

EAP Task Force

GROUP OF SENIOR OFFICIALS FOR REFORM OF THE WATER SUPPLY AND SANITATION SECTOR IN EASTERN EUROPE, CAUCASUS AND CENTRAL ASIA

THIRD MEETING

SUMMARY OF MAIN DISCUSSIONS

The meeting was organised by the EAP Task Force (OECD) secretariat. The Government of Norway provided financial support for the organisation of the meeting

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SUMMARY OF MAIN DISCUSSIONS

The third meeting of the Group of Senior Officials for Reform of the Water Supply and Sanitation Sector in EECCA took place in Paris on February 2nd and 3rd, 2004. About 50 EECCA high-level officials, and representatives from donors, NGOs, IFIs and the private sector participated in the meeting. Mr Hryhory Semchuk, Chairman of the State Committee for Housing Policy and Communal Services, Ukraine, and Mr Palle Lindgaard-Joregensen, former Head of Division at DANCEE, Denmark, opened the meeting.

REVIEW OF ONGOING WORK

At its third meeting the Group of Senior Officials for Reform of the Water Supply and Sanitation Sector in EECCA welcomed the information about demonstration projects on utility performance indicators in Kazakhstan and Kyrgyzstan, as well as reports provided for Georgia and the Russian Federation. Utility performance indicators are now available for 6 EECCA countries. The Group agreed that indicators are an important tool for the management of the reform process. It agreed on the need to develop the indicators methodology further, and on the importance of establishing the collection of indicators on a more stable and sustainable institutional basis. In this context, the plans for an EC funded research project to develop management tools on the basis of performance indicators, as well as a project to deepen and broaden the World Bank's Benchmarking Network were strongly welcomed by participants.

The Group welcomed the progress achieved in developing a guide for performance based contracts between municipalities and utilities. Participants provided specific comments on an outline of the guide that was presented to them. Delegates stressed once more the relevance of this work for advancing efforts to establish utilities as autonomous and commercially run entities, as stipulated in the Almaty Guiding Principles, as well as in the context of recent trends of increasing domestic private sector participation in the sector.

The Group welcomed information on work carried-out in Armenia to prepare Financing Strategies for wastewater collection and treatment and the social implications of water sector reforms. The high-level Armenian delegation stressed the relevance of this work in the framework of their decision making process. Several delegations expressed their interest to receive similar assistance from the EAP Task Force to support reform efforts in their countries.

The Group welcomed information about two projects carried-out under the EAP Task Force's Finance Programme relating to Municipal Multi-Year Investment Planning and to the development of Local Capital and Financial Markets. The projects will result, inter alia, in tool-kits for developing such plans in Russian and Ukrainian cities. Dissemination and training in the use of these tool-kits will be components in the next phase of this work.

WORK PROGRAMME 2003-06

The Group of Senior Officials (GSO) endorsed the detailed EAP Task Force program of work on Water Supply and Sanitation in EECCA for 2003-2006, previously adopted by the EAP Task Force. The new work programme builds on the previous work programme and is organised around three main objectives:

- Monitoring water sector reforms (using utility performance indicators, a review of legal and institutional reforms, identifying the situation in the rural WSS sector)

- Supporting legal and institutional reforms (a guide on performance based contracts, reforms of water-related standards, identifying obstacles and opportunities for private sector participation)
- Promoting financial reforms and managing their social implications (develop a financial planning tool for utilities, assess the social implications of reforms)

The Group welcomed the broadening of activities to include the rural sector. For many EECCA countries this was a difficult and challenging area of work that was particularly important in relation to the achieving the internationally agreed targets for water supply and sanitation agreed at the Millennium Summit and at the World Summit on Sustainable Development.

The Group also took note of the Project Preparation Committee's draft Strategy and discussed its linkages with the EAP Task Force Programme. The Group welcomed the opportunity for closer co-operation with the PPC and endorsed several areas in which cooperation might be strengthened: co-ordination of geographical location of Task Force and IFI activities, peer review and dissemination of information, joint identification of PPC issue meeting foci, joint capacity building activities.

DISCUSSION OF THE ROLE OF THE GROUP OF SENIOR OFFICIALS

The Group discussed its role vis à vis other institutions and actors in the EECCA water sector and identified its responsibility at three levels:

- At the international level the Group is committed to provide inputs, based on its practical experience, into initiatives such as the United Nations Commission on Sustainable Development, the EECCA Environment Strategy, and the EU Water Initiative. The Group also agreed on the importance of supporting activities to achieve the internationally agreed targets for water supply and sanitation agreed at the Millennium Summit and at the World Summit on Sustainable Development. Amongst other things, the Group can help to identify priority actions to support water sector reforms in EECCA, and help in the co-ordination of support actions.
- At the national level it is committed to work closely with the EAP Task Force to support the implementation of its work programme, and to ensure that results and recommendations are brought to the attention of EECCA governments.
- At the local level, the Group supports the dissemination of outputs in order to raise awareness in utilities, municipalities, as well as regional governments about the tools and recommendations developed within the Task Force.

Participants also discussed preparations for a Ministerial Conference to follow-up on the event held in Almaty and to be held in 2005 (Almaty+5). Delegates supported the idea to once again bring together Ministers of Economy, Finance and Environment in a two-day event, possibly in October 2005, and discussed possible items on the agenda. Participants noted that a location for the event was still to be identified and agreed to raise this issue with their administrations.

NEXT STEPS

The Group agreed to provide written expressions of interest for their participation in various parts of the work programme. This would support a consultative process involving various stakeholders to identify the location of demonstration projects.

The Group agreed that the next GSO meeting should be held in one year's time and have as its main objectives to prepare the Almaty+5 conference later in the year.

SUMMARY OF THE DISCUSSION

SESSION 1: RECENT DEVELOPMENTS AND THE ROLE OF THE GROUP OF SENIOR OFFICIALS

Mr. Gillespie, EAP Task Force, presented the work of the Group in the wider international context, including the EECCA Environment Strategy, the EU water initiative and UNCSD. In particular, he described the EECCA Environment Strategy for which the EAP Task Force plays a facilitation role, including support for the identification of priorities, the development of partnerships, the monitoring of progress and the fostering of better communication among stakeholders. He also identified the Strategy's water-related objectives on water supply and sanitation and on integrated water resource management (IWRM). Furthermore, he informed meeting participants about some of the mile stones in water related work in EECCA and beyond, including the UNCSD meeting in April of this year, a Conference of EECCA Environment Ministers in Tbilissi, Georgia in October 2004 and a Conference of EECCA Ministers of Economy, Finance and Environment focusing on water supply and sanitation in the fall of 2005. Mr. Gillespie identified the working methods of the EAP TF, which are based on analysis and exchange of experience and result in the development of Guidelines, Partnerships and Demonstration Projects.

Mr. Lindgaard-Jorgensen, discussed the EECCA component of the EU Water Initiative and presented information about a conference of the Initiative to be held in Moscow on February 26-27 2004. He identified four key objectives of this event: prioritizing building blocks; maintaining donor's interest; identifying investment needs to comply with MDGs on water; and reviewing the status of the development of national IWRM plans for 2005, as required by the international community. Mr. Lindgaard-Jorgensen provided a short overview of ongoing activities under the EU Water Initiative's EECCA component and pointed out how useful the expertise and participation of the GSO would be in this context. He also informed the meeting about major projects in progress and donors activities (i.e., TESIS will provide €3mln for 2003 and €35mln for 2003-2006 to support an investment facility, a secretariat and development of other projects). Therefore there is good evidence that the EU is taking substantial practical steps to support further reforms in the EECCA water sector.

Mr. Rainer Enderlein, UNECE discussed water and sanitation in the ECE region. He commented that IWRM was emerging as a worldwide concept in which all components should be equally valued and considered. Mr Enderlein presented a 3-fold definition of water as an integral part of the ecosystem (a natural resource, a social good, an economic good) and emphasised that the economic and environmental values of water have been finally acknowledged. He provided statistics about potable water and sanitation accessibility, water-borne disease rates and highlighted major water-related problems in the EECAA countries: transboundary inland waters and regional seas, water allocation, and demand management. While wastewater treatment practices have been substantially improved over the past years the problems of poor drinking water quality, water wastage and floods remain acute. Mr. Enderlein introduced participants to the UNECE Convention on the Protection of Transboundary Water Courses and International Lakes. He also highlighted a number of challenges that policy-makers will face when carrying-out reforms. In conclusion, Mr Enderlein stressed the need for an integrated approach to water resource management, with strong stakeholder involvement, pro-poor emphasis and gender sensitivity.

DISCUSSION 1

In the discussion that followed delegates focused on debating the possible role of the GSO in the wider political context. There was agreement that some of the key contributions of the Group are in the area of institutional and legal reforms. Demonstration projects play an important role in showing what is feasible and bringing about concrete changes where they are implemented. Mr. Semchuk stressed that reforms must be understood from bottom to top of the society and that the GSO had to play its role with this respect. The role of the GSO can be perceived as a 3-fold function: International (providing input e.g., into the EU Water Initiative and EECCA Environmental Strategy); National (promoting the Groups work within EECCA governments and supporting the implementation of the EAP Task Force's work programme); Local (disseminating information, projects results and recommendations).

The Georgian delegation suggested that producing an informative letter to EECCA governments to ensure that the GSO work is well understood and appreciated on the top national level would be helpful. This proposal was welcomed and the Group decided to draft a letter under the two Co-chairs authority presenting the GSO and its work, to attract attention to some of its key recommendations.

SESSION 2: MONITORING PROGRESS IN WATER SECTOR REFORMS: RECENT PROGRESS

Mr. Aldabergenov, Agency for Regulation of natural monopolies, protection of competition and support of small businesses of Kazakhstan, presented a recent Task Force performance indicators project and evaluated its role in improving utilities' performance in Kazakhstan. He described the current situation in the water sector and highlighted major obstacles and barriers. He also informed about results of tariff policy improvements and identified two major problems: low consumer ability to pay and an underdeveloped legal basis to enforce payment. Mr. Aldabergenov explained the situation in water production, consumption, and sewerage and referred to a number of documents that have been developed to improve the legislative ground and operational efficiency.

Mr. Ildus Zuliaylov, KYRGYZZHYLKOMMUNSOYUZ, Kyrgyzstan reported findings of the Kyrgyz performance indicators project, where he described current conditions of water supply and sanitation in Kyrgyz republic. He also mentioned that the major problems in tariff reform are the high level of electricity charges and problems with the customer data-base linked to migration of population. He stated that affordability is a key concern and that the situation in the Kyrgyz water sector is continuing to deteriorate.

Mr Patrick Mousnier-Lompré, Ministry of Public Works, Transport, Housing, Tourism and the Sea, France, delivered a presentation of a project to develop a benchmarking tool. He highlighted major objectives of the WATERBENCH project: to support the EAP TF work programme through deepening and expanding data collection; to improve and encourage investment decisions by providing enhanced decision-making tools for those involved. He described the WATERBENCH initiative, its participants, associates, and components. The basic benchmarking methodology was presented. It is based on a model (typological, with reduced number of indicators and score grids) and a tool (comparison software). Then Mr. Mousnier Lompré informed delegates about the WATERBENCH program for 2004, examined following steps and invited partners to promote this initiative in EECCA.

Mr. Antonie Grand d'Esnon elaborated further on the benchmarking approach for water utilities and presented its background, problems and achievements, based on experience in

France. Service quality and sustainability are critical factors to be monitored. Efforts in benchmarking should be focussed on resolving problems related to the maintenance and renewal of infrastructure, which are the most difficult to resolve. Mr. Grand d'Esnon suggested the creation of a Water Club in order to improve networking in water sector and to support the institutionalisation of benchmarking in the EECCA region.

DISCUSSION 2

In the discussion that followed the Group evaluated the applicability of benchmarking in EECCA and its potential institutionalisation. Delegates examined the data collection methodology and the reliability of data, as well as the methods used to calculate different indicators. The Group agreed that a certain degree of standardisation is needed to advance in implementing performance indicators, introducing performance based contracts and promoting water sector benchmarking.

Mr. Ian Naismith of Water Research Centre (WRc), England elaborated on data reliability and pointed out that in the UK it took the central regulator (OFWAT) three years to achieve sufficient levels of data accuracy. He also informed the Group of a project to support the deepening and expansion of the World Bank's benchmarking network. The project will be implemented by WRc and involve coverage of the EECCA region. Mr Naismith referred participants to the project's web-site for more information (www.ib-net.org).

SESSION 3: PROMOTING LEGAL AND INSTITUTIONAL REFORMS: PERFORMANCE CONTRACTS

Ms. Aki Yamaguchi, EAP Task Force introduced the project on Guidelines for performance-based contracts. The purpose of the project is to help define the roles of water utilities and those of municipalities as well as to improve their accountability for fulfilling the expected outputs. The guidelines are intended to serve as a reference for municipalities and water utilities that are considering the development of performance-based contracts to improve the sector performance. The Guidelines are being developed based on lessons learned from case studies within and outside the EECCA region. In the EECCA region, case studies were conducted in Russia and Ukraine. In terms of the timeline for future steps, the first draft of the Guidelines will be due mid February. An expert workshop will be held on 23 February in Paris to discuss and finalise the draft Guidelines. The final paper is due at the end of March 2004.

Mr. Sergey Sivaev, Institute for Urban Economics, Moscow stated that there is a significant market potential in the communal services sector emerging in Russia with a substantial cash flow. Russian domestic investors consider this market as an opportunity; however there is an enormous political risk involved. Mr. Sivaev described the utility's vicious circle and suggested focusing on institutional reforms, management improvement and attraction of investors. He presented three models of reforms: Privatisation of fixed assets (English model); municipal ownership of assets but private operation (French model), and joint public and private ownership of assets. He mentioned that the French model has the most potential to be adapted in Russia. Major types of risks were explained: operational, financial, investment, and property. He stressed that the usage of concession contracts would require substantial reform in the legislation. Mr. Sivaev also identified some other obstacles: no common language between government (power) and business, no common goals, false perception of the private sector's role, and lack of experience.

Mr. Anthony Molle, Gide-Loyrette-Nouel described the objectives of performance-based contracts that are to define the goals, resources as well as to define the mechanisms to measure them. He described key elements in performance-based contracts, which include: scope, legal and institutional framework, performance indicators, financial soundness, incentives, risks, and enforcement/conflict resolution mechanisms. Mr. Molle presented major issues during the contract establishing process (contract scope, priorities setting, relationships identification). The infrastructure refurbishment is crucial for a successful outcome and the number of key indicators must not be excessive. He provided two examples of cash sources (tariffs and subsidies) and specified a possible way for expenditure distribution that could be defined in a performance contract.

DISCUSSION 3

Participants discussed the importance of publicizing the results of this project and also stressed that the transparency of the reform process should receive a high priority. It was suggested that the tariffs should be gradually increased in order to match inflation rate. The Group pointed out the issue of unequal negotiation powers between the contracting parties and suggested that the Guidelines address it. In order to improve operational and regulatory framework, the Group suggested the following: strengthen external audit participation, encourage government certification, and increase transparency of the contracting process. The Group agreed that private operators should be considered as a key actor in EECCA water sector reform process. The Group also discussed FIDIC (international federation of national associations of independent consulting engineers) Contracts and their applicability in developing the Guidelines.

SESSION 4: FINANCIAL REFORMS AND SOCIAL IMPLICATIONS

Mr. Alexander Martusevich, EAP Task Force presented preliminary results of a financing strategy for urban wastewater collection and treatment in Armenia, including assessments of expenditure needs, supply of finance and financing gaps under several scenarios (i.e., Baseline and infrastructure Development scenarios), as well as packages of policy measures which would help to gradually bridge these gaps. The results show that the targets set in the Development scenario are quite realistic. It was noted that per capita income would need to increase 3-fold to allow water utilities to recover the full cost of water through user charges set at the affordability limit. This will take time and therefore for several more years Armenian government will have to provide substantial funds for capital investments in urban water infrastructure from the public budget and/or foreign loans.

Ms Olga Romanyuk, PADCO Ukraine, presented the methodology and results of an affordability analysis that was carried-out in conjunction with the financing strategy in Armenia. Within the project micro- and macro-affordability assessments were carried-out, as well as a willingness-to-pay study. The results show that already at the present low water charges Armenia faces a major affordability problem. While the widespread introduction of water meters will help to contain the affordability problem in 2004 when water tariffs will be increased two-fold¹, the affordability problem is likely to be exacerbated if additional tariff increases occur in 2005-2006. In a scenario projecting another 50% increase of tariffs in 2005, more than 50% of the population was shown to pay more than 4% of their income.

Mr. Alexander Kucherenko, PADCO Ukraine presented the context of the water sector in Armenia, as well as some of the key findings from the project. The study shows that the affordability constraint needs to be remedied through social protection measures, unless a large

¹ Due to the fact that actual per head consumption does not exceed 50% of the consumption norm that was widely used for billing of customers before the introduction of widespread household metering.

portion of the population would be at risk of losing access to drinking water. The study recommends to expand and improve the existing family benefit programme so as to provide the necessary financial assistance to the poor. To be effective, this would require, however, a substantial improvement of the targeting of the programme, as well as increased levels of financial support. The study furthermore shows that social protection can be an effective tool to leverage additional utility revenue, by protecting the poor and raising more revenue from the more well-off parts of the population. In the scenario developed in the report the leverage factor is 4 to 1 (i.e., for one unit of social protection, 4 units of additional utility revenue can be raised).

Mr. Karen Kocharyan, First Deputy Chairman of the State Water Committee of Armenia, informed on the progress in the water sector development and presented major outcomes of the process. Eight important laws have been adopted within the last three years, and in 2002 a new Water Code was issued. He pointed out that the recommendations provided by the EAP Task Force studies to double water tariffs in 2004 will be applied later this year. Mr. Kocharyan defined the demonstration project as successful and expressed gratitude to project teams and to the Norwegian and Dutch governments for their financial support.

Mr. Ruben Davtyan, Head of Department at the Ministry of Finance and Economy of Armenia, informed about the fact that public financing of the water sector in Armenia substantially increasing over recent years. He described on-going WB and KFW loan programmes in the field of water supply and sanitation in Armenia and stated that rehabilitation of the sector is one of the Armenian government's priorities. He informed participants about the Financing Strategy for urban wastewater collection and treatment developed by the EAP TF for 19 cities in Armenia. Mr Davtyan reported that the recommended sector development scenario would be implemented within 2003-2015 though it will require substantial efforts and mobilisation of additional financial resources. He also pointed out that the Armenian Government would appreciate to receive support from the TF for the implementation of the Finance Strategy's recommendations.

Ms. Astkhik Minasyan, Ministry of Social Security of Armenia, referred to some of the social implications raised within the project. She confirmed that a strong social support program is very much necessary. She elaborated on program details and presented a number of recommendations. Ms. Minasyan reported to the Meeting that there is a great need to improve targeting for family benefit program and that the level of financial support is perceived as insufficient and should be adjusted. Her Ministry is working to improve the Family Benefit programme into that direction.

Mr. Dariusz Smialkowski, EAP Task Force presented the project on municipal investment planning referring to water infrastructure in EECCA cities and discussed priorities both for municipal finance reforms and water infrastructure improvement in the EECCA countries. Within this context he mentioned that either the Central Asian pilot city or another Russian demonstration project is yet to be identified. Mr. Smialkowski stated that the stakeholders' participation and transparency of the intergovernmental transfers are critical issues for developing Multi-Year Investment Plans. He reported on outcomes of the project and introduced a set of requirements for capital water projects and incentives for the local governments that want to implement MYIP. The discussion focused on the comprehensive approach to public finance and credit opportunities for water utilities.

Mr. Grzegorz Peszko, EAP Task Force discussed access to local markets and informed the Group about major activities of the Finance Team of the EAP TF. He strongly suggested concentrating on identifying bottlenecks and opportunities in order to succeed in the process of reforms. Mr. Peszko identified two major obstacles to progress - low municipal willingness to borrow and low willingness to lend to municipalities. Additionally, Mr. Peszko described

standpoints and priorities of both parties. He discussed goals that would need to be set to help financial markets to mature and conditions that are needed to improve the situation. He mentioned that it is important to remember that governments would always have to bear the costs of social development as long as affordability of services would remain an open issue. Finally he identified several other projects from the Task Force's Finance Programme that will be relevant to the Group.

DISCUSSION 4

The Group discussed the issue of an increase of water tariffs in the context of increasing use of household water meters, which appeared to be a central topic in the Armenian case. In Armenia, the installation of water meters has resulted in a dramatic decrease of billed volumes. As a result, the planned tariff increases will not be enough to improve utility cash flow towards the levels that were aimed at. The Group recognized that the installation of water meters was not designed as a social objective and the main purpose was to make a positive contribution to reducing operational costs and capital costs in the long run by reducing the size of infrastructure.

Delegates generally agreed that projects like this can provide a useful contribution to the decision making process in EECCA governments. In the course of discussion the Moldovan and Georgian delegations expressed their interest to receive support from the Task Force to conduct a similar study on performance indicators in their respective countries. In connection with this a call for letters of interest to replicate the Armenian study was made and Mr. Börkey clarified the application process, which should be in written form, stating the reasons why such an approach would be timely in the national reform context. These letters will be an important input into a consultative process with stakeholders to identify locations for demonstration projects.

SESSION 5 WORK PROGRAMME FOR THE NEXT YEARS

Mr. Peter Börkey, EAP Task Force presented the Task Force's program in the area of Water Supply and Sanitation in EECCA for 2003-2006. He described its main components (monitoring of progress in reforming the water sector, supporting institutional and legal reforms, and promoting financial reforms while managing their social implications), as well as relevant projects within the Task Force's Finance Programme, and identified the linkage of different projects with the Almaty+5 conference. He invited delegates to work closely with the EAP TF secretariat in identifying relevant inputs and locations for carrying-out different parts of the work programme. More specifically, delegates were invited to provide inputs into work to review progress in implementing legal and institutional reforms since the Almaty Conference in the year 2000, and to express their interest in working with the Secretariat to implement demonstration projects on water related standards, a financial planning tool for utilities, and social implications of water sector reform

Ms. Sara Browning, Executive secretary of the PPC introduced the Project Preparation Committee (PPC), its strategy and areas of co-operation with the EAP TF. She presented history, key factors and major objectives of the PPC and described the PPC's organisational structure as well as the three main areas of its activity: networking and coordination; projects identification and support for preparation; and information exchange. Ms. Browning elaborated on annual targets and target outputs as well as she explicitly presented four key PPC facts, namely: PPC is a demand led organisation; PPC strategy only provides a framework for actions; PPC is investment focused; PPC has a rather light staff, which is integrated into IFIs structures.

DISCUSSION 5

In the discussion that ensued several representatives expressed their interest to work closely with the EAP Task Force on a number of projects, including reform of water related standards; social implications of water sector reforms, and rural water supply and sanitation. NGO representatives supported the extension of the work programme to cover rural water supply and sanitation, where they see a crucial need for assistance. They also stressed their readiness to work with the Task Force to disseminate recommendations for reforms in the water sector at the local level.

A number of questions addressed the role of the PPC and the support that it can provide. Ms. Browning pointed out that the role of the PPC was to act as a liaison structure to ease match making between available funds and projects. She emphasised, however, that the PPC has only facilitation functions and does not possess own funds for substantial investments. She also announced that EBRD renewed its interest in smaller projects, in Central Asia in particular. In response to question whether PPC can support grant obtaining from the EBRD, Ms Browning confirmed that the Committee would be able to play a role of an advisory unit, she pointed out however, that project proposals must be realistic in order to be presented to IFIs and other potential donors.

OTHER BUSINESS

Mr. Gillespie introduced the secretariat's thinking on the Almaty+5 Ministerial. He suggested that the event could be of a two days length, and proposed a number of possible items for the agenda of the meeting:

- Progress after Almaty in the water sector (including rural water sector using MDG)
- Role of different sources and tools for financing;
- Role of Private sector.
- Economic reforms and social implications

Mr. Gillespie invited participants to identify potential issues for the agenda and advised that the next GSO meeting could be an important milestone in the preparation process for the Almaty+5 conference. He suggested that there was a possibility that a PPC meeting could be organized back-to-back with Almaty+5. He suggested that NGOs and the business community, as at the previous conference in Almaty, could provide inputs into the event, as well as nominating delegations to participate in the meeting. Finally, Mr Gillespie indicated that a host country was sought for the event, and invited delegations to reflect on this issue when they return home.

Mr. Lindgaard-Jorgensen advised that to attract Minister's from the west it would be helpful to have some of the following items on the agenda: updates on public health impacts, on infrastructure deterioration, and private sector involvement (both domestic and international). He said that during Almaty+5 western Ministers should receive a clear and strong message whether the situation has improved, what had been done since Almaty, what else is needed to be done, where the donors' assistance is required and how much financial resources this would require. Moreover, potential investors should be confident that issues of health, infrastructure and private sector participation are still the top priorities and need to be addressed further.