

PROJECT FICHE 1

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| Title | Co-financing of investments in the water supply and sanitation sector in the TACIS region | | |
| Total cost | EC contribution € 13.5 Million, Contribution of IFIs and other Donors foreseen | | |
| Aid Method | Project approach – centralised management | | |
| DAC-code | 14020 | Sector | Water supply and sanitation |

1. RATIONALE

1.1. Strategic framework

The project is based on the TACIS Multi-Annual Indicative Programme (MIP) 2004-2006 which states in chapter 6 that work should focus on Sustainable Management of Natural Resources, specifically water management. The TACIS MIP makes special mention of the need to facilitate investments in the water sector in cooperation with IFI's, notably the World Bank and EBRD.

The specific objectives of the 2004-2006 TACIS MIP (chapter 6) for the water sector are:

Johannesburg WSSD (World Summit on Sustainable Development) and MDG (Millennium Development Goals) targets: halving by 2015 the proportion of people not having access to safe drinking water and adequate sanitation and developing by 2005 integrated water resources and water efficiency plans,

Implementation of the EU-NIS partnership on water for sustainable development,

Reduced pollution and improved quality of shared water sources, such as transboundary rivers and lakes, and protect the marine environment of regional seas,

Leveraged investment from IFIs and participation of the private sector in the water sector of the NIS.

1.2. Lessons learnt

The 2004 "Study on Regional Co-operation within the EECCA in the field of Sustainable Management of Water Resources" preparing the work for TACIS regional programme in environment for 2005 – 2008 found that willingness or ability to finance investments in the Water Supply and Sanitation (WS&S) sector (or indeed in any municipal service sector) was limited. The report states the following:

"Note that according to the EBRD representative in Kazakhstan, IMF constraints on Kazakhstan and Tajikistan include sovereign debt to a maximum of 3% of GDP which essentially means that there would be limited funds available for municipal infrastructure. The IMF representative in Tblisi points out that it is not acceptable for IMF programme countries (Armenia, Azerbaijan, Georgia, Uzbekistan, Kyrgyzstan, Tajikistan and Moldova) (the CIS-7 countries) to take on non-concessional loans; concessional loans are typically defined as long payback/long grace period/low interest rate loans, or at least 35% grant financing of projects.

It is also interesting to note that even relatively rich non-IMF countries (countries not subject to IMF restrictions on borrowing) (e.g. Kazakhstan) have modest debts levels and are adverse to taking out loans to support municipal infrastructure (e.g. water sector) however this is a political decision. Due to poor financial management in the past, some governments have obstructed municipalities in taking non-sovereign guaranteed international loans (e.g. Kazakhstan and Georgia) or locally financed loans for that matter."

The main obstacle for water infrastructure investments in the poorest countries seems to be the respective countries inability to take or guarantee non-concessional loans. IMF imposed limitations on taking or guaranteeing non-concessional loans, applies only to governments and not to other actors. This project is designed to alleviate this problem by providing the grant co-financing needed in order to turn a non-concessional loan into a concessional one.

1.3. Complementary actions

The EC has instituted a number of investment support facilities that provide consultancy services to IFIs in making feasibility studies. These services are provided since IFIs in general don't have funds for feasibility studies which hamper their ability to prepare loans for investments. There are a number of investment projects in the Tacis region, the Black Sea Investment Support Facility, the Water Investment Support Facility and the JEP 1 & 2 programmes. These will help to ensure that there is a pipeline of viable loan proposals mature enough to co-finance.

1.4. Donor coordination

Several multilateral and bilateral donors provide technical assistance or finance investments in the field of environment and natural resources management. Water is certainly the most important focal area. As far as water supply and sanitation is concerned, investment projects have been developed by EBRD and WB in several NIS countries.

The EU Water Initiative Working Group for the EECCA, brings together, inter alia, EU Member States and beneficiary countries and can act as a platform of discussion on the criteria to be set for selection of investments undertaken under this project.

2. REGIONAL CONTEXT

2.1. Sector context

The MIP notes that, the centralised command economy, heavy industrialisation, concentration of population in urban areas and lack of attention to environmental problems created severe problems. Practically all countries in the TACIS region suffer from the lack of safe and clean water as well as sanitation. This situation was worsened by the lack of funds for maintenance of existing water/sewage infrastructure following the collapse of the Soviet Union. By now much of that infrastructure is severely deteriorated and large investments are needed to bring it up to standard. The problem is compounded by the fact that many governments are unable to take or guarantee non-concessional loans from IFIs, due to agreements with the IMF. This acts as a considerable obstacle to investments in the water sector. Even where individual municipalities or utilities are able to take loans the inability of the Government to provide a sovereign guarantee frequently prevent projects from getting implemented.

3. DESCRIPTION

3.1. Objectives

The overall objective of the proposed intervention is to contribute to the achievement of the Millennium Development Goals, by increasing access to sustainable water supply and sanitation services in countries of the TACIS region.

The specific objective is to improve quantity and quality of water and waste water service delivery in selected areas of the region.

3.2. Expected results and main activities

Result

Water and sanitation investment projects are selected and implemented, on pilot basis, in disadvantaged areas of the TACIS region.

Activities

For the implementation of the specific projects, the EC will entrust the partner IFIs by entering into a direct agreement which will govern the common pool of funds. The EC will contribute by means of a grant to a loan that an IFI will sign with a beneficiary Country for the execution of a WS&S project.

There shall not be an allocation a priori of the budget either amongst the IFIs or the beneficiary countries. The division of the budget shall be done during the inception period, on the basis of a pipeline of projects that is to be agreed upon by all project stakeholders. The project will explore the possibility to involve the EU Water Initiative Working Group for the EECCA component in the discussion of the project pipeline.

The project pipeline shall meet a number of eligibility criteria, which are to be discussed and agreed upon by the partner IFIs, the European Commission (EuropeAid and DG Environment in consultation with the EU Water Initiative – EUWI - Working Group) and beneficiary governments. It is anticipated that the criteria shall reflect the intention to prioritise the CIS-7 group of countries.

The project pipeline, which will be presented to the EUWI Working Group, will give priority to those investments, that meeting the above-mentioned criteria, have been subjected to a feasibility study under EC-funded preparation facilities in the Region (Joint Environment Programme II, Water Investment Support Facility, Black Sea Investment Support Facility) and other existing regional initiatives, for example the building blocks of the EUWI-EECCA.

In addition the proposed action will link up with the OECD proposal, subject to a separate project fiche, which aims at improving governance in the municipal water supply and sanitation sector in the EECCA countries by means of providing training workshops to municipal and utility staff.

Due to the limited availability of funds, this intervention is meant to be undertaken on a pilot basis: indeed the ultimate expected result is to leverage political commitment in the target countries to address water and sanitation needs of the population. This is to be achieved by promoting replication of the intervention in other municipalities and with the full support of the central governments. The EU Water Initiative could be an the appropriate forum to initiate and promote discussion on this issue.

3.3. Stakeholders

Direct beneficiaries of the project will be the end-users of the water and sewer systems in countries in the TACIS region. The intervention will favour preferably a pro-poor approach, by intervening in low-income areas.

Intermediary beneficiaries of the project will be the municipalities and the public utilities involved in the project, the local and central governments and the civil society organizations (local NGOs, community based organizations, consumer associations, etc).

Where appropriate and in full cooperation with the OECD project, private sector participation will be explored.

3.4. Risks and assumptions

The main assumption is that beneficiary countries place enough emphasis on water-related issues in their poverty alleviation policies, in order to provide the proposed intervention and its future sustainability and replication with a solid political and policies basis.

All stakeholders that will participate financially to the action (central and local governments, IFIs, possible other donors in addition to the EC) will maintain high commitment.

Other risks that can affect the sustainability of the project are technical constraints, for example erratic power supply especially in small towns, which will be addressed by means of including alternative solutions (back-up generators, other more cost effective sources of water supply).

3.5. Conditionalities

Preconditions to be achieved before proceeding with any investment activity are the agreement on the projects amongst the IFIs, the Commission and the Beneficiary after proper consultation with the relevant stakeholders, and consequent division of the project funds and signature of direct agreements with each of the involved IFIs.

Further criteria should be set to ensure that grants provided to the IFIs under these co-financing schemes go with priority to those investment projects for which these grants are necessary to make the investment projects viable.

3.6. Crosscutting issues

Environmental issues are to be reflected in the eligibility criteria. Prior to the start-up of any investment project an environmental impact assessment, approaching EU standards, should have been carried out.

Gender balance is to be taken into consideration if and where the issue is relevant.

4. IMPLEMENTATION ISSUES

4.1. Implementation method

All activities of the proposed intervention are to be implemented through centralised management.

4.2. Budget and calendar

The selected investment projects will be financed by way of grants and loans. Once agreed upon the pipeline of projects, the EC will conclude an agreement with each of the participating IFIs in compliance with the EU relevant financial regulations. A Financing Agreement based on the International organisation agreement will be signed with each IFI considered (for instance EBRD etc.), following joint management as foreseen by the Financial Regulation. The project should be set up in such a way that it allows for a multi-donor action where the conditions exist.

It is expected that the EC budget for the action (€ 13.5M) will leverage about € 27M from different partner IFIs in terms of loans. However this preliminary budget can be further expanded with the contribution of beneficiary governments and/or other donor institutions and countries, whose financial involvement is to be explored on an ad hoc basis for each of the pipeline projects.

The expected duration for the action is 36 months

4.3. Procurement and award of grants procedures

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

All programme estimates must respect the procedures and standard documents laid down by the Commission, in force at the time of the adoption of the programme estimates in question.

As explained in paragraph 3.5, agreement among IFIs, the EC and the beneficiary Governments is conditional to undertake any investment under the proposed project fiche. However the process of identification, selection and initial appraisal of future investments is driven, for each individual investment, by the relevant IFI, being the major single financial stakeholder. For this reason the IFI, for a particular investment, is not replaceable in its role of leading actor and has a de facto monopoly with respect to concluding the investment as being identified by the IFI.

4.4. Performance monitoring

Quarterly and annual reports will be produced by the partner IFIs. Objectively verifiable indicators will be agreed upon and included in the individual direct agreements at the start-up of the project.

4.5. Evaluation and audit

Evaluations and audits will be carried out using standard EuropeAid procedures.

