

Conversely, a concern of potential clients is likely to focus on the escalation of overall project costs & budgets. Plus, potential clients must answer the question if “underbidding” is a legitimate tactic for newcomers to enter into a market?

Lessen the Bidding Burden

Numerous respondents indicate the burdens in the bidding process and propose to establish standardized forms for pre-qualification and proposals (by contract types and per project needs).

Potential clients may be concerned about increased costs and budgets to develop and implement such items. Plus standardization can lead to over generalization, without sufficient consideration of specific requirements. This presents an opportunity to evaluate how much company “proposal” costs are reflected in the final project implementation costs, and whether this offers an opportunity to indirectly reduce project costs.

Establish & Enforce Rules of Engagement/ Third Party

Survey respondents indicate a need to establish and enforce clear rules of engagement for the entire span of project involvement, as a key mechanism to improve transparency in the market. Moreover, respondents wish to designate an external party (IFI/ donor or national PPP working group? –for cost efficiency) as “controller” of the procurement process.

6.7 Strategy: Project Execution

Respondents indicate the need for projects with more realistic goals and additional structures to offset the possibility of a dysfunctional project team.

Feasibility Assessment: <u>Project Execution</u>		
CORRECTIVE MEASURE	Associated Risk	Possible Risk Mitigation
1. Realistic Performance Standards	<ul style="list-style-type: none"> Excessive burden on public rather than private partner 	<ul style="list-style-type: none"> Thorough Project Preparation with on-the-ground, long-term assessment PPP transition period
2. Engage 3rd Party as “Honest Broker” to address dysfunctional project teams	<ul style="list-style-type: none"> Excessive reduction of project responsibilities from contract parties 	<ul style="list-style-type: none"> Clear responsibilities and contracts with performance thresholds
LIKELY RESULTS:		
<p>Greater Participation and Inputs by Domestic Companies in the ECA water markets? YES. The likelihood of a viable and harmonious project with increase market attractiveness.</p> <p>Greater Domestic Capacities in expertise (short-term) & capital (long-term)? INDIRECTLY. With ever greater market participation, domestic company capacities will gradually increase. The prospect of domestic companies providing capital would remain very low.</p> <p>Effective and Efficient Water Utility Management Markets in all ECA communities? YES. With more viable projects, contracts will be completed per requirements, speeding the improvement of water services.</p>		

Realistic Performance Standards

A key detriment to project execution is performance standards which are incompatible with the on-ground situation. In some cases project preparation may not be sufficient to capture the complexities of the local context or risks may be excessively attributed to “incorrect” partner.

Sufficient time is necessary, especially if no prior experience has been gained in a national-regional context or local market, to understand the baseline and various market influences. This suggests investment in greater onsite assessments and even a transition period (such as 1-2 year Technical Assistance – utility commercialisation project) may provide cost-effective in the proper structuring of PPP contracts.

Engage 3rd Party as “Honest Broker”

Survey respondents desire relief from the risk of a break down between contract parties. An “honest-broker” (IFI/ donor or national PPP working group?) may provide a constructive option to keep the project team focused on progress towards contract obligations.

6.8 Strategy: Expand the Domestic Market Sphere

This strategy focuses on the demand side factors, with an overall attempt to expand customer base coverage by sustainable water services, whether through public or private models, and expand the opportunities for domestic inputs.

Feasibility Assessment: <u>Expand the Domestic Market</u>		
CORRECTIVE MEASURE	Associated Risk	Possible Risk Mitigation
1. Service Area Groupings: <ul style="list-style-type: none"> • urban with rural • affluent with poor • established with new 	<ul style="list-style-type: none"> • Reluctance of established entities to yield influence & domain • “Market building” – based on artificial unions, without staying power 	<ul style="list-style-type: none"> • Parallel training & incentives • Grass roots inputs for groupings configurations • Thorough project Preparation
2. New Finance Mechanisms – focused on unsustainable utilities in rural and poor areas	<ul style="list-style-type: none"> • Reluctance of established entities to relinquish influence & domain 	<ul style="list-style-type: none"> • Parallel training & incentives
3. PPP Demonstration & Pilot Programs	<ul style="list-style-type: none"> • Reluctance of utilities to yield influence & domain 	<ul style="list-style-type: none"> • Parallel training & incentives • Support by National PPP Working Group
LIKELY RESULTS:		
<p>1. Greater Participation and Inputs by Domestic Companies in ECA water markets? YES. More opportunities in new market segments will spur interest in the market.</p> <p>2. Greater Domestic Capacities in expertise (short-term) & capital (long-term)? YES. With ever more project experience, domestic companies will have the opportunity to develop and hone their skills - breaking the vicious cycle of too little experience & expertise to win jobs. The prospect of domestic companies providing capital will remain low, but can be a condition of the new finance mechanisms (matching funds).</p> <p>3. Effective and Efficient Water Utility Management Markets in all ECA communities? YES. With greater attention to deprived market segments, current levels of service in urban and rural areas are likely to improve. Many water utilities are likely to remain unsustainable, without prospect for internal improvement.</p>		

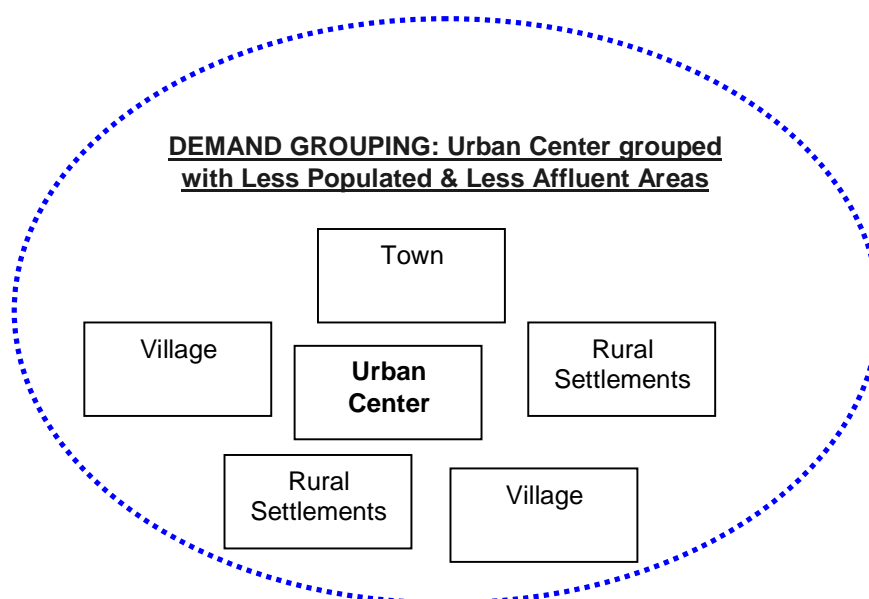
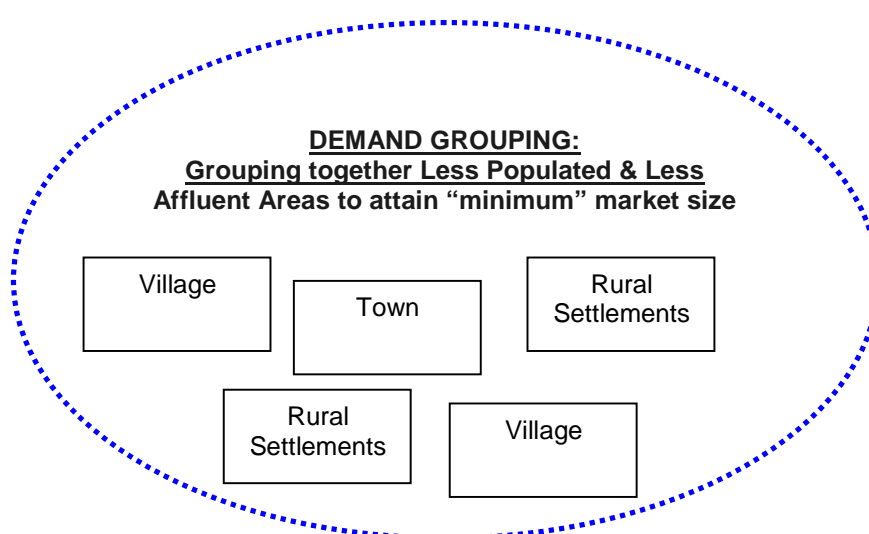
Service Area Groupings

The key limitation to private sector involvement, and often public water utility service, in secondary cities, rural areas and poor populations, is the market size and wealth. Some markets challenged by “geographic” and “socio-economic” factors face additional burdens and disadvantages:

- Insufficient numbers of inhabitants and associated financial resources can reduce the economic viability/ attractiveness of professional activities
- Excessive costs to develop projects in secondary cities and remote markets, can render a project unfeasible before even getting started

Therefore, demand-side groupings can be created to overcome these obstacles and increase market attractiveness. Such clusters are often compatible with the overall progression in the water sector towards river basin management and integrated water resources management principles. Service area groupings may offer opportunities to achieve greater market opening through grouping smaller and poorer market segments together to create more viable and attractive markets (to all types of private sector participants), such as (see illustrations):

1. Several secondary cities
2. Secondary cities with surrounding rural areas
3. Primary cities with poorer sections/ neighbourhoods
4. Primary cities with secondary cities and rural areas



The majority of domestic respondents indicate a willingness to work in more remote and many more are willing to work in economically deprived areas. Coupling this finding with the need for greater service coverage in rural and poor areas provides a potential match of market supply and demand forces:

- New niche markets (presumably too small for established market participants), in which market newcomers can build experience & references

New Finance Mechanisms

Many impoverished ECA countries not only lack sustainable water utilities, but also the wealth to finance an intervention, which can propel water services back onto a sustainable track. Creation of a new finance instrument, targeting rural and poor utilities (and service populations) could provide impetus to break the unsustainable cycle and provide a foundation for a greater market sphere. The tradition of ISPA and Phare for the EU accession countries are often noted as successful examples in this regard.

PPP Demonstration – Pilot Projects

Some ECA markets may present sceptical market participants. A demonstration project (perhaps organized through the national PPP working group?) can provide an example of the procedures to prepare and implement a PPP to overcome local population, utility or owner biases and misconceptions.

6.9 Strategy: Grow Domestic Expertise

The focus of this strategy is for measures to increase the quality of domestic companies and utilities, for a greater pool of expertise available to the ECA region. Several measures can be utilized to provide the largely still fledgling private sector a boost.

Table 19: Feasibility Assessment: <u>Develop Domestic Expertise</u>		
CORRECTIVE MEASURE	Associated Risk	Possible Risk Mitigation
1. PPP Exploratory/ Transition Period: <ul style="list-style-type: none"> • Last chance for Public Utility • Human resource strategy • Bid Submission by Utilities 	<ul style="list-style-type: none"> • Reluctance of utilities and owners to yield influence & domain 	<ul style="list-style-type: none"> • Parallel training & incentives
2. Projects matching Domestic Capacities <ul style="list-style-type: none"> • Match Project Type& Size • Service and Management Contracts • Dedicated Components 	<ul style="list-style-type: none"> • Favouritism in company selection • Only limited responsibility and risk transfer to private sector 	<ul style="list-style-type: none"> • Open and transparent bidding • Support by National PPP Working Group
3. Service Provider Groupings: <ul style="list-style-type: none"> • Public utilities with Private companies: technical assistance to outsourcing • Domestic with International companies • Water with non-water companies 	<ul style="list-style-type: none"> • Domination of non-domestic, non-private partners • “Market” building – based on artificial pairings – without staying power 	<ul style="list-style-type: none"> • Separate roles, responsibilities and payments for each entity • Grass roots inputs for appropriate groupings configurations
LIKELY RESULTS:		
<p>1. Greater Participation and Inputs by Domestic Companies in ECA water markets? YES. More opportunities in compatible areas of expertise will spur interest in the market.</p> <p>2. Greater Domestic Capacities in expertise (short-term) & capital (long-term)? YES. With ever more project experience over the short to middle term, domestic companies will have the opportunity to develop and hone their skills - breaking the vicious cycle of too little experience & expertise to get jobs. The prospect of domestic companies providing capital will remain low, as financial success does not necessarily translate into readiness for investment.</p> <p>3. Effective and Efficient Water Utility Management Markets in all ECA communities? MORE LIKELY. With such inputs, domestic expertise will improve, as will levels of service in urban and rural areas. Many water utilities may escape the “un-sustainability” cycle.</p>		

PPP Exploratory/ Transition Period

Many ECA markets with unsustainable water utilities can benefit from a transition period leading either to a “commercialised” utility or some form of public-private-partnership.

The advantage of a transition period is to present the “last chance” for a utility to complete a self-transformation to sustainability. This last-chance can take the form of a technical assistance or merely specified targets with deadlines to ensure the utility meets key operational and financial efficiency levels. Such a mechanism puts the burden on the utility to improve or face the consequences.

A key concern in many ECA markets is the social role fulfilled by public utilities as “employers”. Therefore, any improvements in efficiency and effectiveness in water utility management must contain a human resources strategy to consciously address the concerns of employees.

A transition period can also function as an appropriate “project preparation period”. If the utility fails to reach its performance standards, sufficient data and information will be available to structure a viable PPP project.

Another mechanism of a transition period may include the requirement that the utility submit a bid for any PPP component, to present a true competition of public and private to prove the best solution for the community.

Projects Matching Domestic Capacities

A key to improving the pool of expertise available to the ECA water markets is acknowledging the current character of the domestic companies – and incorporating this knowledge in the structuring of projects:

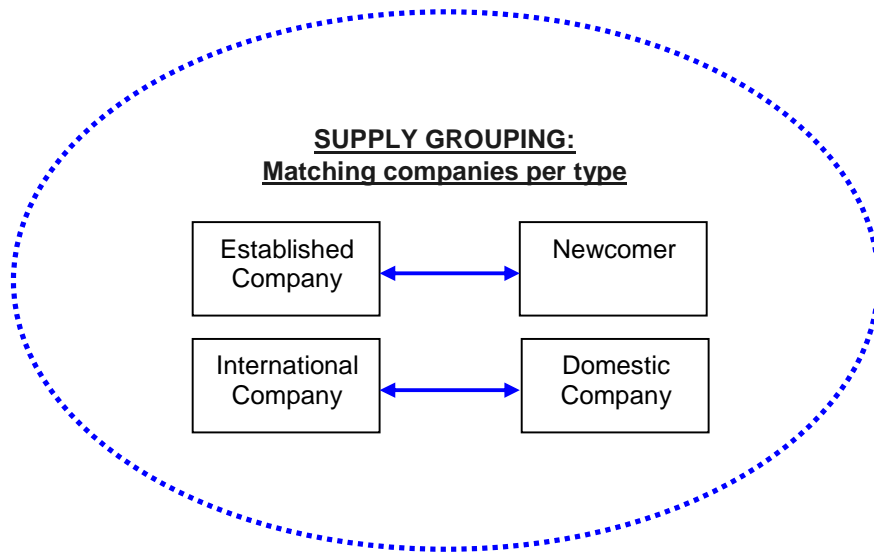
- **Project Size:** creating smaller projects or large projects with individual small components (to be let separately) will match the predominantly small size and capacities (execution and financial) of domestic companies (most respondents have 25 or less employees and a turnover of less than 1 million).
- **Project Type:** domestic companies report most confidence in particular technical (engineering) and administrative (bookkeeping, human resources), but not in overall utility management (with the exception of operators)
- **Contract Type:** most respondents report a preference for service or management contracts, with only regional preferences (EU candidate states) for higher forms, such as BOT.

Another option is provide dedicated project components for domestic companies, as is recommended in Balkans and EU candidate countries. Market openness must be maintained in such structures.

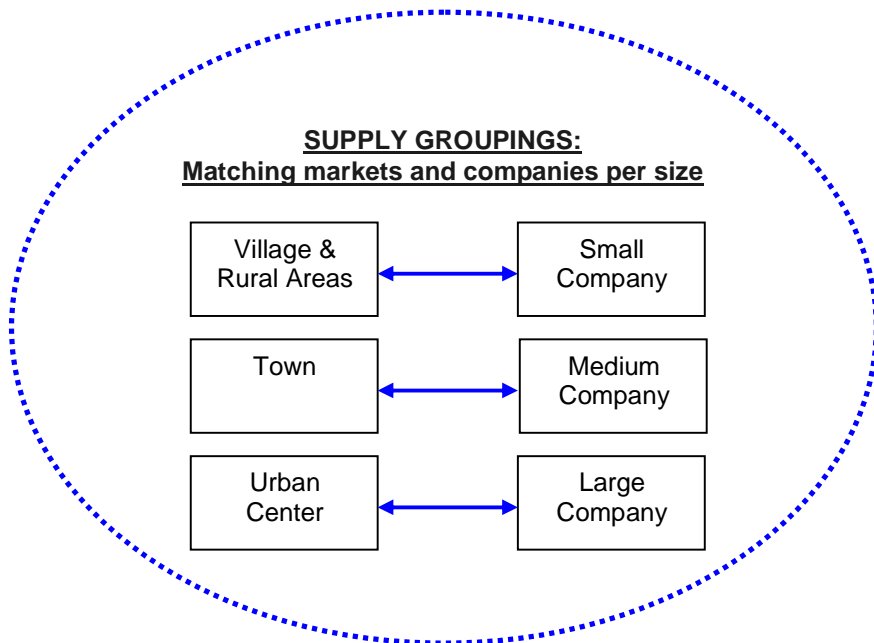
Service Provider Clusters

Project structures with groupings from the “supply side”, reflecting the size and type of companies, can provide opportunities to expand domestic opportunities and provide market openings in the ECA region:

- Pairings of established market participants with newcomers, to build the domestic pool of qualified companies
- Pairings of international with domestic companies, to build local company capacities



Project structures with required groupings (joint ventures, partnerships, etc.) per company size, can develop new capacities and expand the pool of capable market participants.



6.10 Strategy: Develop Domestic Capital

A key aspect to improving water utility services and management in the ECA region is to inject investment capital to affect a reversal in the “unsustainable” cycle prevalent in many utilities. Investment capital is necessary, for example, to improve or expand existing infrastructure systems and provide modern outfitting for water utility staffs. Yet, survey respondents have declared an inability/ strong aversion to providing investment capital. However, the local finance market has an advantage in the exclusion of foreign currency exchange risk.

<i>Table 19: Feasibility Assessment: <u>Develop Domestic Finance Capacities</u></i>		
CORRECTIVE MEASURE	Associated Risk	Possible Risk Mitigation
1. Parallel Measures to Develop the Local Banking Sector	<ul style="list-style-type: none"> • Long-term process to yield tangible results • Exposure to local economic woes 	<ul style="list-style-type: none"> • Short-term support through national & international entities
2. Stakeholder Financial Commitments – <ul style="list-style-type: none"> • Initial investments by participants • Community referendums 	<ul style="list-style-type: none"> • Initial risk exposure borne by market participants 	<ul style="list-style-type: none"> • Investment Guarantees
3. Initial – Matching Investments by External Sources	<ul style="list-style-type: none"> • Initial risk exposure borne by external parties 	<ul style="list-style-type: none"> • Matching local investments
4. Investment Guarantees	<ul style="list-style-type: none"> • Even more project costs transferred to disadvantaged entities 	<ul style="list-style-type: none"> • Additional costs covered by external parties
LIKELY RESULTS:		
<p>1. Greater Participation and Inputs by Domestic Companies in ECA water markets? YES. Any increase in domestic investment shall boost the success of the water markets.</p> <p>2. Greater Domestic Capacities in expertise (short-term) & capital (long-term)? YES. Such measures increase the ability for domestic investment, but generally over the long-term.</p> <p>3. Effective and Efficient Water Utility Management Markets in all ECA communities? MORE LIKELY. With mobilization of some domestic capital, service and sustainability are likely to increase over time.</p>		

This strategy assumes that the basic revenue question has been successfully resolved through development of a sustainable tariff, to cover operations costs at a minimum.

Parallel Measures to Develop the Local Banking Sector

A key advantage of such a measure is to eliminate the foreign exchange risk common to international investments. With water service revenues collected in domestic currencies,

international investors face a currency exchange risk over the course of the period to recoup their investment. However, if all or some capital can be obtained in local currencies, the foreign exchange risk can be lessened or eliminated, improving prospects for available capital into the ECA water sector.

The development of a banking sector, tuned into the needs of a water sector, is a long-term proposition, especially in impoverished countries. Other IFIs with relevant financial sector experience, such as the International Finance Corporation, can be included in projects or national strategies to grow such country capacities in parallel. Water companies will strive for credit worthiness.

Stakeholder Commitments

Some domestic investment capital can be raised through investment requirements, as stipulated per contract conditions. Investments can be phased in starting with repair materials (based on long-term averages) and building up over years for more substantial contributions. Community referendums can form part of the basis to raise local capital. Customer requirements, such as meter purchase, etc. are also suitable.

Initial – Matching Investments by External Sources

Many domestic companies are reluctant to simultaneously orient themselves in a new project and at the same time provide investment capital in an unknown, untested market. One approach is to structure projects with an initial project phase, in which the investments are funded by the IFI or donor. After a stipulated period, in which key financial capacities of the local market are identified and understood (tariff increases, staff reductions, investment needs, etc.), investment requirements can be phased to the domestic partners.

Investment Guarantees

Insurance is a key tool available to counter non-commercial risk in investments or private contracts, such as available through the World Bank Group's Multilateral Investment Guarantee Agency (MIGA). The MIGA reinsurance and coinsurance activities can help emerging economies attract private investment and enhance investor confidence through:

- Political Risk Insurance, both to investors and lenders
- Transfer Restriction Coverage: currency inconvertibility, exchange rate, etc.
- Physical Damage & Business Interruption: war, civil disturbance, terrorism
- Breach of Contract, Expropriation, Wrongful call of performance bonds

In addition, MIGA also provides complementary services as an “objective” intermediary, honest broker, capacity building and investment facilitation services. These types of services plus the insurance itself add costs to project development and implementation.

7.0 CONCLUSIONS

The ECA region presents a wide variety in community water service markets, according to effectiveness, efficiency and sustainability. The market for domestic participation in water utility management is characterized as young, with a large number of new and relatively small companies striving to gain market access, wherever municipalities and utilities allow.

The key messages from within ECA, according to a survey via questionnaire of market experts and participants, regarding the possibility of greater domestic inputs for water utility management are:

Market Deficiencies

1. The **need for improved community water services** persists in the ECA region, more urgently in the rural and poor areas, especially in impoverished countries.
2. **Market limitations persist at the national, sector and local levels** and act to dissuade greater participation by domestic companies. Barriers tend to present the greatest obstacles to market entry in the poorer ECA countries.
3. Domestic companies currently have **modest levels of experience and expertise**, but are confident of their ability to perform in service and management contracts.
4. Domestic companies provide **no short- or medium-term capacity for capital infusion** into the market.

Market Strategies

5. Strategies are available to eliminate or decrease barriers and **create a more attractive and accessible market** to domestic companies.
6. Options exist to create more market opportunities and, thereby, **grow domestic company capacities in water utility management** towards greater levels of private sector responsibility.
7. Measures exist to gradually **grow the local finance market** and to develop, over the long-term, capital inputs by domestic companies.
8. **Complementary strategies**, mobilizing both domestic and international inputs of expertise and capital, may offer the best hope for water service improvements to the entire ECA region.

8.0 RECOMMENDATIONS: STRATEGIC ACTION PLAN

No universal strategy can be applied throughout the ECA region, according to the uniqueness of the respective countries and individual water markets, to promote greater inputs of domestic companies. Yet, several options are available to guide the “opening” of the ECA water market to a greater range of domestic companies, as a key component of a comprehensive strategy to improve community water services.

To foster more accessible, transparent, effective and efficient water utility management markets in ECA, **five key measures** are recommended for consideration by local, national and international entities, as they develop water service initiatives in specific ECA communities and countries:

1. Support country efforts to foster a **stable and predictable business setting**
 - support country & cross-sector activities which foster a stable business environment, especially in the Balkans and also CIS and EU candidate states, and thereby reduce “non-project” risk (provide safeguards, as necessary)
2. Undertake reforms, spearheaded by a national committee, for a more **attractive and accessible water market**, open to public and private mechanisms for water utility management
 - Establish a national PPP working group, comprised of ministry officials with municipal and utility counterparts – supported by national or international funds - to promote, lay the groundwork and build the market for private domestic inputs, as a key strategy to meet the millennium development goals
 - establish the basis for effective and efficient community water services, whether through public or private water utility management models (commercial tariff policy with social policies, open enabling legislation)
 - refine procurement to be and appear to be open and transparent (justifiably)
 - ensure viable projects, realistic performance standards with proper risk allocation and safeguards
3. Expand the **domestic market sphere**
 - market organization to provide more market opportunities with new finance instruments
4. Develop the **capacities of domestic companies** for expertise (short- to medium-term) and capital inputs (long-term)
 - Expertise: create more opportunities for domestic companies to gain experience by structuring projects to match their capacities and by pairing with international companies.
 - Capital: greater levels of private investments appear possible with appropriate guarantees and matching incentive; parallel promotion and development of the local banking is an essential long-term prospect
5. Promote greater **synergies and cooperation between all market segments and participants**: national and international, public and private.

ENDNOTES

¹ *Private Sector Participation in Municipal Water Services in Central and Eastern Europe and Central Asia – Conference Write Up*; Paris, 10-11 April 2002; Posch & Partners Consulting Engineers; May 2002

² *Private Sector Participation in Municipal Water Services in Central and Eastern Europe and Central Asia – Conference Write Up*; Vienna, 2-3 July 2003; Posch & Partners Consulting Engineers; August 2003

³ Website of The World Bank

⁴ Website, United Nations Population Fund – Country Profiles

⁵ Neue Zürcher Zeitung; 5 August 2004; *Eine Gesundheitskrise gefährdet Russlands Wachstum* P[A Health Crisis endangers Growth in Russia]

⁶ Transition Report Update, April 2004, EBRD - European Bank for Reconstruction and Development

⁷ Website, Source: *World Bank - Country Income Categories, United Nations Population Fund* United Nations Population Fund – Country Profiles

⁸ *Meeting the MDG Drinking Water and Sanitation Target – A Mid Term Assessment of Progress*; UNICEF & World Health Organization; August 2004

⁹ Organization for Economic Cooperation and Development, Brochure on Environmental Action Program

¹⁰ *Private Sector Participation in Municipal Water Services in Central and Eastern Europe and Central Asia – Conference Write Up*; Paris, 10-11 April 2002; Posch & Partners Consulting Engineers; May 2002

¹¹ *World Panel on Financing Water Infrastructure*, 3rd World Water Forum - World Water Council – Global Water Partnership, March 2003

¹² Website of The World Bank

¹³ Website of the United Nations, www.un.org/millenniumgoals/

¹⁴ Multilateral Investment Guarantee Agency

¹⁵ *Private Sector Participation in Municipal Water Services in Central and Eastern Europe and Central Asia – Conference Write Up*; Paris, 10-11 April 2002; Posch & Partners Consulting Engineers; May 2002, p.18

¹⁶ *Private Sector Participation in Municipal Water Services in Central and Eastern Europe and Central Asia – Conference Write Up*; Paris, 10-11 April 2002; Posch & Partners Consulting Engineers; May 2002, p.5...presentation by Jamal Saghir

¹⁷ *Private Sector Participation in Municipal Water Services in Central and Eastern Europe and Central Asia – Conference Write Up*; Paris, 10-11 April 2002; Posch & Partners Consulting Engineers; May 2002, p.5...presentation by Jamal Saghir

¹⁸ *Private Sector Participation in Municipal Water Services in Central and Eastern Europe and Central Asia – Conference Write Up*; Paris, 10-11 April 2002; Posch & Partners Consulting Engineers; May 2002, p.8

¹⁹ Toolkits for Private Participation in Water and Sanitation, The World Bank, 1997

²⁰ *Developing Best Practices for Promoting Private Sector Investment in Infrastructure – Water Supply*; Asian Development Bank; 2000