

Task 4.1: Analysis of Opportunities for Harnessing Local Capital and Financial Markets to Support Water and Environmental Infrastructure Investments in EECCA Countries

Objective

To provide a sound and realistic road map for facilitating access of municipalities and utilities to local capital and financial markets for financing water and environmental infrastructure investments.

Background

More than a decade of neglecting maintenance of environmental and water infrastructure has led to accumulation of significant needs of capital investments. Operational revenues of water utilities (e.g. from user fees) will not be able to contribute much to meeting these needs as users can hardly afford paying for operation and maintenance alone. Public budgets will continue to play an important financing role in financing investments, social safety nets and in facilitating access to credit. However, budgets are stretched by necessary fiscal consolidation and will face expenditure constraints for several years to come. Private sector utility operators could contribute to the management and operation of utilities rather than to equity financing of capital investments.

Until recently, local financial sector and local capital markets, knocked down by the Russian financial crisis in 1998, have been unable to provide debt financing adequate to infrastructure investments. Important constraints on the demand side also continue to undermine the willingness of municipalities and utility operators to use debt to finance investments. However, several signals seem to indicate that the investment climate in this sector is improving while the capital and financial markets start showing signs of maturity. Opportunities for using local currency debt to finance local infrastructure investments are just emerging, in particular in the largest and/or strongest economies in the region – Russia, Ukraine and Kazakhstan. More information and facilitation is needed to accelerate these positive developments and harness opportunities for water and environmental infrastructure.

Activities

- Evaluate the maturity of the municipal credit systems in Russia, Ukraine and Kazakhstan and accessibility of credit institutions and instruments to water and environmental project owners. Analysis should be supported by time series data and indicators.
- Identify and analyse key demand and supply side drivers of, and key obstacles to, developing municipal credit markets (bank loans and bonds). The demand side analysis should include both ability and willingness of municipalities and municipal utilities to borrow for financing of municipal water and environmental infrastructure projects. The supply side analysis should focus on local financial institutions and instruments, such as local bank loans and municipal bonds issued for domestic markets.
- Outline a strategy for designing competitive municipal credit market institutions and instruments that would be accessible and affordable to municipal water and environmental projects. The strategy should be developed without prejudices to any models of municipal credit systems, e.g. loan-, or bond-based, and should identify what can practically work best in the particular context of countries under study in the short to medium term. The strategy should outline the sequence of medium and long term regulatory and institutional reforms. It should also contain more detailed concepts of a number of priority practical interventions that could be implemented quickly with international technical assistance in order to facilitate the development of the most realistic market institutions and financial products relevant to financing municipal water and environmental infrastructure.

- Conduct regional meeting(s) in Russia, Ukraine or Kazakhstan to agree on priorities for action and to facilitate international partnerships to achieve specific market development goals and implement specific demonstration projects.

Outputs

- Analytical report with demand and supply side analysis and recommendations on the priority demonstration projects that could realistically facilitate access of municipalities and utilities to local credit systems (loans and bonds) for financing their water and environmental infrastructure investments;
- Regional meeting (s).

Benefits/Outcomes

- Unbiased information on opportunities and constraints in the most promising EECCA countries (what will work and what won't);
- Clear priorities for international partnerships to achieve real results on the ground in the short to medium term;
- Better understanding of the risk of debt financing of water and environmental infrastructure in EECCA countries.