



EAP Task Force

Document 32

Joint Meeting of the EU Water Initiative's EECCA Working Group and the EAP Task Force Environmental Finance and Water Networks

29 March –1 April 2005, Chisinau, Moldova

OUTLINE PAPER: FINANCING STRATEGIES FOR THE WATER SUPPLY AND SANITATION SECTOR IN EECCA

Participants are invited to take note of the document and to provide their comments on its content. In particular delegates are invited to provide their views on the key messages contained in the document and to highlight any country experience that they would wish the secretariat to include in the document when it will be developed into its full length.

ACTION REQUIRED: For information and discussion.

1 Objectives

An important obstacle to achieving environmental goals in many countries has been the failure to adequately address the associated financial issues: the costs of achieving goals; how those costs could be minimised; and the challenge of matching costs with available resources. The need for a fresh approach has become evident as EECCA countries struggle to maintain even the low levels of services currently delivered by environmentally-related infrastructure.

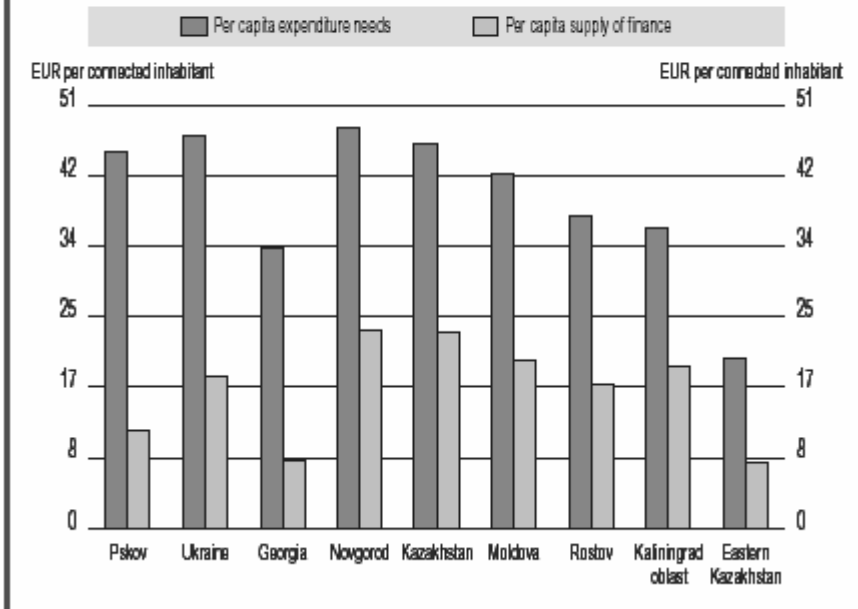
The Danish government and the OECD have jointly developed an approach to meet these challenges. This approach, backed by a special decision-support tool called FEASIBLE, has been applied in several EECCA countries. The main ideas underlying this approach are realism, affordability and cost-effective use of resources. The paper to be prepared for the Moscow Ministerial meeting would build on the results of these studies and in particular examine the role that revenues generated by tariffs will need to play in order to achieve national water supply and sanitation objectives.

2 Key Issues

Analysis of financing strategies gave quantitative estimates of the scale of under-funding and deterioration of infrastructure. In all the countries studied, significant financing deficits were measured even for the baseline scenarios, which included very modest targets of merely operating and repairing those facilities in operation when the study was undertaken. Usually only around half of the funds required to meet these targets are being provided (figure 2). This chronic under-funding of basic running costs, especially of regular, preventive maintenance was the major reason for a significant decrease in the level and quality of infrastructure services.

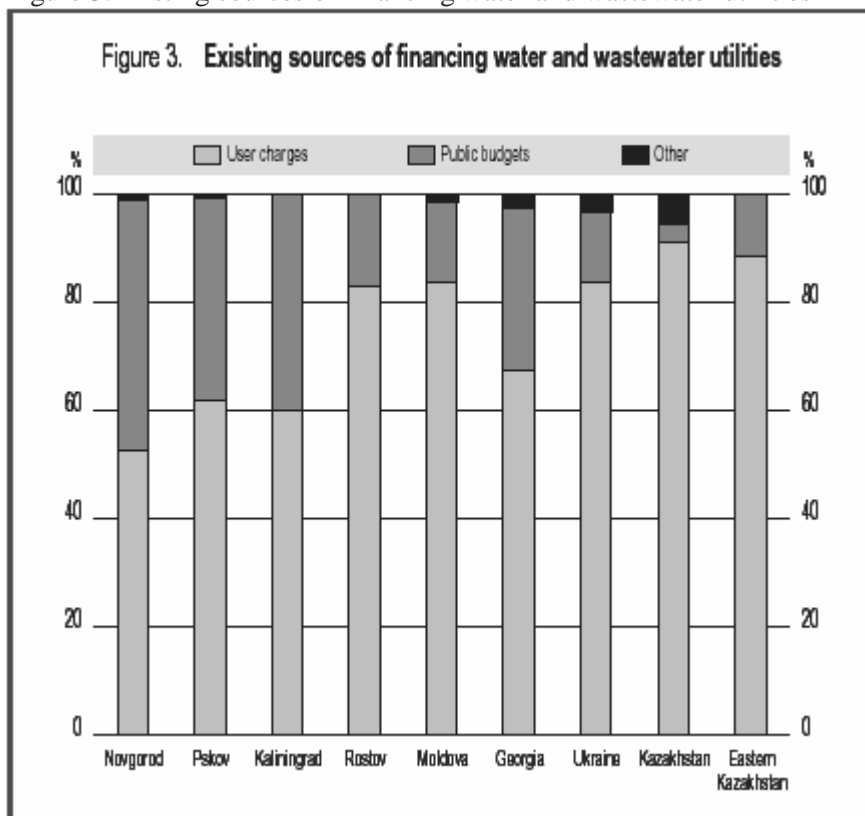
If the water-related MDGs were to be taken as targets, the financial short-falls would become even larger. This raises the question of what would be politically and socially acceptable targets for the water supply and sanitation sector that realistically could be financed.

Figure 2. Annual expenditure needs and financing available to operate and maintain the present, low level of water and wastewater services in EECCA countries (EUR per connected inhabitant in the first year of the baseline scenario)



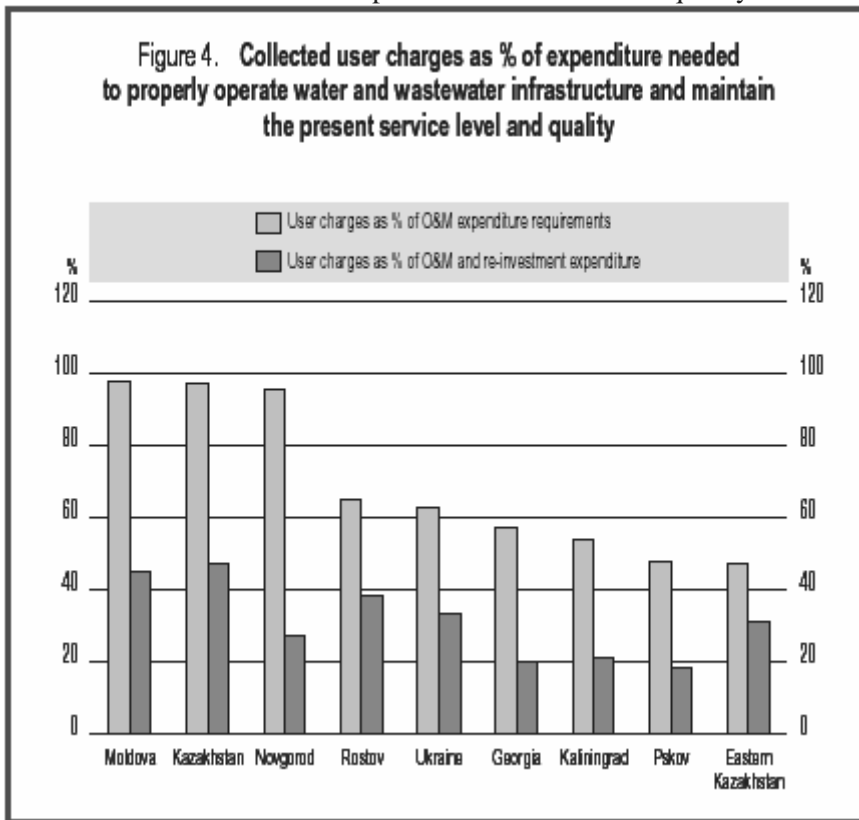
User charges account for the major share of financing. The remaining funds for water utilities come mostly from public budgets. The share of other resources such as bank credits, bonds, environmental funds, foreign grants and loans or private equity is marginal compared to user charges and public funds. (figure 3).

Figure 3. Existing sources of financing water and wastewater utilities



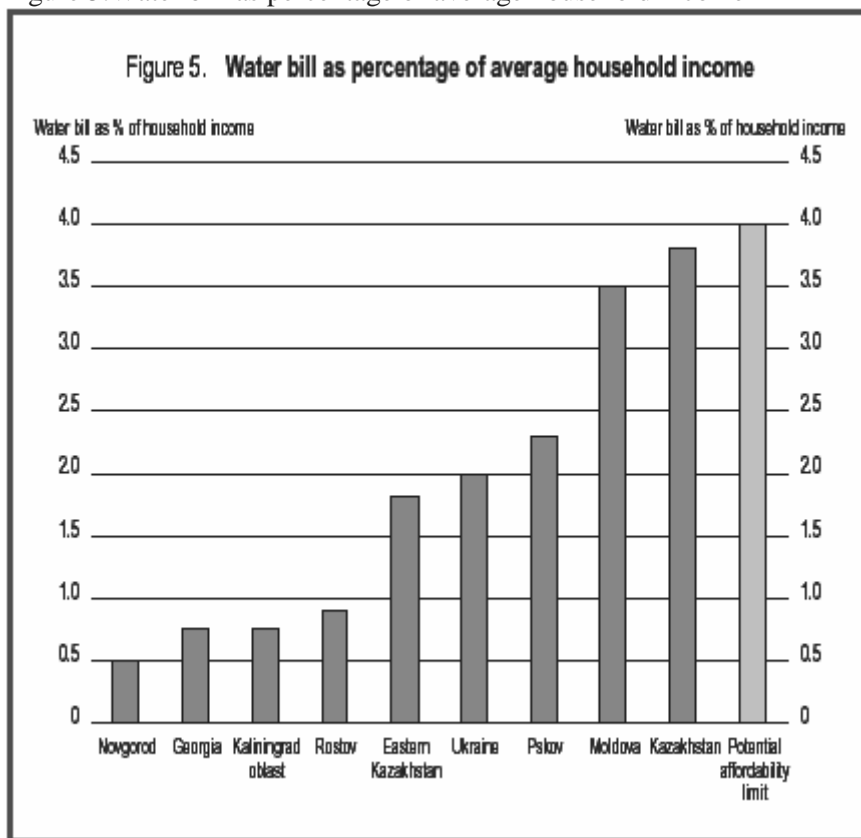
Among the countries and regions studied, only Moldova (despite extremely low income per capita) and Novgorod, on average, bill users at a level close to full operating costs. However, not all billed fees are actually paid. Collected user charges nowhere cover more than half of the costs of operating and maintaining existing assets (figure 4), if maintaining includes re-investment to keep the current level and quality of service. Some variation within countries is also present (e.g. in Kazakhstan).

Figure 4. Collected user charges as % of expenditure needed to properly operate water and wastewater infrastructure and maintain the present service level and quality



Most households seem able to pay more than they actually do, despite low incomes. There is evidence, in fact that they are often willing to pay more for improved services. In several countries studied, the average fees paid for water and wastewater services as a proportion of average household income (0.5% -2.5%) are well below international benchmarks for countries of similar income levels (typically 3%-5%). On the other hand, Kazakhstan (on the country level) and Moldova are recovering a much higher share of costs from households, with charges approaching the limits of what the house-holds on average can probably afford (Figure 5).

Figure 5. Water bill as percentage of average household income¹



Even in countries and regions that impose relatively high charges on users, affordability is a serious problem for a relatively small share of the population (10%-30%). These most affected social groups are also often well defined, e.g. pensioners, disabled. Replacing existing price subsidy schemes with more targeted income support for specific social groups would be more efficient and result in overall savings in public budgets. Furthermore, experience from environmental financing strategies, supported by the experience of OECD countries, demonstrate that as tariffs increase water consumption decreases. As a result, the total water bill to households will not increase in direct proportion to tariff increase.

In Armenia, the OECD EAP TF demonstration project established that a tariff increase by 100% in 2004 would put the water bill in Yerevan at some 3% of average household income (a level considered as affordable), while it will be over 4% (the affordability limit) of the income of some 15% of the households. These households would then need a targeted income support.

The FEASIBLE analyses have revealed that baseline financing will need to be increased in all EECCA countries if further deterioration is to be prevented. Very substantial increases in financing would need to be made if the water-related MDGs are to be achieved.

All financing sources and instruments will need to be mobilised in a synergistic fashion. There will be no magic solutions brought about, for example, by earmarked environmental funds or private sector participation. User

¹ The data presented here has been collected between 1999 and 2002. Since then the situation has changed in some countries. For instance, in the case of Russia the price of WSS has been increasing more rapidly than the consumer price index and the average revenue of households, thus confirming the relevance of the affordability and social protection issue.

charges will be the most important long-term source of finance for operation and maintenance expenditure. Public budgets will have an essential role to play in the short and medium term in financing capital investments, providing social protection and facilitating access to credit. Scarce public funds and donor grants need to be strategically prioritised and used more efficiently. Achieving the water-related MDGs suggests that donor finance would have to play a greater role than until now, particularly in the poorer EECCA countries. The importance of domestic financial and capital markets will grow over time as the framework conditions become more enabling. International financial institutions (IFI) will continue to play an important role in providing long term debt to major capital investments and promoting financial and management discipline. The role of the private sector will for many years be more important in providing managerial know-how than as a source of finance.

Increasing the supply of finance to bridge the deficits could involve significant burdens on some EECCA countries. In order to fully cover the operating and maintenance costs of the current urban water infrastructure alone, Moldova would, for example, need to spend an equivalent of 3.2% of current GDP per year, Georgia 3.0% and Kazakhstan 1.2%. In all cases, this would imply doubling or tripling the current level of expenditure in the water sector.

3 Task Force and other inputs

- DANCEE, OECD EAP Task Force (2000), *"Moldova, Background Analyses for the Environmental Financing Strategy"* (in English and Russian) prepared by COWI A/S
- DANCEE, OECD EAP Task Force (2000), *"Novgorod, Background Analyses for the Environmental Financing Strategy"* (in English and Russian) prepared by COWI A/S
- DANCEE, OECD EAP Task Force (2001), *"Environmental Financing Strategy for Kazakhstan - Background Paper"* (in English and Russian), prepared by COWI A/S
- DANCEE, OECD EAP Task Force (2001), *"Environmental Financing Strategy for Georgia - Background Paper"* (in English and Georgian) prepared by COWI A/S
- DANCEE, OECD EAP Task Force (2002), *"Environmental Financing Strategy for the Pskov Region of the Russian Federation - Background Paper"* (in English and Russian) prepared by COWI A/S
- DANCEE, OECD EAP Task Force (2003), *"Environmental Financing Strategy for the Municipal Water and Wastewater Sectors in the Ukraine, Background Analysis"* (in English and Russian) prepared by COWI A/S
- EBRD, DANCEE (2002), *"Water Prices in CEE and CIS Countries; A Toolkit for Assessing Willingness to Pay, Affordability and Political Acceptability"* (in English) prepared by COWI A/S
- European Commission, Tacis (2003) *"Development of the Pilot Financing Strategy for Urban Water Supply and Sanitation in Eastern Kazakhstan Oblast"*
- European Commission, TACIS in co-operation with the OECD EAP Task Force Secretariat (2003) *"Financing Strategy for the Urban Water Supply and Waste Water Treatment in Yaroslavl Oblast (RF)"*
- European Commission, TACIS in co-operation with the OECD EAP Task Force Secretariat (2003) *"Financing Strategy for Urban Water Supply and Waste Water Treatment in Rostov Oblast"*
- OECD EAP Task Force (2003), *"Affordability, social protection and public participation in urban water sector reforms in EECCA: Key issues and Recommendations"*, Paris 2003
- OECD EAP Task Force in co-operation with the State Committee of Water Economy and the Ministry of Finance and Economy of the Republic of Armenia (2004), *"Financing Strategy for Urban Urban Wastewater Collection and Treatment infrastructure in Armenia"*, Paris 2004

4 Possible Questions for Ministers

1. Given international commitment to the water-related MDGs and the serious financial challenges of achieving the much more modest objective of maintaining existing water infrastructure at its current low level, how can EECCA countries establish objectives for the water sector that are realistic and socially and politically acceptable?
2. What are the opportunities and obstacles to further increasing tariffs? How could any potentially adverse impacts of tariffs best be addressed?