

Some pointers for the EBRD's strategy on Municipal and Environmental Infrastructure (MEI)

For more information

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Goals of transition in the MEI sector

The concept of transition to a market economy has for the last two decades predominantly rested on concepts such as efficiency, commercialisation and private sector participation, however this perception has undergone several changes in recent years. The first element is the realisation that without the development of good quality institutions, just adding the private sector does not bring the desired results. The economic crisis has similarly shown that a market economy alone is no guarantee that people's lives will be improved in a sustainable way. Another crucial aspect that has come to the fore is the need to promote transition to a low-carbon economy, as the issue of climate change becomes ever more pressing.

In the MEI sector the issue of transition is particularly contentious because advanced market economies have varied arrangements for the provision of municipal infrastructure, and there is no clear answer as to what the goal of economic transition is. Applying conventional market solutions and private sector participation across the board has brought mixed results, particularly in the water supply sector, and goes beyond what is needed to function as a market economy. MEI improvements per se are crucial for building healthy economies and that it is therefore not necessary to cling too tightly to the EBRD's market and private sector mandate within this sector, but rather to support all projects which best contribute to the delivery of good quality public services.

Considering that the ultimate goal of transition is to improve people's lives and the environment in transition countries, the EBRD's new MEI sectoral strategy therefore needs to outline concrete, on the ground goals that the bank wants to achieve during the coming period, rather than concentrating mainly on the methods it intends to use as the last MEI policy did. In the sections below we propose such goals.

The previous MEI strategy emphasised the need for promoting greater efficiency and higher quality in the provision of local authority services, and we expect that these aims are ongoing. However these concepts needed to be further explained: Is efficiency being referred to in terms of overall value for money for public and users' money, as we would advocate, or more narrowly in terms of cutting operational costs? What does 'quality' consist of in municipal services?

CEE Bankwatch Network's mission is to prevent environmentally and socially harmful impacts of international development finance, and to promote alternative solutions and public participation.

Water supply and sanitation

Goals

The EBRD needs specify what it is trying to achieve with its water supply and wastewater treatment investments, with detailed priorities and indicators so that the projects can be evaluated based on their concrete on the ground impacts rather than just the transition-related indicators. We believe the goals need to include:

- **Increasing the number of people with access to affordable drinkable tap water**
- **Decreasing water losses from water supply systems**
- **Decreasing the amount of untreated sewage discharged into watercourses**
- **Increasing the regulatory and enforcement capacity of public sector bodies**

As for the sectoral transition indicators, we agree that decentralisation and efficiency increases are important, as well as having an effectively functioning public regulatory body. However some of the current MEI policy's transition indicators are more questionable.

1) Having private sector participation (PSP) as an indicator of success is not useful in our opinion. PSP in water supply is a means to an end, not an end in itself.

Having a private company involved says nothing about whether environmental regulations are being complied with, service is being improved or efficiency is being increased.

PSP in the water sector is also not an integral part of a market economy. For example it is forbidden for private companies to carry out water supply management in both the Netherlands and Uruguay, although both of these are clearly market economies, and many other market economies have the majority of their water sector run by public companies.

Indeed, private sector participation in the water sector

has been extremely controversial and the results have not been particularly impressive globally. A recent overview of studies comparing public and private operation of water supply globally found that private sector participation has not reduced costs,¹ although this has been one of the main advantages cited in favour of private sector participation.

Another report, by the World Bank's Public-Private Infrastructure Advisory Facility², has found that in the water and electricity sectors, private sector participation has resulted in increased efficiency, *but* that this has not necessarily translated into increased investments or lower tariffs, meaning that either the starting tariffs were so low that increased efficiency still has not led companies to a sustainable position, or that the additional income has simply ended up as company profits that have not been re-invested. This highlights the fact that efficiency, whilst desirable, cannot be seen as an end in itself.

Meanwhile on in the more advanced market economies, there have been indications that private water management contracts may not provide good value for money, for example in Paris, which has recently re-municipalised its water supply, and in Berlin where a contract has recently been published that appears to guarantee profit to the private water operator.

As the public sector is also the owner and manager of the majority of utility companies in transition countries, and this looks set to be so for many years to come, it seems wiser to concentrate on building the capacity of public sector companies and regulators rather than pointing to private sector management as a solution. One way forward may be to implement *public-public partnerships* in order to build capacity.

1 Germà Bela and Mildred Warner: Does privatization of solid waste and water services reduce costs? A review of empirical studies, Departament de Política Econòmica, Universitat de Barcelona, and West Sibley Hall, Cornell University, 11 October 2008

2 Gassner et al. World Bank/PPIAF, 2009

2) The current transition indicators see full cost recovery in water supply and sanitation as a goal, and cross-subsidization as something to be eliminated. However we would question how realistic this is.

In the water supply and sewerage treatment sector in CEE and FSU countries investments have been neglected for decades. For health and environmental reasons, (but also for legal reasons in EU new member states and candidate countries) it is necessary to comply with EU environmental standards on drinking water quality and pollution of water bodies by discharged wastewater. Funding for these investments can in theory be secured either by higher revenues from the provision of services or from outside sources via subsidies from public authorities (EU, country government, municipality) or by a combination of both.

As for revenues and tariffs, there has been a clearly visible trend in the CEE new EU member states from 1990 – 2005 of decreasing water consumption per capita, followed by a stabilisation during the last 5 years. This can be explained by rising tariffs, as in these countries water supply fees are calculated based on the volume of water supplied and waste water discharged. The total effect on increasing the revenues of water utilities is therefore questionable and very much dependent on how the tariffs are increased, as well as the economic situation of the service users.

This seems to indicate that no massive windfalls can be expected from full cost recovery that would provide enough income to undertake the necessary investments.

This leaves subsidies of various kinds. The water services sector is a natural monopoly where no direct competition is present at the level of service providers. It is not possible due to technical reasons to have more than one service provider in a particular area. Therefore potential cross-subsidies inside the sector (e.g. between tariffs for water supply and sanitation) or from other sectors are not problematic from the point of view of competition, as they cannot create any disadvantages.

As there is a critical need for investments and full cost recovery at a level that would enable the necessary financing does not seem viable in most areas of CEE and FSU countries, there is a strong need for subsidies from the public sector. The absence of competition in water supply and sanitation means that any cross-subsidization from other sectors of public services will in any case not breach competition principles and rules. Therefore cross-subsidies should not be excluded as one of the possible sources of investments if the public service provider opts for it. Indeed the current ownership and management structure of water utilities together with EU funding programs creates the environment in which there exist various different sources of grants for the investment needed.

Cost recovery and subsidies for investments in sector of public water services therefore need to be balanced with regard to a) the affordability of good quality water services to households and b) the need for investments. As *full* cost recovery would most likely lead to the disconnection of socially and economically weak users and fail to leave sufficient funding for the necessary investments, **we believe it is more realistic to aim for *transparency of water utilities' income and subsidisation*** than to abolish cross-subsidisation altogether.

Issues in the EBRD's water sector operations

Although these may not be seen as priorities for a sectoral policy, these are issues which are particularly important for the water and sanitation sector, and therefore we would recommend the EBRD to state in the policy how it intends to deal with them.

Affordability

The EBRD has systems for assessing affordability in place, however there are some indications that they may not always be sufficient. A working paper

prepared for the EBRD in 2005³ outlined the low availability of reliable data on affordability in the region and pointed out that the problem may become worse before improving. This is especially likely to be true given the current global economic situation and **the MEI team needs to pay additional attention in each project that vulnerable people are sufficiently assisted.**

Public participation in decisions on water issues

The UN Economic and Social Council Committee On Economic, Social And Cultural Rights has asserted that: *“The right of individuals and groups to participate in decision-making processes that may affect their exercise of the right to water must be an integral part of any policy, programme or strategy concerning water”*⁴. However, as few water projects are classed as environmental category ‘A’ by the EBRD, there are rarely any public consultations, even in projects concerning large changes such as the introduction of private sector participation or water metering. Nor is it common to set up supervisory councils including civil society representatives, even though these could assist in improving the regulatory capacity of the public authorities. **We recommend that the creation of such councils is made a condition of loans where significant changes such as tariff increases or private sector participation are included in the project.**

Promotion of private sector participation with unclear justification

The EBRD has made significant investments into private sector water operators in recent years, and in the Tbilisi water supply project that was later cancelled, consultants recommended private sector participation without any real reason, as the public

company was recognised as having made significant improvements during recent years. **If private sector participation in this sector is to be supported a robust methodology should be developed to ensure that is only employed where it will bring clear and properly analysed benefits compared to public management of water and wastewater facilities.**

Poor value for money for the public

One of the issues around private sector participation is that the private sector is very unwilling to take risk unless it charges a high price for it, and public sector officials are usually inexperienced in gaining good value for money. In addition PSP contracts are often confidential, removing the corrective possibilities that media or civil society scrutiny would bring. An example of a project where the public does not seem to have gained good value for money is the Zagreb wastewater PPP project, which has been criticised as being extremely expensive – with constantly increasing costs – and oversized. It is argued that it would have been better to renovate the city’s antiquated drainage system first to minimise the mixing of clean rainwater from the nearby mountain and the genuinely dirty wastewater. In addition the anaerobic digestion element of the facility results in half-treated sludge, which the same company then uses as an argument for building an incinerator at taxpayers’ expense. However there is no clear reason for this as the sludge could have been treated adequately with anaerobic digestion if the company had wished to do so. **This project points to the need for the EBRD – as a public sector body – to pay much more attention to scrutinising contracts and ensuring that the public sector is getting good value for money, as well as requiring clients to publish contracts.**

Lack of effective regulation

The UN Economic and Social Council Committee On Economic, Social And Cultural Rights has stipulated that *“Where water services (such as piped water networks, water tankers, access to rivers and wells) are operated or controlled by third parties, States parties must prevent them from compromising*

3 Samuel Fankhauser and Sladjana Tepic: Can poor consumers pay for energy and water? An affordability analysis for transition countries, EBRD, May 2005

4 UN Economic and Social Council Committee On Economic, Social And Cultural Rights, Twenty-ninth session Geneva, 11–29 November 2002 Agenda item 3: Substantive Issues Arising In The Implementation Of The International Covenant On Economic, Social And Cultural Rights, General Comment No. 15 (2002): The right to water (arts. 11 and 12 of the International Covenant on Economic, Social and Cultural Rights), Art. 48 p.15

*equal, affordable, and physical access to sufficient, safe and acceptable water. To prevent such abuses an effective regulatory system must be established, in conformity with the Covenant and this General Comment, which includes independent monitoring, genuine public participation and imposition of penalties for non-compliance.*⁵ This is essential to ensuring the quality of service that the EBRD wishes to support. **Therefore the bank should not finance private sector participation in the water sector where there is ineffective regulation, and in all water projects should make improvement of regulation one of the project elements.**

Investment in private water services companies with unclear added value:

During the last few years the EBRD has invested significant amounts into Veolia Voda and Aqualia, which are both owned by much larger companies. It is unclear why these companies required public financing, and what the EBRD's added value is in these investments. Has the EBRD been able to adequately assess in advance to what extent these companies will improve so many people's water and wastewater services that it justifies such a level of public investment? **We recommend that if the EBRD wishes to finance private sector participation in water projects – even though its benefits are being increasingly questioned – that it finances only individual investment projects that can be assessed on their own terms, rather than blanket investments in private water companies.**

Potential conflict of interest in equity investments in public service companies

Where the EBRD invests in private utility companies, which then go on to make contracts with municipal authorities, it may be difficult for the EBRD both to ensure that the public sector obtains good value for

money and that the returns of the private company are maximised, as the EBRD has a natural interest in ensuring that the company it has invested in is profitable. A previous enquiry on this topic yielded the response that *“When financing concessions, the Bank looks to ensure that projects are in compliance with its concession policy, which is entitled Financing of Private Parties to Concessions,”*⁶ however this has not fully addressed our concerns.

Collective metering

Although it may work in advanced market economies where levels of bill payment are higher and poverty is lower, experience from transition countries suggests that collective metering is a frequent source of mistrust and sometimes outright conflict among neighbours. **We would recommend examining the local situation and consulting local people for each project, but treating collective metering with extreme caution.**

Municipal Solid Waste (MSW) Management

Goals

The main goals of the EBRD's municipal solid waste investments need to include not only economic management-related issues but also the on-the-ground measurable results, including:

- **Increasing the number of people served by waste collection services**
- **Implementation of the polluter pays principle that would allow recycling and waste reduction to become more competitive**, eg. through introduction of landfill taxes
- **Construction of a network of EU-standard sanitary landfills** (in conjunction with the

5 UN Economic and Social Council Committee On Economic, Social And Cultural Rights, Twenty-ninth session Geneva, 11–29 November 2002 Agenda item 3: Substantive Issues Arising In The Implementation Of The International Covenant On Economic, Social And Cultural Rights, General Comment No. 15 (2002): The right to water (arts. 11 and 12 of the International Covenant on Economic, Social and Cultural Rights), Art. 24 p.9–10

6 E-mail response from Mr Jean-Patrick Marquet, EBRD, 13.05.2009

point below)

- **Decreasing waste production and increasing recycling and composting levels** (beyond what is required by EU law in the more advanced transition countries)
- **Rehabilitation of substandard waste dumping sites**

The bank needs to specify what it expects to do in these areas, which countries it will concentrate on, and what the indicators of success will be.

Issues in the EBRD's waste sector operations

Insufficient inclusion of sustainable methods of waste management.

The need for a basic network of sanitary landfills should not exclude the need for the EBRD to promote waste prevention, recycling and re-use as part of its projects. While economic realities obviously have to be taken into account it is important that there are no double standards, with recycling elements for advanced transition countries and only landfills for less advanced ones. The need to both rehabilitate old landfills and construct new waste management facilities simultaneously creates a heavy financial burden for state and local authorities and users, and makes it easy for authorities to ignore innovative practices such as separated collection and recycling. We believe that **the EBRD should add environmental value in this area precisely by ensuring that no disposal facility projects are financed without a separated collection and recycling component, designed according to local conditions.**

Insufficient implementation of the polluter-pays principle

Related to the above, one of the main reasons why waste prevention and recycling is not attractive to decision-makers is because it is cheapest to build landfills. When the EBRD finances waste management projects, where possible **it needs to ensure that waste policy in the relevant country ensures that a**

landfill tax or similar payment incentivises recycling and waste prevention.

Insufficient public participation.

This is a frequent issue for all projects in transition countries but waste projects are often the most controversial and **stakeholder engagement needs to be examined particularly carefully, with a real openness to consider other project options.**

Poor site selection

Closely related to the issue of public participation is the experience of inappropriate site selection. Siting waste management facilities is always difficult to agree on with local communities, however there have been several occasions where the chosen site has been particularly inappropriate, being either close to tourist facilities or being too small to host a waste management facility for more than a few years. **Improved stakeholder engagement and a willingness to re-examine sites selected by national authorities would help to resolve this issue.**

For landfill rehabilitations, clarity is needed on where the hazardous elements removed from existing illegal landfills will go. In the case of the Zagreb Jakusevac rehabilitation financed in 1998 and 2003 this led to a disastrous hazardous waste incinerator being built outside the scope of the EBRD project, without any EIA at all. The incinerator burnt down in 2002 but around 250 tonnes of hazardous ashes are still at the site, improperly stored.

The EBRD is to be commended for not having financed any municipal waste incinerator projects during the current sectoral policy period, and we recommend that it also does not do so for the foreseeable future. Waste incinerators are the most expensive waste management method by far, and as well as burning valuable resources and resulting in air pollution and hazardous ash and filter residues, they also limit future waste management choices due to their need for a constant supply of waste and money. This is a particular problem in transition countries where there is very high scope for improvement of

waste prevention and recycling, combined with financial constraints, and decisions to build incinerators now are likely to inhibit steps towards sustainable resource use during the coming decades.

Urban transport

Goals

The overall goals of the EBRD's investments in the urban public transport sector need to include:

- **Increasing walking, cycling, and urban public transport usage**
- **Halting the removal of tram and trolleybus services in cities**
- **Reducing congestion in cities through traffic reduction measures**
- **Increasing the energy efficiency of urban transport systems**
- **Introducing the use of sustainable renewable energy for urban public transport**

Issues in the EBRD's urban transport sector operations

In this sector Bankwatch has mainly monitored the Tbilisi public transport project, approved in 2005. The main issues that arose in this project were:

- Inadequate city transport planning: Lack of an adequate number of buses led to increased overcrowding in buses as minibuses were banned from the main streets and the city authorities discontinued the tram and trolleybus services. Some of the buses purchased are no longer operational, and certain lines have been discontinued, making the overcrowding even more dramatic and increasing prices for users who have to change buses more frequently and pay each time.
- Catalytic converters were not fitted, and the

poor fuel quality means that the buses could only comply to the EURO 1 standard, so the buses still pollute heavily.

- The fee collection system introduced in July 2007 was highly problematic. After just a month, the conductors that had been introduced were fired because of the increased costs necessary to pay them.
- Inadequate fee support for economically vulnerable people – too few people were identified as being eligible for support.
- The whole economic set-up of the bus company remains extremely unclear, with large losses, no clear estimate of the number of passengers.

The recommendations which arose were mainly project-specific but could be summarised as:

- The need for a comprehensive and publicly consulted city transport development plan
- The need for better economic planning of the changes planned within the project
- The need for a better affordability assessment

District heating

The EBRD's goals in the district heating sector need to include:

- **Increasing the efficiency of district heating systems**
- **Increasing the usage of sustainable renewable energy in district heating systems**

As we have very little experience in monitoring district heating projects we do not include issues to address in this sector.

Social sectors

During the current policy period the EBRD has barely invested in the social sectors such as health, education, public housing etc. However, with the onset of the economic crisis and the need for increased attention to social issues, some commentators, such as in the Besley report commissioned by the EBRD, have cautiously pointed to a potential for more investments in the social sectors. **However, we do not believe that a private-sector-oriented bank is the appropriate institution to undertake such investments.**

Given the EBRD's market-oriented focus though, it has been suggested that the EBRD could finance public-private partnerships in these sectors in order to combine social purposes with its private sector focus. Bankwatch does not believe the EBRD should follow this route. First, introducing PPPs into the social sectors goes far beyond what is required for a market economy. Second, there is very little evidence to show whether PPPs offer good value for money in these sectors. It is mainly in the UK that this has been tried on a large scale, and the figures have mostly been considered confidential, yet when researchers have had access to them, it has been found that PPPs have been *much* more expensive than public procurement would have been.

One of the main problems of PPPs is the building up of large payment obligations for the coming decades – an issue that has come to the fore during the economic crisis. The new UK government has slashed the predominantly PPP Building Schools for the Future programme, and the Hungarian and Portuguese governments have both announced major reviews of their decisions to use PPPs in public infrastructure projects.

In addition there have been problems relating to the inflexibility of PPP contracts in the UK National Health Service, which mean that in times of tight budgetary conditions, all the cuts have to be made in non-PPP parts of the health service budget.

Most experts agree that PPPs should only be used where they offer clear advantages over traditional public procurement, however the methods of assessing such advantages have proved controversial. In many cases in CEE there often does not appear to be any assessment at all, while the existing public sector comparator models have been criticised for being easy to manipulate, with highly subjective categories such as discount rates. Likewise there is rarely any assessment of a public sector option, but with a turnkey contract, which may help to avoid cost and time overruns.

One of the main concerns stifling debate about this issue is the lack of transparency in PPPs and the amount of information and documents that remain unpublished due to commercial confidentiality classification.

Bankwatch therefore does not recommend that the EBRD becomes more involved in the health, education and social housing sectors. We believe that there are other more suitable public bodies that could support these important sectors.

Recommendations:

Overall

1) The new MEI strategy needs to state clearly what the EBRD wants to achieve on the ground in the constituent MEI sectors (ie. waste, water supply etc.) and how these would improve people's lives and the environment. It should clearly distinguish between ultimate, on-the-ground aims and the EBRD's methods of achieving them. Suggestions have been given in the main text of goals we believe need to be included.

2) Public participation needs to be improved in waste and water projects, particularly where major changes are envisaged such as private sector participation, significant tariff increases, the construction of waste management facilities etc.

- a) Public hearings and consultations must be held on the different components of water projects.
- b) Companies should provide a development plan and clear time-bound information about the investments to be made and the costs to residents over the whole period of the project.
- c) Affordability should be assessed in consultation with vulnerable groups and mechanisms for social assistance assured.

3) The EBRD needs to pay increased attention to affordability and the way in which vulnerable groups eligible for assistance are defined.

Water and wastewater

4) There is a need to re-examine what the EBRD is trying to achieve with its water supply and wastewater treatment investments, with an emphasis on clear goals such as increasing the number of people with access to clean water or complying with EU legislation, rather than viewing private sector participation as a goal in itself.

5) Likewise private sector participation in the water sector should not be used as a transition impact indicator, as it is not a pre-requisite for a market economy.

6) The EBRD should consider adjusting its stance on full cost recovery and cross-subsidisation and define how realistic it believes these are in transition countries and how utilities can transparently ensure the necessary financing for investments.

7) We call on the EBRD to critically examine the claims made in favour of private sector participation, particularly in water supply management. If private sector participation in this sector is to be supported a robust methodology should be developed to ensure that is only employed where it will bring clear and properly analysed benefits compared to public management of water and wastewater facilities.

8) The use of *public-public partnerships* for building the capacity of water companies and other municipal companies may be a potential area for the EBRD to explore in its new strategy period.

9) We recommend the creation of a public supervisory mechanism as a condition of loans where significant changes such as tariff increases or private sector participation are included in the project. The council should be able to participate in key decision making processes including project design, water tariff setting, investment obligations etc.

10) The EBRD should not finance private sector participation in the water sector where there is ineffective regulation.

11) If the EBRD decides to continuing financing private sector participation in the water sector, it would be better to finance individual investment projects where the project elements can be clearly examined, rather than making equity investments in private water companies that may or may not win contracts and implement them appropriately.

12) We would recommend the EBRD to re-examine whether adequate safeguards are in place for avoiding conflicts of interests in equity investments into public utilities or whether the EBRD should avoid equity investments in such sectors.

13) Regarding collective water metering, we recommend examining the local situation and consulting local people for each project, but in general treating collective metering with extreme caution.

Waste

14) The EBRD can and should, through the project development process, ensure that the solutions which are implemented are not only EU-compliant, but result in high levels of waste prevention, re-use, recycling and composting. In more advanced

transition countries this should exceed what is required by EU law, but in all cases the EBRD should add environmental value by ensuring that no disposal facility projects are financed without a separated collection and recycling component, designed according to local conditions.

15) The EBRD should encourage national authorities, either through technical assistance or directly through projects, to implement landfill tax or a similar payment to stimulate recycling and waste prevention.

16) For landfill rehabilitations, it is important that the EBRD always ensures that it is clear during the EIA process whether any hazardous waste is present at the existing dump and what will happen to it during the project.

17) The EBRD is to be commended for not having financed any municipal waste incinerator projects during this MEI policy period, and we recommend that it also does not do so for the foreseeable future.

Urban transport

18) All urban transport projects must be included in publicly consulted urban transport development plans.

19) Economic assessments of projects and passenger numbers need to be carried out more carefully.

District heating

19) The EBRD needs to ensure that as well as increasing energy efficiency, it also introduces sustainable renewable energy sources in district heating systems.

Social sectors

20) We recommend that the EBRD, as a market and private-sector-focused bank, does not increase its

involvement in the social sectors.