DENMARK: A CASE STUDY – RELATED BEST PRACTICE OR LESSONS LEARNED ON WATER AND SANITATION

ENVIRONMENTAL FINANCING OF THE WATER SECTOR AND INFRASTRUCTURE

Introduction

The project presented here concerns the development of what is called environmental financing strategies for water and sanitation in Russia and Georgia, Moldova, Kazakhstan, and Ukraine.

The background for the project was the recognition that there is a very low and often deteriorating service level in terms of regularity and quality of drinking water supply and that there is a lack proper wastewater treatment in the EECCA region.

The project was initiated as a response to the limitations of national environmental strategies and action plans to address the financial issues in achieved the objectives stated in environmental actions plans. By working with financial barriers to implementation, the project, in particular, has addressed the commitment to increase access to basic requirements such as clean water and sanitation as they are expressed in the commitment to sustainable development in the Johannesburg Declaration on Sustainable Development. Furthermore, the project also has addressed the important issues of "Financial resources and mechanisms" and "Information for decision-making"

The project was initiated and financed by The Danish government and it was implemented in cooperation with the OECD. The OECD's publication Financing Strategies for Water and Environmental Infrastructure (2003) covers this project and parts of the case description below is extracted from this publication. The project was implemented in the period from 1999 to 2002. Part of the reporting was presented at the Almaty Conference in the year 2000.

Description of case, activities, challenges and constraints

The project comprised a number of activities. Before the case studies in the selected EECCA countries were implemented, a methodology for how to analyse the relation between costs and finance was developed and in related to the methodology, a supporting decision tool was also developed.

The main activities were:

- Development of the environmental financing strategy methodology;
- Development of a supporting computerised decision tool;
- Seven individual case studies covering the water supply and sanitation sectors in Georgia, Moldova, Kazakhstan, Ukraine and three regions in Russia, viz. Novgorod, Pskov and Kaliningrad.

Below each activity is further elaborated.

An environmental financing strategy is a methodological framework for medium- to long-term strategic balancing of environmental and infrastructure service targets with available financing. It is applicable in the environmental sectors that require investment-heavy environmental infrastructure.

An environmental financing strategy aims to verify the realism and affordability of the general long-term objectives of sector policies and programmes. The strategy provides a long-term predictable framework for preparing mid-term investment programmes and for project pipelines in the public sector at different levels of government.

FEASIBLE is a software tool developed to support the preparation of environmental financing strategies for water, wastewater and municipal solid waste services. By calculating the investment, maintenance and operational expenditure that would be required to reach specified targets expressed in terms of selected technical measures, FEASIBLE can be used to facilitate the iterative process of balancing the required finance with the available finance. It provides a systematic, consistent and quantitative framework for analysing feasibility of financing environmental targets.

Applied together, the EFS methodology and the FEASIBLE model provide a framework for systematic costing of environmental targets in line with the best international standards and for assessing the implications of aggregated costs on liquidity and household affordability. They facilitate the development of scenarios that show where the bottlenecks lie, and what kind of funding and other intervention may be needed. In that way, they offer a commonly understood language of communication among all relevant stakeholders involved in the development of the environmental and municipal infrastructure sectors, especially among environmental, technical and financial stakeholders.

The case studies have included detailed data collection of water and sanitation infrastructure information describing the existing situation. Similar data on the provision of financial resources for the sectors have been collected.

The analyses of infrastructure data in the selected EECCA countries have shown that the percentage of the urban population with access to water supply and wastewater treatment services is higher than in countries at a similar income level, but that these services are inefficiently designed and very costly to operate and maintain. Therefore, the actual quality of received services is often very low.

At the same time, the existing arrangements for providing these services are financially unsustainable. Thus, in most EECCA countries there is a chronic shortage of funds for proper operation and maintenance of infrastructure, such as small repairs, replacement of worn-out parts, small capital repairs and essential rehabilitation. This has resulted in the rapid loss of the economic and technical value of assets. If corrective action is not taken, it may eventually lead to the physical collapse of the infrastructure, with severe consequences for human health, the environment and economic activity.

The grave situation in EECCA calls for a fundamental reform in the approach to financing environmentally-related infrastructure and the associated policy and institutional arrangements. Overly ambitious plans to extend the coverage and level of infrastructure services need to be replaced by more realistic, modest capital improvement programmes, tailored at providing essential repairs and rehabilitation of critical elements of infrastructure in order to maximise efficiency gains (mainly reduction of energy costs) within the limits of what households and public budgets can afford.

Impact of case and lessons learned

The EFS methodology and the FEASIBLE model have proven their applicability in EECCA countries. Significant policy impacts have been achieved in the projects implemented:

- The EFS has been adopted as a basic policy document in almost all the case countries.

- The EFS has changed the investment priority programmes in several cases.

- The EFS has promoted policy change regarding tariff setting and water demand policies and reforms of unrealistic standards.

- The EFS has been used by donors in the reformulation of water sector programmes.

In Novgorod Oblast (Russia), the EFS for the water sector was officially adopted by Regional Government and used to identify a portfolio of projects co-financed by the Oblast and international donors. The municipal waste EFS for the Novgorod Oblast led to a revision of the waste management plans that involved the identification of more cost-effective regional solutions. In Moldova, the EFS was adopted as an official policy document and supported a draft government resolution relaxing unrealistically stringent wastewater effluent standards. In Kaliningrad (Russia), the EFS was used to identify a portfolio of projects co-financed by the Oblast and international donors. In Ukraine, the EFS was used to support a comprehensive water sector strategy. In Pskov (Russia), the EFS stimulated a policy debate about infrastructure development targets that were revealed as being financially unsustainable and unrealistic. In Georgia and Kazakhstan, the EFS has provided a revealing "reality check" on possible co-financing arrangements with IFIs and donors.

However, it must be kept in mind that the impacts seen so far are mostly of a visible, short-term nature given the relatively short span of time in which the EFS methodology has been applied. Changes in policies, procedures, institutional and organisational structures are long term by nature. Likewise, the more indirect impacts, such as changed perceptions of government officials stemming from training and working with EFS methodologies, are difficult to capture and are only likely to have a visible impact in the longer term.

The experience accumulated to date suggests that the environmental financing strategy methodology can be useful tool for governments in developing realistic plans to achieve nationally or internationally agreed targets. The financing strategies can be useful not only to help plan the government budget, but also in suggesting how policy instruments that affect the capacities and decisions of other public and private financial agents might be reformed.

Environmental financing strategies are also used by donor countries and IFIs to check if local co-financing commitments are realistic, to co-ordinate different donor and IFI programmes, to identify country pipelines of supported investment projects and to provide an additional dimension (bigger picture) for appraisal of the financial viability of individual investment projects.

Based on the EFSs developed so far, three factors have been particularly important to achieving a wider impact of the EFS:

- Ability to mobilise the key stakeholders and to ensure their leadership and ownership of the process of developing the EFS.
- Timing and co-ordination with other sector planning initiatives and budgeting procedures in the relevant country/region. Clearly, the potential impact of a financing strategy can be much greater in a country where a reform process is already underway, and where the stakeholders know what to do with it.
- Co-ordination between governments at different levels (national, regional, local). This is important as in many EECCA countries local governments have full responsibility for providing municipal services and developing the municipal infrastructure, including capital investments planning.

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