



A research project supported by the European Commission



FP5: Energy, Environment and Sustainable Development
Key Action 4: City of Tomorrow and Cultural Heritage
Thematic Priority 4.1.2: Improving the quality of urban life
Contract No: EVK4-2002-0095

HYPERLINK
"http://www.watertime.org"
www.watertime.org
HYPERLINK "C:\\Documents and
Settings\\dr46\\Desktop\\watertime@w
atertime.org" watertime@watertime.org

D7: International Context

(revised and updated July 2004)

David Hall, PSIRU, University of Greenwich, d.j.hall@gre.ac.uk
Klaus Lanz, International Water Affairs, Klaus.Lanz@t-online.de
Emanuele Lobina, PSIRU, University of Greenwich, e.lobina@gre.ac.uk
and Robin de la Motte, PSIRU, University of Greenwich, r.delamotte@gre.ac.uk¹

1	INTRODUCTION.....	3
1.1	AUTHORSHIP.....	3
2	ACTORS: EUROPEAN INSTITUTIONS.....	4
2.1	EUROPEAN UNION LEGISLATION: OVERVIEW.....	4
2.2	EU ENVIRONMENTAL LEGISLATION.....	4
2.2.1	<i>The 'environmental' Water Directives.....</i>	<i>4</i>
2.2.1.1	The Surface Water Directive.....	5
2.2.1.2	The Dangerous Substances Directive.....	5
2.2.1.3	The Groundwater Directive.....	5
2.2.1.4	The Draft Directive on Environmental Liability.....	6
2.2.1.5	The Bathing Water Directive.....	7
2.2.2	<i>The 'Sector' Directives Affecting Water Protection.....</i>	<i>8</i>
2.2.2.1	The Nitrates Directive.....	8

¹ The authors would like to thank Ben Page, Christelle Vézon, and especially Robin Simpson for comments on earlier versions of this paper. The responsibility for contents rests with the authors.

WaterTime partners:

[PSIRU, Business School, University of Greenwich, UK](#)
[ERL, Universidad Complutense de Madrid, Spain](#)
[Institute of Environmental Engineering and Biotechnology \(IEEB\), Tampere, Finland](#)
[International Water Affairs, Hamburg, Germany](#)
[Eötvös József College, Hungary](#)



2.2.2.2	The Pesticide Directive.....	9
2.2.2.3	The IPPC Directive.....	10
2.2.2.4	The planned REACH Directive.....	10
2.2.3	<i>The ‘Municipal’ Water Directives.....</i>	<i>11</i>
2.2.3.1	The Drinking Water Directive.....	11
2.2.3.2	The Urban Waste Water Directive.....	12
2.2.4	<i>The Water Framework Directive –Objectives and Administrative Setup.....</i>	<i>14</i>
2.2.4.1	River Basin Management.....	14
2.2.4.2	Recovery of costs for water services.....	14
2.2.4.3	Special protection of drinking water resources.....	15
2.2.4.4	Public Participation.....	16
2.2.4.5	Priority substances and the operation of waste-water treatment plants.....	16
2.3	EU COMPETITION, SINGLE MARKET AND TRADE RULES.....	17
2.3.1	<i>The EU Treaties and public services.....</i>	<i>17</i>
2.3.2	<i>Transparency Directive.....</i>	<i>17</i>
2.3.3	<i>Procurement directives.....</i>	<i>18</i>
2.3.4	<i>Other policies: competition, internal market, PPPs and public services.....</i>	<i>18</i>
2.3.5	<i>Fiscal impact of economic policies.....</i>	<i>19</i>
2.4	OTHER EUROPEAN ACTORS.....	20
2.4.1	EIB.....	20
2.4.2	EBRD.....	20
2.4.3	HELCOM Helsinki Commission.....	21
2.4.4	Aarhus Convention.....	22
3	ACTORS: WATER COMPANIES.....	25
3.1	PRIVATE WATER COMPANIES IN A GLOBAL CONTEXT.....	25
3.2	HISTORICAL CONTEXT.....	26
3.3	STRUCTURE OF THE GLOBAL WATER MARKET.....	26
3.3.1	<i>Joint ventures.....</i>	<i>27</i>
3.3.2	<i>Endless concessions.....</i>	<i>28</i>
3.3.3	<i>Political economy of water corruption.....</i>	<i>29</i>
3.4	MULTINATIONALS’ STRATEGIES.....	30
3.4.1	<i>Consolidation and expansion of domestic markets.....</i>	<i>30</i>
3.4.2	<i>Identification of promising national markets.....</i>	<i>31</i>
3.4.3	<i>Action to facilitate the creation of a favourable environment.....</i>	<i>31</i>
3.4.4	<i>Action aimed at influencing local decision makers.....</i>	<i>32</i>
3.4.5	<i>Alliances with international and local actors.....</i>	<i>32</i>
3.4.6	<i>Subcontracting to vertically integrated subsidiaries.....</i>	<i>33</i>
4	ACTORS: INTERNATIONAL INSTITUTIONS.....	34
4.1	INTRODUCTION.....	34
4.1.1	<i>Ideology and liberalisation and privatisation.....</i>	<i>34</i>
4.1.2	<i>Fall of the communist bloc.....</i>	<i>34</i>
4.1.3	<i>Role of international financial institutions.....</i>	<i>34</i>
4.2	IMF.....	34
4.2.1	<i>Lending conditionality.....</i>	<i>34</i>
4.2.2	<i>Undermining sovereignty.....</i>	<i>35</i>
4.2.3	<i>Gatekeeper to international finance.....</i>	<i>36</i>
4.3	WORLD BANK.....	36
4.3.1	<i>Conditionality.....</i>	<i>37</i>



4.4	WTO/GATS.....	38
4.5	UNITED NATIONS.....	39
4.5.1	Dublin/Rio principles: ‘water is an economic good’.....	39
4.5.2	Millennium Development Goals (MDGs): water supply as developmental objective.....	39
4.5.3	Ecosoc: Water as a human right.....	40
4.5.4	Other.....	40
4.6	OTHER ACTORS.....	40
4.6.1	ISO.....	40
4.6.2	OECD.....	40
4.6.3	International finance capital.....	41
4.7	NGOs.....	41
5	CONCLUSION.....	43
	ANNEX A: PRIVATE OPERATORS IN CEE, NIS AND THE BALKANS.....	44
	ANNEX B: WORLD BANK DOCUMENTS.....	47
	ANNEX C: EIB/EBRD FUNDING FOR PUBLIC SECTOR WATER.....	53
5.1	EIB.....	53
5.1.1	Poland: Lodz Water gets EIB funding.....	53
5.1.2	Poland: EIB finances Szczecin water projects.....	53
5.1.3	Poland: EIB finances Torun water.....	53
5.1.4	Poland: EIB finances Zywiec communes syndicate.....	54
5.2	EBRD.....	54
5.2.1	Poland: Krakow gets EBRD funding (“sound financial standing and management”).....	54
5.2.2	Poland: Bydgoszcz gets EBRD funding.....	54
5.2.3	Latvia: EBRD finance Riga water on non-sovereign basis and twinning with Stockholm Vatten.....	54
5.2.4	Lithuania: Kaunas water gets EBRD finance on non-sovereign basis - twinning with Stockholm Vatten... 55	
5.2.5	Russia: Kaliningrad gets EBRD and aid funding and support from Swedish and Danish water companies.. 55	
5.2.6	Russia: St Petersburg gets EBRD funding and technical assistance from Finnish and Swedish water companies.....	56
	ANNEX D: FACTORS OVERVIEW.....	57
6	NOTES.....	58

Company names

As a result of mergers, takeovers and restructuring, companies may change their names. The French water groups in particular have used various names for both the groups and their water divisions since 1990. Throughout this article, for the sake of clarity, the two largest groups will be referred to respectively as ‘Suez’ – whose water division has also been known as Lyonnaise des Eaux, or Ondeo – and ‘Veolia’, which has been previously known under the names of Generale des Eaux and Vivendi.

1 Introduction

Urban water networks are intrinsically tied to geographical location in a way that most other goods and services are not. In the great majority of countries, the key public authorities governing the sector cover relatively small geographical areas – towns, cities, and municipalities. Therefore, the decisions analyzed by



Watertime are, at heart, local ones. These local decisions are, however, made in a national and international context. Local actors may take into account local factors, local stakeholders, and local politics, but they may be constrained by national legal systems and EU directives, or influenced by international economic and political developments. Watertime's national context reports (see www.watertime.net) examine how national-specific factors impact on the city or cities studied.

This report examines the international actors and factors constrain and influence local decision-making on the structure of water systems in Europe. The report is structured to address issues which are of formal relevance to decision-making, as outlined in the Analytical Framework, by identifying the actors at these levels which take certain initiatives;

The report is not intended to provide a global overview of the different structure of water systems – that would be a summary of local conditions, not an account of international actors. Nor is it an attempt to provide a global evaluation of the relative merits of different systems, which would again be a global summary and evaluation of (mainly) local processes and systems. It seeks rather to identify the actors which, by operating at international level, influence or constrain local decision makers, and the mechanisms through which they exercise that effect.

1.1 Authorship

This paper is a collaboration between the four authors listed on page one. Section 2 was written by Klaus Lanz, International Water Affairs, and David Hall, PSIRU, University of Greenwich. Sections 3, 4 and 5 were written by David Hall, Emanuele Lobina, and Robin de la Motte, PSIRU, University of Greenwich.

2 Actors: European institutions

2.1 European Union legislation: overview

For the past 25 years, EU law has been increasingly replacing national legislation concerning water use and protection as well as water-related services. Legislation introducing Community-wide standards for water protection was part of the first wave of EU in the 1970s, followed by health-related directives such as the Drinking Water Directive and legislation covering certain polluting economic activities (UWWD, Nitrate Directive, IPPC Directive). It is the purpose of this paper to assess potential effects of this new layer of supranational legislation on the water services sector.

Until recently, the water sector with its pronounced municipal character remained free of direct Community interventions concerning competition and legal organisation. Lately, however, the EU Commission is considering Community-wide rules to introduce competition and to potentially cut back municipal activities in the water sector. While the environmental directives have in the past helped to continually improve and secure the position of municipal water supplies by introducing ever stricter protection of water resources, the intended new wave of economic legislation is likely to exert the opposite effect.

Due to the peculiarities of the water sector, enforcing commercial approaches is likely to create entirely new conditions for water supply and sewerage services. Firstly, competition introduces a fairly short term financial planning horizon to a sector with a need to look ahead for as far as 100 years or more for developing and upgrading infrastructure. Secondly, under enforced competition and increased pressure to lower costs, the precautionary approach to resource protection and infrastructure (e.g. considerable technical redundancies) typical of the water sector, are likely to be replaced by the increased use of risk assessments and cost-benefit analyses in an attempt to quantify health and environmental effects. Given the difficulties in expressing ecological and social factors in monetary terms, the corresponding effects are likely to be underestimated. As a result, there is a tendency for a lower priority for resource protection and infrastructure maintenance.

The following sections are intended to assess how the different past, present and potential future Community rules are affecting the water sector and the ability of municipalities to deliver services for which they are constitutionally responsible in all Member States except Great Britain.

2.2 EU Environmental Legislation

To facilitate an overview of existing EU environmental legislation on water, a distinction is made in this chapter between three groups of legal acts: firstly general legislative acts on the protection of water and water bodies (4.2.1), secondly acts aimed at controlling commercial activities with a strong influence on water quality (4.2.2.), and thirdly environmental acts directly regulating municipal activities in the water and waste water sector (4.2.3.). The Water Framework Directive, as an overarching legislative undertaking, will be dealt with in an additional section (4.2.4.). It should be noted that this chapter does not give an exhaustive description of all water-relevant EU directives, but focuses on directives with a perceivable or potential effect on water and waste waters services.

2.2.1 The 'environmental' Water Directives

Generally, the early water protection directives of the 1970s and early 1980s had little influence on decisions in urban water management, mainly since no direct cost was involved for the water operators. In principle, these directives aimed at and in some areas also effectively achieved better protection of water bodies and hence of drinking water resources. If there was a tangible effect on water suppliers, an improved raw water quality would have meant lower costs for treatment and developing new water resources. On the other hand, it is clear that the net effect of these directives was low, since for several reasons (one of which being reluctant implementation by the Member States) they never fully achieved their objectives. Despite the adoption of environmental water directives, the quality of most European waters kept deteriorating during the 1980s and (concerning agricultural pollution) until today.

2.2.1.1 The Surface Water Directive

Council Directive 75/440/EEC concerning the quality required of surface water intended for the abstraction of drinking water in Member States was the first EU water directive, and a reaction to the increasing awareness that pollution had become a major problem for the safe supply of drinking water in the Community. It focused solely on surface waters, groundwater was at that time still regarded as generally unaffected by contaminants. The directive prescribes levels of drinking water treatment depending on the quality of the resource. In many respects, the Surface Water Directive can be regarded as a precursor of the Drinking Water Directive (see chapter 3.1). The directive will be repealed by the Water Framework Directive.

2.2.1.2 The Dangerous Substances Directive

Council Directive 76/464/EEC on pollution caused by certain dangerous substances discharged into the aquatic environment was adopted because chemical contamination of Community waters and the oceans had become an increasing and potentially damaging phenomenon. The European governments agreed that this problem required some kind of coordinated action. At the time, Directive 76/464/EEC set relatively ambitious goals for the prevention and minimisation of water pollution from dangerous chemicals. The urge expressed by most Member States to harmonise the implementation of protective measures was however not only inspired by the need to improve the environment, but also to avoid distortion of competition in polluting industries affected by respective policies.

Directive 76/464/EEC, being at the interface of industrial and environmental policies, has remained a contentious legislative act for 25 years. While its provisions are clear – elimination of Black List substances (Annex I) and reduction of pollution by Grey List substances – its wording leaves considerable discretion to Member States how to actually implement them. Also, strong industrial pressure has delayed and in many cases altogether prevented the adoption of the required EU daughter directives laying down measures and objectives for individual black substances. As a result, out of 129 Black List candidate substances, only 18 have been regulated, and not a single one has been tackled since 1990.²

The effect of the Dangerous Substances Directive on water resources used for the abstraction of drinking water is potentially positive because it introduces measures aimed at preventing certain dangerous chemicals from entering the aquatic environment. A recent survey of the programmes established under the directive however confirmed major differences in national approaches and ambitions.³ Some Member States have extended protective measures to their entire territories, others limited their activities to specific river basins. In various countries, phosphorous and nitrogen emissions have been tackled in order to reduce nutrient loads in rivers and groundwater and to combat eutrophication. Where such measures are in place and effective, the resource situation of water suppliers should be improved.

The Dangerous Substances Directive will be replaced by the Water Framework Directive (WFD) in 2013, while the Black and Grey Lists are already annulled and are presently being replaced by a (much less comprehensive) list of priority substances under the WFD. It has been argued that the level of water resources protection which is effected by EU dangerous chemicals legislation has continuously decreased over the decades.⁴ Combined with the reluctance of some Member States to implement even the existing provisions, the effect is a fairly uneven playing field throughout the EU for water companies and municipalities with the responsibility to supply clean drinking water to their citizens.

2.2.1.3 The Groundwater Directive

The purpose of *Directive 80/68/EEC on the protection of groundwater against pollution caused by certain dangerous substances* is to prevent the discharge of certain toxic, persistent and bioaccumulating substances

² Lanz, K. and Scheuer, S.: EEB Handbook on EU Water Policy under the Water Framework Directive, Brussels 2001. <http://www.eeb.org/publication/EEB%20Water%20Handbook%20Absolut%20Final%202001.pdf>

³ France, S. and Zabel, T. (2001): <http://europa.eu.int/comm/environment/water/water-dangersub/article7ofdirective77464eec.pdf>

⁴ Pallemarts, M. Production, Toxics, and Transnational Law: An enquiry into the effectiveness of international and European Community Environmental Law. Dissertation, Vrije Universiteit Brussel, 1998.

into groundwater. Two lists of dangerous substances have been established under the directive: substances whose direct discharge into groundwater is prohibited (List I), and substances whose direct discharge into groundwater must be limited (List II). Indirect discharges of substances on List I and both direct and indirect discharges of substances on List II require prior authorisation.

Laying down strict rules on the prevention of chemical inputs to groundwater, the Groundwater Directive also covers certain activities of water suppliers and could have been of major relevance to them. In some EU locations, water companies resort to artificial infiltration of surface water to store or augment groundwater resources. Although the infiltrated water is treated, dangerous substances potentially enter the groundwater as a result of this practice. Artificial infiltration is regarded by the Groundwater Directive as an indirect discharge into groundwater. However, in order to limit consequences on drinking water suppliers and to facilitate artificial infiltration, special less stringent rules apply for artificial infiltration. Environmental organisations argue that in some cases artificial infiltration is not strictly necessary for water supply, and that the practice should be limited in order to protect groundwater resources from avoidable contamination. Attempts to introduce such a precautionary approach with stricter conditions for artificial infiltration into the Water Framework Directive were turned down by European Parliament and Council not least because of resistance from the water supply associations.

The effect of the Groundwater Directive on water and waste water services is difficult to assess, but must be considered as rather limited. While no additional costs are incurred on water operators, there is a potential positive effect because of the improved protection of underground water resources. The potential savings due to efficiently protected groundwater resources are substantial. The usual way of dealing with polluted groundwater is to tap onto deeper laying aquifers – a practice entailing major investments for the establishment of new wells as well as higher pumping costs. The extent to which the Groundwater Directive has effectively prevented pollution and improved the resource situation of drinking water suppliers is however unclear.

Despite the enormous importance of groundwater for EU drinking water supplies, the future of groundwater protection in the EU is presently uncertain. The Groundwater Directive will be repealed by the WFD by the end of 2013, yet Member States and the European Parliament were unable to agree about a future groundwater policy under the WFD. Both protection concepts and the actual level of groundwater protection were highly contentious and omitted from the WFD in order not to jeopardise the directive.

Member States agreed in 1999 to ask the Commission to come forward with a daughter directive to the WFD by the end of 2002. The Commission has tabled its proposal in September 2003. Its main approach has been criticised by NGOs as well as many Member States, mainly because it does not secure a level of protection equivalent to the existing Groundwater Directive to be repealed in 2013. The Commission's approach is basing its objectives for groundwater on drinking water quality standards which are deemed environmentally questionable and difficult to monitor.

The European Environmental Bureau assumes that the reason for the legislative delays is the Commission's "good governance" strategy which requires an extended impact assessment of the planned groundwater legislation, including a classical cost-benefit assessment. The EEB is concerned that such an exercise might significantly underestimate potential environmental benefits of groundwater protection as well as costs of long-term groundwater pollution, both difficult to assess in monetary terms. As a result of such a skewed cost-benefit assessment, the level of groundwater protection intended for the new Groundwater Directive may well turn out lower than under existing EU legislation.⁵

⁵ EEB/CCB Water Seminar Report. December 2002, Brussels.

2.2.1.4 The Draft Directive on Environmental Liability

In principle, many activities of water and waste water companies are covered by the draft directive on environmental liability.⁶ It has been argued however that although applicable to the water services sector, the directive if adopted unchanged would hardly alter current national legislation on liability.⁷ The history of that directive being rather long, with initial proposals (limited to waste disposal) tabled as early as 1989, and subsequently a Green Paper and a White Paper in 1993 and 2000, the text of the proposed directive reflects the accumulated concerns of various potentially affected parties. Unless the directive undergoes drastic strengthening during the negotiations between Council and European Parliament, it will have little effect on the water and waste water services sector, neither restraining its own activities nor protecting it from accidental or careless contamination of its resources. In that respect, the Directive on Environmental Liability is likely to suffer the same fate as many other recent EU environmental legislation: Although legitimately attempting to tackle pressing problems, commercial and other interests are succeeding in watering down objectives and applicability of the directives to the point where their effectiveness is compromised.

2.2.1.5 The Bathing Water Directive

The 1976 EC Bathing Water Directive (76/160/EEC) is one of the first water-related laws adopted by the European Community. It has been in force for over 25 years and is currently in the process of being amended to reflect the latest scientific knowledge and to improve its compatibility with the Water Framework Directive. The Commission has tabled its proposal for a revised Bathing Water Directive in October 2002 (COM(2002)581 final).

In the Commission text, the number of bacteriological indicator parameters is reduced from 19 in the current directive to only two. At the same time, however, the Commission propose more stringent health standards concerning faecal pollution – the main concern in bathing water. To make the assessment of beach water quality less susceptible to bad weather (leading to sewer overflows and faecal pollution) and other unpredictable polluting incidents, the status of bathing waters will be assessed on the basis of a three-year trend (rather than one year's results). Furthermore, locations with beaches of exceptionally good water quality will be allowed to advertise this fact.

The somewhat tighter microbiological standards have raised opposition from coastal communities. Some currently good beaches would not fulfil the proposed minimum requirements for good bathing water quality, and despite of unchanged water quality might be classified in a lower status. However, the new standards would only take effect in 2010, which would give municipalities time to take action in order to meet the new standards.

The British Department of Environment, Food and Rural Affairs (DEFRA) has commissioned studies on costs and benefits of the proposed legislation, and concludes that the additional costs incurred for agriculture and waste-water operators (and hence consumers) outweigh the benefits brought about by a strengthening of the Bathing Water Directive. However, DEFRA states that precise figures on costs and benefits are in many respects rough estimates (DEFRA 2003).

The extension of the definition of bathing waters from mere swimming activities to kayaking, rafting, wind-surfing and the like is another highly contentious issue, not least to the municipalities responsible for waste water treatment. By extending the scope to other activities, the number of water bodies subject to the Bathing Water Directive might rise considerably, for instance because the water body used for wind-surfing extends much further from the coastline than for swimming purposes, or where entire stretches of a river are used for kayaking. Some municipalities fear that a costly upgrading of waste-water treatment plants would be required to meet the standards in these additional water bodies.

⁶ European Commission: Proposal for a Directive of the European Parliament and of the Council on environmental liability with regard to the prevention and remedying of environmental damage. COM (2002) 17 final. January 2002. http://europa.eu.int/eur-lex/en/com/pdf/2002/en_502PC0017.pdf

⁷ Lee, R.G.: EU Proposals on Environmental Liability: From a Private to a Public Law Framework. http://www.cf.ac.uk/cplan/downloads/env_law-8.pdf

Environmental and consumer organisations arguing from the public health point of view believe that an extension of the scope is useful and necessary. They argue that water-related recreational activities have changed considerably since 1976, and that the likelihood to swallow polluted water while swimming or kayaking or wind-surfing is the same. In its assessment of the Commission proposal for the new Bathing Water Directive the EEB also addresses the fears voiced by some municipal authorities. It is argued that a full assessment of all sources of pollution would reveal agricultural contamination to be the main cause of exceeding bacteriological parameters. An extension of the scope to recreational activities other than swimming would therefore most likely affect agriculture and not generally require building new or upgraded waste-water treatment plants (EEB, 2003).

In October 2003, the European Parliament supported the extension of scope as well as the additional requirement to meet the WFD's chemical standards for bathing waters. In the Commission's proposal, bathing waters failing to meet the WFD's chemical standards would still be classified as good if their bacteriological status is good. The Parliament demanded that a beach or river failing to achieve good chemical status under the WFD (for instance because of the presence of hazardous chemicals) must not be classified as good quality. Hence, the EP suggested to lay down as an additional requirement for good bathing water quality that the beach or river water meet all WFD chemical standards (European Parliament 2003).

In summary, the potential effects on municipalities and waste-water operators of a revised Bathing Water Directive depend on the text finally adopted. The reservations of some municipalities and authorities based of potentially excessive costs involved to achieve the tighter standards seem exaggerated. In most locations, the extra requirements of the proposed directive will not exceed the requirements already laid down by the Water Framework Directive. Where further activities are necessary to achieve the new standards, the deadline of 2010 should be reasonable to select the most effective measures (e.g. curbing agricultural runoff vs. additional treatment of municipal waste-water) and to spread costs over several years. A further motivation for municipalities and authorities to embrace more stringent objectives for bathing waters might be that the potential health, environmental and economic benefits of such a quality improvement would be reaped mainly at the local level, improving local tourism as well as local public health and environment.

2.2.2 The 'Sector' Directives Affecting Water Protection

The EU directives aimed at controlling certain sources of pollution were adopted as a reaction to the inadequacies and the lack of efficiency of the first wave of EU water legislation. Since they are directly targeting certain polluting activities, the commercial interests of the respective sectors had a pronounced bearing on their outcome. For instance, the inclusion of pesticide limit concentrations for groundwater as a pre-condition for the registration of pesticides was opposed by the pesticides manufacturers (but finally included under public pressure). The influence of commercial interests has in some cases weakened the objectives, in others led to wording open for interpretation and thus to unequal protection standards between Member States (e.g. Nitrate and IPPC Directives).

From the point of view of urban water supply, the sector directives are contributing to the improvement of raw water sources. The effect of the Pesticide and Nitrate Directives however very much depends on the pressure which water suppliers (often combined with environmental and consumer protection NGOs and the general public) have been able to exert on national policies. In countries where the protection of drinking water resources is (partly) taken on and financed by the water companies, these directives tend to be more stringently implemented than where resource protection is entirely an obligation of the state.

2.2.2.1 The Nitrates Directive

Council Directive 91/676/EEC concerning the protection of waters against pollution caused by nitrates from agricultural sources (the Nitrates Directive) can be regarded as a complimentary sister directive to the Urban Waste Water Directive (see chapter B.3.2). Both are aimed at reducing excessive nutrient levels in EU waters which jeopardise drinking water supplies, aquaculture, tourism and many other economic or non-economic water-related activities. The Nitrates Directive requires Member States to designate zones vulnerable to eutrophication and to take action to reduce inputs of nitrates from agricultural activities in surface and groundwater.

A recent report by the Commission on the implementation of the Nitrates Directive states that presently at least 30 to 40 % of EU rivers and lakes show eutrophication symptoms or introduce high nitrogen loads to coastal waters and seas.⁸ Agriculture accounts for 50 to 80 % of these inputs, depending on Member States, watersheds and annual variations. The situation is even more critical for groundwater. Underground aquifers are renewed much more slowly than rivers and nitrate contamination will take decades to decrease even after inputs have been reduced. More than 20 % of reported aquifers show concentrations above 50 milligrams per litre and are hence unsuitable as drinking water, 40 % are above 25 milligrams per litre (natural nitrate levels in groundwater are well below 10 mg/l). Judging from the agricultural nitrogen inputs into soils, the extent of the problem is likely to be even greater. The report points out “delays in nitrates transfer from soil to groundwater (2-3 years for shallow waters in sandy soils, 10-40 years for deep waters in chalk limestone)”, and criticises “inadequate designation of vulnerable zones by a majority of Member States in areas exposed to high nitrogen pressure, and insufficient measures so far.” As a result, “a high and stagnant level of nitrate concentrations in groundwater is to be recorded, with about 40% of the EU territory being of concern in this respect.”⁹

The Commission considers that meanwhile most Member States realise that the additional costs induced for drinking water treatment, or by eutrophication damages in dams or coastal waters will still increase. It also recalls that the “investments dedicated to urban wastewater treatment will be inefficient regarding nutrients if a parallel effort is not devoted to an effective reduction of agricultural nutrients losses.” The question remains if Member States are willing and able to undertake the necessary changes in agricultural practices.

There is no doubt that the Nitrates Directive is a directive supportive of the water sector in that it potentially lowers investments both in treatment technology and developing new water resources. Water companies are legally responsible to supply drinking water below the nitrate limit value of 50 milligrams per litre. They therefore depend on a complete and efficient implementation of the Nitrates Directive in order to fulfil this requirement. So far, however, the measures taken under the Nitrates Directive have been generally disappointing from the point of view of water suppliers. Alternative preventive approaches on nitrates initiated by water companies themselves have proven more efficient. In many regions, water companies have entered into agreements with farmers in their catchment areas to lower the use of nitrates and pesticides or even to convert to organic farming. However, any extra burden incurred on farmers by such contracts and agreements is currently borne by the water consumers via water fees. While this approach may be regarded as running contrary to the polluter pays principle (and in fact against provision in the WFD’s Article 9), it is in the absence of a well-functioning EU legislation on nitrates the best way to prevent pollution of water resources and the costs involved of treating them.

It should be noted that water suppliers are not legally entitled to protect their water resources, and that agreements and contracts with farmers are a voluntary initiative in order to lower treatment costs and hence the overall cost to consumers. This precautionary approach is mainly embraced by public water suppliers, but not usually shared by the private water industry. For instance, when the Commission sued Suez in France for supplying drinking water above the nitrate limit of 50 mg/l to consumers over several months, Suez in turn sued the French State for not protecting the groundwater resources they took the water from. The French High Court ruled that it is exclusively the obligation of the state to protect waters, and that water suppliers are merely responsible to install adequate treatment equipment.¹⁰ However, profoundly different philosophies exist on this issue, with most Northern Member States considering the prevention of pollution at source to be a natural part of a water supply company’s tasks.

⁸ Commission Report COM(2002) 407: The Implementation of Council Directive 91/676/EEC concerning the Protection of Waters against Pollution caused by Nitrates from Agricultural Sources. Synthesis from year 2000 member States reports. Brussels 2002. <http://europa.eu.int/comm/environment/water/water-nitrates/report.html>

⁹ European Commission: Implementation of Council Directive 91/676/EEC concerning the protection of waters against pollution caused by nitrates from agricultural sources. Luxembourg 2002. http://europa.eu.int/comm/environment/water/water-nitrates/91_676_eec_en.pdf

¹⁰ Suez against the French State: <http://www.senat.fr/rap/102-215-2/102-215-241.html>

2.2.2.2 The Pesticide Directive

Council Directive 94/414/EC on the placing on the market of plant protection products has been one of the most contentious, and from the point of view of water supply associations, one of the most important aspects of EU law.

The Drinking Water Directive of 1980 had taken a strictly precautionary approach on the presence of pesticides in drinking water, stipulating that the maximum level should be 0.1 micrograms per litre for each individual pesticide and 0.5 micrograms per litre for the sum of all active ingredients. This uniform maximum admissible concentration does not correspond to established toxic effects of pesticides, but is an expression of the objective that pesticides should not at all be present in drinking water. At the time of the negotiations leading up to Directive 91/414/EC, many water companies throughout Europe were struggling to satisfy this limit. Considerable resources of groundwater as well as river water showed concentrations well above the maximum drinking water level for some agricultural chemicals. Treatment is difficult and expensive, so in most cases of pesticide contamination, water suppliers opted to abandon the polluted reservoirs and to move on to deeper lying aquifers or distant mountain sources (or sometimes to mix polluted with pesticide-free water).

The water suppliers' associations found themselves in an uncomfortable position concerning pesticides. On the one hand they depended on preventative measures limiting the input of pesticides into their raw water, on the other hand they did not want to antagonise farmers or even the influential chemical industry as manufacturers of pesticides. A minority of water suppliers opted for abandoning the strict pesticide standards in drinking water, but due to considerable public pressure, the precautionary pesticide limit for drinking water finally found its way into the Pesticide Directive. Only pesticides for which it can be demonstrated that their normal use does not cause concentrations in groundwater above the drinking water limit (0.1 micrograms per litre) can be registered in the EU.

Even today, with strict provisions on groundwater laid down in directive 91/414/EC, pesticides in groundwater and rivers still pose a major problem for many water suppliers and potentially public health and entail considerable (treatment) costs for consumers. It is difficult to assess precisely what the present situation would be without the relevant provisions of the Pesticide Directive, yet there is little doubt that the level of contamination and the number of individual agricultural chemicals in European water resources would be far higher. In that respect, the continuing pressure by European water supply associations to uphold the pesticide limit value and to enforce it by means of the Pesticide Directive has well paid off and potentially saved huge costs for water treatment and developing new resources. It should be noted that the 0.1 micrograms per litre limit has been confirmed in the revision of the Drinking Water Directive in the late 1990s and is most likely to become part of the new Groundwater Directive coming up as a daughter directive to the WFD (see chapter 1.3).

2.2.2.3 The IPPC Directive

General assessment: The IPPC Directive does not affect waste water operators (whose discharges into water are regulated by the Urban Waste Water Directive). Municipalities or companies responsible for supplying drinking water are unlikely to have profited from it in terms of improved quality of water resources.

Council Directive 96/61/EC on Integrated Pollution Prevention and Control is positioned to be at the heart of all industrial legislation as regards the environment. It substitutes previous media-specific environmental legislation (on water, air) by introducing a new integrated permitting procedure for 30 industrial sectors (e.g. the chemical, metal, mineral, and waste-treatment industries). The competent authorities shall issue permits to prevent and control pollution into water, air and land (Art. 1). Industries have to apply preventive measures against pollution, avoid significant pollution and waste production and recycle or deposit unavoidable waste (Art. 3). Only large installations are covered, while small and medium enterprises continue to be regulated by sectoral legislation such as the Water Framework Directive.

The IPPC Directive does not, however, set concrete EU-wide limits or standards. In order to satisfy the obligations under the IPPC Directive, the competent (i.e. national, regional or local) authorities have to define emission limit values (ELVs), accident prevention measures, monitoring requirements and other

conditions on a case-by-case basis (e.g. for each individual installation). Pivotal to this exercise is the concept of 'Best Available Techniques' (BAT) which is defined by the directive as the "most effective and advanced stage in the development of (industrial) activities." In principle, the emission limit value achieved by an activity utilising BAT (e.g. a manufacturing process) will set the standard. However, the directive creates considerable legal uncertainty by stating that while ELVs shall be established on the basis of BAT, this should be done "without prescribing the use of any technique" (Art. 9.4). This wording reflects industry opposition to the idea of making BAT a legally binding instrument applicable throughout the EU. By diluting the definition of BAT and limiting its applicability and paramount validity, the IPPC Directive does not bring about the harmonisation of standards widely regarded as necessary to solve international environmental problems, and is hence systemically unsuited to deliver the ambitious aspirations laid out in its articles 1 and 3.¹¹

Seven years after the adoption of the IPPC Directive, the Commission remains unsatisfied with its implementation by the Member States.¹² The Commission states that if it becomes clear that the efforts of authorities are insufficient, or that some Member States are consistently setting lower limits, it might introduce a "harmonised" approach with EU-wide minimum pollution limits as "the rule rather than the exception". The approach of the IPPC Directive leaving Member States wide latitude to develop emission limits to suit local economic and geographical conditions is seemingly not delivering the aspired results. If this development is confirmed, EU environmental legislation is likely to turn back to more prescriptive, top-down and EU-wide standards.

2.2.2.4 The planned REACH Directive

In 2001, the European Commission tabled a White Paper on Chemicals Policy which aimed at a thorough review of the Community's entire legislative system on the control of chemicals. The approach chosen by the Commission has been termed REACH: registration, evaluation and authorisation of chemicals. Since the proposed new legislation would introduce a better control and potentially make available more data about chemicals and their potential harm to health and the environment, it has found the support not only of environmental and consumer organisations, but also the national and EU associations of water suppliers. EUREAU, the EU water suppliers and waste water operators association, points out that the water sector is directly bearing the brunt of increased pollution, for instance by persistent chemicals increasingly questioning the supply of safe drinking water.

The proposed new regulatory system is intended to cover the production, import and use of chemicals. REACH aims to create a uniform system where both existing and new chemicals have to be registered and assessed. Chemicals of very high concern will need authorisation prior to any use. The system is likely to place an increased responsibility upon industry to provide data on substances.

Water supply associations demand an improvement of the public knowledge base and a more precautionary approach to the handling of chemicals. For EUREAU, the following objectives for a new chemicals policy are important from the point of view of water suppliers¹³:

- a. It should be possible in the long term to abstract drinking water from surface waters without complex treatment
- b. Waste-water entering sewers from commercial activities and households should not contain chemicals which make treatment in waste water treatment plants impossible or excessively expensive

¹¹ Hey, C. and Taschner, C.: EEB Industry Handbook. Brussels 1998.

http://www.eeb.org/publication/eeb_industry_handbook.htm

¹² Implementation problems: Consultation of stakeholders about the Communication from the Commission on the Road to Sustainable Production. Progress in implementing Council Directive 96/61/EC concerning integrated pollution prevention and control. June 2003. http://europa.eu.int/comm/environment/ippc/ippc_consultation.htm

¹³ EUREAU: Eureau Comments on REACH, EU Commission Internet Consultation, 10 July 2003.

- c. To achieve that goal, substances which may be discharged to drinking water resources or sewers by commercial activities or households should to the largest possible extent be readily degradable
- d. Knowledge should be exchanged between chemicals' manufacturers and the water sector about the degradability of substances entering the water cycle, including access to data on the behaviour and fate of such substances in drinking water and waste water treatment processes.

EUREAU further stresses the importance of time-limited authorisations for doubtful substances and of the substitution principle for dangerous chemicals. If substances are persistent, bioaccumulative or toxic, EUREAU urges them to be replaced by less harmful alternatives in order to minimise societal costs, not least for additional investment in treating drinking water and waste water.

However, the likelihood of strong legislation on chemicals is low given the massive opposition by the chemical industry and some Member States – notably Germany, France and the UK. It remains to be seen if the new chemicals legislation – if adopted at all – will actually improve the resource situation of water suppliers and help to reduce the chemical complexity of waste water.

2.2.3 The 'Municipal' Water Directives

The two directives on drinking water quality and urban waste water are so far the most direct EU interventions in the water services sector. By prescribing minimum water quality standards for human consumption and standards for waste water collection, treatment and disposal, they are regulating service standards and are incurring direct costs to water supply and sanitation enterprises.

2.2.3.1 The Drinking Water Directive

The quality standards laid down in *Council Directive 98/83/EC on Water intended for Human Consumption* have been developed with strong input from the national and international associations representing the water services sector. They can be regarded as a compromise not only between health and financial considerations (e.g. lead piping, halomethanes), but also between different water supply philosophies in Europe. From the experience with the 1980 Drinking Water Directive, the water sector has learned to anticipate and calculate costs incurred in everyday practice. One result was that cost was a much more important issue in the negotiations leading up to the revised directive of 1998. For instance, a large number of quality standards (such as odour, taste, colour) have been deleted from the directive at the request of water supply associations to lower the testing requirements. The deadline for keeping the new limit value for lead (and thus for replacing lead pipes) has been quite generously extended until 2013 to spread the considerable cost involved in some countries.

It might be argued therefore that the financial impact of the Drinking Water Directive on urban water management should be well buffered, spread over reasonable timescales, and be entirely predictable for at least a decade ahead. Only a few new parameters have been added to the revised directive or tightened while a considerable number have been dropped entirely. Furthermore, the rules for temporary exceedences of limit values have been relaxed, giving water suppliers much more time and discretion on how to rectify the problem.

Generally, securing the quality of drinking water is not a major (financial) concern of water suppliers. Much higher costs result from the maintenance and replacement of the extensive and expensive infrastructure. Even if pollution of water resources increases, supply companies can always resort to treatment. Although treated water is principally not as pure and pristine as unpolluted water in nature, it still satisfies the requirements for drinking water. It should be noted however that there is a veritable split in philosophy in Europe concerning treatment of drinking water. While suppliers mainly in German speaking countries and Scandinavia regard water as a natural resource which should ideally be supplied unpolluted and untreated, others (e.g. in France or the UK) tend to see tap water as a 'manufactured good' which regularly needs treatment before consumption. The 'natural water' philosophy is obviously closer to publicly run water companies who try to avoid the cost of treatment technology they have to acquire externally. Large multinational companies however with their own water treatment subsidiaries think differently about this issue because building and operating treatment facilities is part of their business and contributes to their turnover.

2.2.3.2 The Urban Waste Water Directive

General assessment: arguably the strongest EU influence on urban water management so far. Incurred huge costs in relatively short time, thus creating technical and financial difficulties. The more a municipality is left alone with this task, the higher the financial pressures and the likelihood of private involvement. Where governments or EU funds supplemented the required investments, municipal operators were more likely to cope.

Adopted as a reaction to strong algal blooms in the North Sea in the late 1980s and to public pressure on politics to address this problem, the objective of Council Directive concerning waste water treatment (91/271/EEC) is to protect the environment from the adverse effects of discharges of urban waste water and of waste water from industrial sectors of the agro-food industry. It has taken on a monumental task – and in fact is incurring equally monumental cost. The environmental effect is however remarkable: maps of river water status in countries like Germany show nutrient and pollution levels in rivers to have dramatically decreased over the last decade.

The Urban Waste Water Directive (UWWD) has established ambitious requirements for the collection and treatment of wastewater in cities and towns, down to a size of 2,000 inhabitants (respectively their waste water equivalent) within a relatively near time horizon. It triggered (and continues to trigger) multi-billion investments throughout Europe, arguably the largest common infrastructure project undertaken by the EU in its history.¹⁴ The following objectives and deadlines apply in detail:

- **31 December 1998:** Secondary and tertiary treatment had to be provided in all agglomerations with a population equivalent (p.e.) of more than 10,000 discharging their effluent into a sensitive area (see below) or its catchment area.
- **31 December 2000:** Secondary treatment and collection system in *all* agglomerations of more than 15 000 p.e. (also outside sensitive areas).
- **31 December 2005:** collection and treatment systems in all agglomerations above 2000 p.e. with secondary or appropriate treatment (both within and outside sensitive areas and their catchments). Where a collection system already exists in smaller agglomerations, installation of an appropriate treatment system.

The term ‘sensitive area’ is a central concept of the directive. Discharges to sensitive areas require earlier and more ambitious action. Member States have had to designate sensitive areas according to the following criteria:

- water bodies which are found to be eutrophic (i.e. over-loaded with nutrients such as nitrogen and/or phosphorus compounds)¹⁵ or which in the near future may become eutrophic without action;
- surface freshwaters intended for the abstraction of drinking waters in which the concentration of nitrates might exceed 50 mg/l of nitrates unless action is taken.

The effect on municipal waste water operations of this directive was strong, but not uniform in all regions and between Member States. So far, the directive has been implemented rather differently (and hence the costs incurred have been very unequal). Secondly, the manner in which the various Member States tried to cover the financial burden determined the effect on urban water politics and finances. Some countries introduced waste water levies and earmarked them for financing treatment plants. In this case, most of the investments would have been paid for by water users. Other Member States tried to shoulder the burden entirely from taxes, thus keeping water prices and the extra financial burden on municipal spending low. Where municipalities have been made entirely responsible for financing the infrastructure extension (such as

¹⁴ For figures on investment levels see: Goldsmith, Hugh (2002), “EU Water Policy and Paying for it”. European Investment Bank. <http://www.wb.home.by/wbi/sdwatermedianetwork/pdfs/goldsmith2.pdf>

¹⁵ On causes and effects of eutrophication see: World Health Organization Regional Office for Europe and European Communities: Eutrophication and health. Luxembourg 2002. <http://europa.eu.int/comm/environment/water/water-nitrates/eutrophication.pdf>

France), the effects were felt the most. It has been argued that the costs incurred on municipalities by the UWWD resulted in a push for more private involvement in France (Hassan J, 1995).

The Urban Waste Water Directive is triggering particularly large investments in accession states. For instance, the Czech government estimates the figure for achieving EU water standards at \$ 2.5 billion to be invested in the water sector until 2010. The largest part of the investment concerns nitrogen and phosphorus removal (biological treatment) and the construction of sewerage systems and waste water treatment plants in small towns of the category 2,000 to 5,000 population equivalents. In this category alone, 99 new treatment plants, 21 new sewerage systems and 141 upgrades will be needed. An estimated 85 % of funds are expected to come from private and municipal sources, with the remainder provided by the Czech Government's State Environmental Fund and EU funds.¹⁶ Clearly, many municipalities will be hesitant to secure such substantial funding, particularly in a politically unattractive sector as waste water. Increased private involvement in the water sector of accession states is hence a likely consequence of the UWWD.

The Urban Waste Water Directive indirectly also increases the volume of sewage sludge produced. While the directive itself does not prescribe exactly how the sludge should be disposed off (apart from a ban of its dumping at sea by the end of 1998), most Member States have introduced national legislation limiting the environmental effects of sludge disposal. Switzerland was the first country in 2003 to ban agricultural use of sewage sludge, and several Member States are contemplating a similar move.¹⁷ Both rising sludge volumes and new stricter legislation will lead to a strong growth of investment in sludge treatment equipment. A recent study estimated sales to rise from \$1.36 billion in 2000 to \$2.05 billion by the end of 2007.¹⁸ This is expected to lead to large multinational water companies (mainly Suez and Veolia with their respective subsidiaries Degrémont, USFilter and OTV) further extending their positions in the waste water sector. As these companies are able to provide complete turnkey solutions to waste water and sludge treatment, some municipalities instead of merely buying technology from these companies may consider privatising their waste water operations altogether.

The Urban Waste Water Directive has introduced a level of technology and financing to the water sector which have led to a considerable strengthening of multinational water companies. While squeezing municipal budgets and thus creating incentives to privatisation, the required investments have resulted in a boom in the construction and equipment industries. It may be argued that multinational water companies who are also active in planning, construction and equipment had a dual advantage from the UWWD: by boosting turnover due to EU-mandated investments and by taking over water and waste water operations from financially weakened municipalities.

2.2.4 The Water Framework Directive –Objectives and Administrative Setup

The European Parliament and Council Directive 2000/60/EC establishing a framework for Community action in the field of water policy (Water Framework Directive, WFD) was adopted in 1999 after many years of preparation and negotiations, is an attempt to improve and consolidate EU water legislation in the face of continued severe problems with the status of European waters and the implementation of earlier EU water directives.¹⁹ Its main purposes are the protection and improvement of the aquatic environment and to contribute to a sustainable, balanced and equitable water use (Article 1).

¹⁶ The United States Central and Eastern Europe business information center (CEEBC) 2001.
<http://www.mac.doc.gov/EEBIC/COUNTRYR/Czechr/market/CZEquipmenServices.htm>

¹⁷ EUWID 2003.

¹⁸ Frost and Sullivan: The European Sludge Treatment Equipment Market. March 2001. Press release:
<http://www.waternunc.com/gb/F&S08.htm>

¹⁹ For an assessment of Member States implementation of EU water legislation see: Demmke, C.: Towards effective environmental regulation: Innovative approaches in Implementing and Enforcing European Environmental Law and Policy, European Institute of Public Administration, October 2000.
<http://www.jeanmonnetprogram.org/papers/01/010501.html>

The Water Framework Directive is in many ways breaking new ground in environmental legislation. Innovative instruments have been introduced to EU water policy such as an ecology-based assessment of water status, river basins as administrative planning units, pronounced public information and consultation requirements and, finally, the use of financial instruments in its implementation. Since the directive is aimed at all water users in a given river basin, water supply and waste water operators will be fully integrated in the implementation process, be it as water abstractors or dischargers of waste water. It should be noted however that the WFD is solely an environmental directive aimed at improving the status of EU water resources, and the economic elements are devised to support that objective. The WFD is not intended and in fact cannot be interpreted as an instrument to influence, alter or optimise water or waste water services other than concerning their environmental performance (see below).

The WFD's key objective is to improve the ecological status of surface and groundwater bodies. The ecological objectives are laid down in Article 4 and specify the status requirements and deadlines for the different water bodies defined under the WFD (surface water, wetlands, groundwater, heavily modified and artificial waters). Generally, a good ecological status should be achieved by the end of 2015. However, several exceptions and derogations have been established which considerably compromise the legal effect and potential outcome of the WFD. Deadlines may be extended by up to 18 years (Article 4.4), less stringent environmental objectives may suffice in the case of disproportionate costs involved (Article 4.5), and waters strongly affected by human activity may be designated as heavily modified waters for which the much less stringent objective of good ecological potential shall be achieved (Article 4.3).

2.2.4.1 River Basin Management

Perhaps the most important achievement of the WFD is the change to water management by river basins. Not only does river basin management imply that the entire catchment of a river will be treated as one ecological and hydrological entity, the integration of all uses and potential pressures will allow an exhaustive overview of all activities affecting the river basin. This will help to end the sectoral and often separate administration of river catchments by a host of independent authorities with little or no common planning (e.g. agriculture, shipping, energy, environment etc.). Common river basin management plans are a key element to understand, assess, regulate and monitor the development of river basins. These plans will be drawn up on the basis of thorough analyses of activities and ecological status, and will be open to substantial public participation and consultation. Where a river basin is unlikely to achieve the objectives by 2015, extensive programmes of measures have to be drawn up and implemented.

The WFD has also laid down the requirement to perform an economic analysis of all water uses and water services in a given river basin (Article 5, Annex III²⁰). The precise extent of this analysis is not prescribed by the directive and hence in principle left to the Member States. The WATECO document developed by Member States and key stakeholders in the course of the so-called 'Common Implementation Strategy' (CIS) of the WFD has laid down rough guidelines which economic information to gather and how to assess it.²¹ However, this guidance document is not legally binding.

²⁰ ANNEX III: Economic Analysis

The economic analysis shall contain enough information in sufficient detail (taking account of the costs associated with collection of the relevant data) in order to:

(a) make the relevant calculations necessary for taking into account under Article 9 the principle of recovery of the costs of water services, taking account of long term forecasts of supply and demand for water in the river basin district and, where necessary:

- estimates of the volume, prices and costs associated with water services, and
- estimates of relevant investment including forecasts of such investments;

(b) make judgements about the most cost-effective combination of measures in respect of water uses to be included in the programme of measures under Article 11 based on estimates of the potential costs of such measures.

²¹

European Commission: Economics and the Environment. The Implementation challenge of the Water Framework Directive. Main Document. Brussels 2002.

http://forum.europa.eu.int/irc/Download/k4egA6JBmRGHbYUuOI2YK1j-gGwyMERK/ef3qLhTqOUdCoIqdJ_qGZqOXAhGjLHfU/mtjsNLcAyh7wUfSp22frYqSpi_SRuqL/Economic%20Guidance%20Document%20%28Main%20Text%29.pdf

2.2.4.2 Recovery of costs for water services

One element of the economic analysis of particular interest to the water and waste water sectors is the assessment of the recovery of the costs of water services. The objective is to answer the following key questions:

- How much do current water services cost?
- Who pays for these costs?
- What is the current cost-recovery level?

In a recent pilot study on WFD implementation in the German section of the Middle Rhine River basin, an attempt was made to collect and evaluate economic characteristics relating to water supply and sewage disposal. The investigation focused *inter alia* on the recovery of costs for water services including economic and resource costs. The study found that access to the required data was sometimes difficult and data gaps existed, but that overall a meaningful analysis was feasible (with the result that cost recovery in the Hessian part of the survey was at 90 % in the water sector, and that state groundwater charges covered economic and resource costs).²² Since similar analyses will become EU-wide standard practice under the WFD, water and waste water service operators would be well advised to produce and publish the necessary data in time.

A second important economic element of the WFD is the principle of cost recovery. Member States shall, according to Article 9.1, “take account of the principle of recovery of the costs of water services, including environmental and resource costs.” Water services are defined by the Directive as services “providing abstraction, impoundment, storage, treatment and distribution of surface water or groundwater, and waste-water collection and treatment facilities which subsequently discharge into surface water.” (Article 2.38). Hence, all public or private municipal activities in the water sector are covered. It should be emphasised that Article 9 does not make cost recovery for water services mandatory. As long as water pricing policies provide adequate incentives for efficient use of water resources, and as long the objectives and purposes of the directive aren’t compromised, Member States will not be in breach of the directive if they don’t apply the principle of recovery of costs for water services (Article 9.4). Member States and their competent authorities will continue to be able to choose a lower level of cost recovery in water services, as long as it is duly reported in the river basin management plans.

The WFD further contains a provision that all water uses should make “an adequate contribution to the recovery of the costs of water services”, with particular regard to the polluter pays principle (Article 9.2). This clause is generally interpreted to mean that agricultural or other activities causing pollution of drinking water resources and hence additional treatment costs should reimburse the water supply operators for these costs. If this principle were in fact applied, water supply companies and consumers would be unburdened of a considerable cost factor currently fully borne by the water sector.

All in all, the economic instruments have been introduced to the WFD to guarantee an improved protection of the aquatic environment by preventing pollution and inefficient use. The German Environment Agency (Umweltbundesamt, UBA) stresses that the WFD does not require a “one-dimensional economisation” of EU water protection, nor does it give a prescription for the operational setup of water services. This is first of all reflected by the First Preamble of the Directive stating that “water is not an economic product like any other, but, rather, a heritage which must be protected, defended and treated as such”. In UBA’s analysis, the directive will contribute to a future where the “common good water” continues to be governed and managed by “collective, democratic processes”, while the use of economic instruments is intended as one element amongst others to improve decision-making.²³

²² European Commission: Economics and the Environment. The Implementation challenge of the Water Framework Directive. Accompanying documents to the Guidance. Brussels 2002. <http://www.umweltdaten.de/wasser/guidance.pdf>

²³ <http://www.umweltdaten.de/wasser/analyse1.pdf>

2.2.4.3 Special protection of drinking water resources

One specific aspect of the WFD may prove to greatly improve the level of protection and the quality of “bodies of water intended for the abstraction of water for human consumption” and “bodies of water intended for such future use” (Art 7). The WFD stipulates “that under the water treatment regime applied ... the resulting water will meet the requirements of Directive 80/778/EEC as amended by Directive 98/83/EC”. In other words: Water supply companies can expect that drinking water resources will be sufficiently protected under the WFD as to secure continued supply without the need to install more treatment technology. As high quality water resources are a pivotal prerequisite of a sound water supply system, Article 7 should help to improve the position of water supply operators against potential polluters. Together with the principle of Article 9 that polluters should cover the extra (treatment) cost incurred on water suppliers, a strong instrument has been established under the WFD to defend drinking water resources and to enforce the polluter pays principle.

2.2.4.4 Public Participation

The Water Framework Directive’s Article 14 introduces an obligation on Member States to encourage active involvement of the public in the implementation of the Directive. Public participation is foreseen not only in the course of developing river basin management plans (RBMPs), but starting with the implementation of the WFD (transposition into national legislation, analysis and characterisation of water status, development of programmes of measures). Most importantly, Member States shall ensure public information and consultation and encourage active involvement throughout the process of RBMP development. The public should be involved at all stages, beginning with the drafting of the timetable and work programme for RBMPs (deadline December 2006), followed by the identification of significant water management issues in the river basin (deadline December 2007) and finally in the drafting of the river basin management plans themselves (deadline December 2008). In each step, a six-month period should be allowed for comments from the public and interested parties, and the received comments taken account of in the final papers. Background documents and full information on the process should be made available to the public.

Requirements of Article 14 WFD (Public information and consultation) (European Commission 2002)²⁴

The highly transparent and public character of the process leading up to RBMPs is likely to bring about more accessibility of technical, environmental and commercial information regarding water supply and sewerage services. To what extent public participation and hence full access to data is also applies for the economic analyses of water services in the river basins remains to be seen. In any case, in Member States with a tendency to treat water-related data such as the contaminants contained in waste-water discharges or the extent of groundwater pollution as confidential, water and waste-water operators will have to expect more public requests for hitherto unavailable information.

2.2.4.5 Priority substances and the operation of waste-water treatment plants

The WFD’s ecological objectives for rivers also apply for discharges of waste-water treatment plants. If good ecological status is missed in a river stretch below a waste-water treatment plant, waste-water operators would be required to install additional waste-water treatment steps. EUREAU as the representative of EU waste water operators points out that the presence in waste-water of persistent, untreatable substances is likely to create major problems because the additional treatment technology would have to be financed by waste water operators. EUREAU stresses the presence of non-degradable substances is not their responsibility and in fact beyond their control.

Waste-water treatment plants are designed to remove biologically degradable substances and nutrients such as nitrates and phosphate as well as suspended solids. They are not designed and in fact unable to break down and remove certain other substances, especially if these substances display hazardous properties such as toxicity, persistence and bioaccumulation, or are present at low concentrations. Responsibility for the presence of such persistent substances is deemed by EUREAU to rest with the (private or commercial) user of such chemicals and the manufacturers (or importers). Operators of waste-water treatment plants should

²⁴ European Commission 2002: Guidance on Public Participation in relation to the Water Framework Directive, December 2002

not be obliged to install and finance additional treatment technology to remove chemicals whose presence they can neither prevent nor influence. According to EUREAU, only a reduction or prevention of hazardous substances at source, i.e. by either banning them or restricting their use so that they can't enter sewers or the water cycle, would satisfy the polluter pays and prevention at source principles.

In this respect, EUREAU is also a strong supporter of the substitution principle for harmful chemicals. Replacing persistent chemicals by more degradable alternatives would in fact help to lower the tonnage of such chemicals reaching waste water treatment plants, and hence potentially entering the water cycle via its effluents. EUREAU believes that substitution would introduce more beneficial competition to the chemical sector and help to lower discharges, emissions and losses of substances of particular concern for waste water operators.

2.3 EU Competition, Single Market and Trade Rules

2.3.1 The EU Treaties and public services

Public services or services of general interest are not central to the EU treaties. The objectives of the EU are primarily concerned with trade rules and policies. The one section of the treaty that provides a positive declaration concerning public services is Article 16. This uses the terminology of 'services of general economic interest', and declares that the EU and the members states 'shall take care that such services operate on the basis of principles and conditions which enable them to fulfil their missions'. This does not appear to commit states or the EU to any particular services or any particular scale or level of provision, but simply to making them work effectively.²⁵ Even this commitment to helping services work effectively is "without prejudice to Articles 73, 86 and 87" of the treaty.

Articles 86 and 87 concern public undertakings and state aid (Art 73 concerns transport), and these have very specific declarations. Article 86 states that for public undertakings concerned with services of general interest, member states 'shall neither enact nor maintain in force any measure contrary to' the Treaty, especially the competition rules'. It adds the more open statement that undertakings operating such services are subject to the competition rules 'insofar as the application of such rules does not obstruct the performance, in law or in fact, of the particular tasks assigned to them'.²⁶ Article 87 imposes a blanket limitation on state aid to undertakings 'in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, insofar as it affects trade between Member States, be incompatible with the common market'. It then proceeds to give exceptions - three categories of aid which 'shall be' compatible with the market: 'aid having a social character, granted to individual consumers', aid for natural disasters and for former east Germany; and five categories which 'may be compatible' - economic development, projects of European interest, economic activity, cultural support, and other.²⁷

The charter of fundamental rights of the EU, finally agreed in 2001, mentions public services, but does not make any commitment to a general European right to public services. Instead it simply 'recognises and respects access to essential public services as provided for in national laws and practices, in accordance with the Treaty establishing the European Community, in order to promote the social and territorial cohesion of the Union'.²⁸ This statement implies that public services are a subsidiarity issue, and so the only function for the EU is to 'recognise' whatever services each country provides. It is implied that the EU's interest in public services is to promote 'social and territorial' cohesion. The EU emphasises that the Charter does not create any new rights, simply summarises the rights enjoyed as a result of the EU's operations.

²⁵ Hall, David (2001), "EU competition policies and public services", PSIRU: Greenwich, www.psiru.org

²⁶ Consolidated Treaty Art 86: see Annexe II for full text

²⁷ Consolidated Treaty Art 87: see Annexe II for full text

²⁸ Article 36 of the Charter of Fundamental Rights of the European Union

2.3.2 Transparency Directive

The Transparency Directive, first introduced in 1980 and amended in 2000, requires the maintenance of clear and distinct accounts, as its name suggests. However, this directive is concerned to enforce the provisions in article 85 and 86 against state aid being used anti-competitively, not to enforce a public right to information in respect of public services such as water. It does not therefore address the transparency problems with privatised water concessions identified, for example, by the French Cour des Comptes in 1997 which stated that: “The lack of supervision and control of delegated public services, aggravated by the lack of transparency of this form of management, has led to abuses”.²⁹ The report cites many examples: in one major city, Metz, the private water company did not submit any accounts to the city council for 20 years; in Bandon-Savary (near Toulon), a Veolia company charged the council twice over for the same treatment, every year.³⁰

2.3.3 Procurement directives

The Procurement Directives of the EU are a set of rules requiring public tendering throughout the EU of all public authority contracts to purchase goods, building works, or services from the private sector. The objectives are multiple: to avoid discrimination in favour of contractors in the public authority’s own country; to create an efficient market by ensuring a level playing field for competition; and to provide some protection against nepotism and corruption. The directives do not require compulsory tendering of services before work can be done by a public authority – that decision is left to the public authority: only if the choice is made to use an external contractor must the tendering provisions of the directive be applied.

There are two areas of ambiguity surrounding the procurement directives, both of which have a significant impact on public and private provision of water services. The first concerns the position of services which are carried out on behalf of a public authority by an ‘arms-length’ public sector organisation: In a number of countries, local councils have formed intermunicipal associations to enable them to provide common services on a more efficient scale, very commonly in water. Private contractors have brought cases arguing that such a contract is not covered by the exemption for in-house operations, and should be treated as an outsourced contract, thus triggering the requirement for tendering, but the ECJ has held that in cases where certain needs in the general interest could not be rendered sufficiently by private companies, the State may require that activity to be carried out by public authorities or organisations over which it wishes to retain a decisive influence.³¹ Similar issues arise under local laws concerning the competence of public authorities: for example, in Italy, Veolia has argued that it is ‘ultra vires’ for Italian municipal water companies to act outside their territory.³²

The second area of uncertainty concerns concessions, which is a common form of contract under which water supply and sanitation services are delegated. However, as confirmed by an EC paper in 2001, the procurement directives do not cover concessions, and so formal competitive tendering under EC procurement rules is not required in respect of such contracts.³³ As a result, concessions in France or Italy may be opened to tender under national laws, but are not required to be open to companies from other EU countries.

Both of these questions are expected to be reviewed again in the green paper on PPPs due in 2004, along with the question of whether to require tendering of activities assigned to companies owned by public authorities.

²⁹ Cour des Comptes: La gestion des services publics locaux d’eau et d’assainissement. Rapport public particulier. Janvier 1997. See www.ccomptes.fr/Cour-des-comptes/publications/rapports/eau/cdc72.htm

³⁰ Hall, David (2001), “EU competition policies and public services”, PSIRU: Greenwich, www.psiru.org

³¹ The key cases are: C-320/91, *Corbeau* [1991] ECR I-2533, para. 11; C-41/90, *Höfner* [1991] ECR I-1979, para. 29; C-159/94, *Commission v. France* [1994] ECR I-5815, para. 59; C-393/92, *Almelo* [1994] ECR I-1477, para. 49; C-360/96, *Gemeente Arnhem and Gemeente Rheden v BFI Holding BV*, [1998] ECR I-6821, para. 52;

³² Lobina, E. and Hall, D. (1999), “Italian Water Industry 1999: A Profile”.
<http://www.psiru.org/reports/9902-W-Italy-Leg.doc>

³³ Draft Commission interpretative Communication on concessions under Community law on public contracts. 2001
http://europa.eu.int/comm/internal_market/en/publproc/general/concen.htm

2.3.4 Other policies: competition, internal market, PPPs and public services

A number of recent initiatives by different EC directorates show both the range of EC policies which affect the water sector, and a clear policy trend favouring liberalisation of water in the EU, along the lines of the liberalisation of electricity.

At the start of 2002 the European Commission's DG Competition commissioned a report into the water sector, which was delivered in December 2002.³⁴ From the report it is apparent that DG Competition sees itself as needing to act in the European water sector in the interest of providing a competitive environment for the private sector, and to do so by consulting providers, and businesses seeking opportunities.³⁵

In 2003 DG Markt, in its annual paper on the strategy for the internal market of the EU for the next three years, identified services of general interest, and water in particular, as sectors where the DG wants to open more of the market to private sector operators.³⁶ DG Markt chose to highlight the sections relating to SGI, and especially water, in its press release (PR)³⁷ and FAQ³⁸ on the strategy paper. Commissioner Bolkestein had also made clear his support for liberalisation in the water sector, and implied that a directive requiring liberalisation of the water sector may be proposed in the near future: in a speech in November 2002³⁹ he stated that liberalisation was a good thing and an inexorable trend, even in water, although some countries such as the Netherlands were not following that trend, and

"Worse still, some people want to have nothing whatsoever to do with it...[but]...The market presses on, also in the water sector... The current trend will also take on a European dimension one day...As soon as [the Water Framework Directive (WFD) is implemented], we shall be better placed to look at water as a cross-border product."

The European Commission's DG Regional Policy in 2003 produced a *Guide to Successful Public-Private Partnerships*.⁴⁰ This was specifically designed to make ISPA funds (funding infrastructure development in accession countries) more easily available to private sector projects,⁴¹ and states that "The European Commission has an interest in promoting and developing PPPs within the framework of the grants it provides" (EC 2003: 7). Although the document includes a disclaimer which makes it clear that it is not an EC policy document, the document is at least indicative of certain strands of Commission thinking.

Finally, the EC published a Green Paper on Services of General Interest (SGI) – i.e. public services – in May 2003, in response to requests by the European Council and European Parliament to clarify the status of SGI by devising an EU framework directive.⁴² However the green paper has a more complex approach, effectively offering a framework for liberalisation of further services along the lines already introduced in

³⁴ "Study On The Application Of The Competition Rules To The Water Sector In The European Community" December 2002. Prepared By Wrc And Ecologic For The European Commission - Competition Directorate General Study Contract No. Comp/2002/E3/Si2.334052

http://europa.eu.int/comm/competition/publications/studies/water_sector_report.pdf

³⁵ Hall, David (2003), "Water and DG Competition", PSIRU: Greenwich, www.psiru.org

³⁶ Internal Market Strategy Priorities 2003 – 2006 . Communication From The Commission May 2003

http://www.europa.eu.int/comm/internal_market/en/update/strategy/index.htm

³⁷ Internal Market: Commission presents ten-point plan for making Europe better off IP/03/645 Brussels, 7th May 2003 http://www.europa.eu.int/rapid/start/cgi/guesten.ksh?p_action.gettxt=gt&doc=IP/03/645/0/RAPID&lg=EN&display=

³⁸ FAQ: Internal Market Strategy 2003-2006 Frequently Asked Questions. DN: MEMO/03/100 Date: 07/05/2003 http://europa.eu.int/rapid/start/cgi/guesten.ksh?p_action.gettxt=gt&doc=MEMO/03/100/0/RAPID&lg=EN&display=

³⁹ Speech by Commissioner Frits Bolkestein Member of the European Commission in charge of the Internal Market and Taxation, to Institute of Economic Affairs, London, 7 November 2002 "Nuclear energy needed more than ever" http://europa.eu.int/comm/internal_market/en/speeches/spch-02-543_en.htm

⁴⁰ European Commission, Directorate-General Regional Policy, "Guidelines for Successful Public – Private Partnerships", March 2003, http://europa.eu.int/comm/regional_policy/sources/docgener/guides/ppp/ppp_en.pdf

⁴¹ de la Motte, Robin, and Hall, David (2003), "The European Commission's Guide to Successful Public-Private Partnerships - a critique", PSIRU: Greenwich, www.psiru.org

⁴² Green Paper On Services Of General Interest COM(2003) 270 Final

[Europa.Eu.Int/Comm/Secretariat_General/Services_General_Interest/Docs/Com_2003_270_Fi_En.Pdf](http://europa.eu.int/Comm/Secretariat_General/Services_General_Interest/Docs/Com_2003_270_Fi_En.Pdf)

sectors such as telecoms, post, rail, electricity and gas, and the annexe on ‘policy instruments’ includes a section on the GATS provisions of the WTO.⁴³

2.3.5 Fiscal impact of economic policies

The EU convergence criteria, the so-called “Stability Pact”, requires that prospective members of the EU and EMU (i.e. the euro) cut their general government financial deficit (GGFD) and national debt (ND) to 3 and 60 percent respectively.⁴⁴ This has affected public services in two ways: firstly, it has encouraged the sale of public enterprises as a way of reducing debt; secondly, it has encouraged restructuring which involves private sector financing – e.g. through sale of public enterprises, or through the use of concessions or the private finance initiative of the UK - and so reclassifies debt finance for capital expenditure as non-governmental.

The table below indicates the impact of the convergence criteria in 1996, as countries sought to comply in the period leading up to the introduction of the common currency.

Table: EU Countries responses to convergence criteria

	GGFD/ GDP (96 forecast)	ND/GDP (96 forecast)	Comments	Source
Austria	-4.5%	73.9% (97)	Govt program to reduce GGFD to -2.6% in 99, ND to 72% by 97. Measures inc: privatisations of bank, PO, tobacco, salt	Die Presse 12.7.96
Belgium	-3.0%	131%	Govt want GGFD -2.8% in 1997, but polit opposition to measures inc ss cuts, pay restraint	Reuters 8.7.96
Germany	-3.5%	62.4 (97)	Measures inc privatisations, defence cuts, cuts in coal subsidies; wages, sick pay cuts.	Reuters 8.7.96
Italy	-4.5% (97)		New govt keep old target for -4.4% GGFD 1997, -3.0% in 1998 crit by EU; inc privatisation receipts.	Reuters 2.7.96
Spain	-3.5%		Nat west says privatisation receipts and expenditure cuts needed to reach -3.5%	Cinco Dias 12.6.96
Portugal	-3.0%	70%	May involve cuts/tax rises; cuts in investment politically difficult	Reuters 31.5.96
Greece	-7.6%		Privatising banks, telecoms (under IMF recommendations)	Reuters 24.5.96
Netherlands		80%	Considering further share sales	

Sources: see final column

2.4 Other European actors

2.4.1 EIB

The EIB (European Investment Bank) is the EU’s financing institution, whose aim is to “contribute towards the integration, balanced development and economic and social cohesion of the Member Countries”. Outside the EU the EIB implements the financial components of agreements concluded under European development aid and cooperation policies. This provides the mandate for lending to CEE countries, as well as some developing countries. In 2001, EIB lending for environmental projects (including water and sanitation), both within and outside the EU, totalled €9bn. Water projects accounted for 29% of total EIB lending in environmental projects from 1990 to 2001.⁴⁵

⁴³ Hall, David (2003), “A critique of the EC green paper on Services of General Interest”, PSIRU: Greenwich, www.psir.org

⁴⁴ The requirements are set out in article 104 of the Consolidated Treaty http://europa.eu.int/eur-lex/en/treaties/dat/EC_consol.pdf and Protocol No 20 on the excessive deficit procedure (1992) <http://europa.eu.int/eur-lex/en/treaties/selected/livre335.html>

⁴⁵ http://www.eib.org/environment/docs/urbandev_en.pdf

At least in its lending operations to EU or CEE countries, it appears that the EIB has imposed no conditionality involving PSP, and has funded both privately and publicly operated projects. However, according to its own website, the EIB “has become a significant player in the innovative financing of infrastructure through Public-Private Partnerships (PPP)”. It is not clear whether the EIB’s Structured Finance Facility (SFF) contains an implicit conditionality or not. The SFF was set up “to match the types of funding to the requirements of projects with a high-risk profile and to pursue its equity financing and guarantee operations in favour of large-scale infrastructure schemes ... The aim of the SFF is to provide value added for priority projects by complementing the commercial banks and capital markets”.⁴⁶ It remains to be seen whether the SFF is only suited for project finance and in general as a support to high-risk PPPs.

See Annex C for examples of EIB lending to publicly owned water operations in Poland.

2.4.2 EBRD

The European Bank for Reconstruction and Development (EBRD) has been a significant player in the privatisation of water and sanitation in eastern Europe. The Bank was established in 1991 with the aim of assisting countries of CEE and CIS regions with the transition to market-orientated economies. It provides loans, equity investments and guarantees for private and public sector projects in the areas of infrastructure (including municipal and environmental infrastructure such as water services) and other sectors in 28 countries of the region.

The EBRD’s market-oriented development mandate gives it a general bias towards privatisation which is also apparent in the municipal and environmental infrastructure (MEI) sector, which includes water and sanitation. The Bank generally pursues the “promotion and optimisation of private sector participation”, together with other objectives such as decentralisation, commercialisation and corporatisation of services, development of regulatory structures and environmental improvement.⁴⁷ The conditionality of EBRD finance “typically” includes private sector involvement and other reforms such as decentralisation, commercialisation and corporatisation, cost recovery, tariff reform and creditworthiness strengthening.⁴⁸ Overall, the amount of finance provided to the private sector in MEI has increased from zero in 1994 to nearly €80m in 1999 (on a projected total of €200m).⁴⁹ The EBRD has financed most of the major water privatisations in CEE, such as Sofia, Bulgaria; Budapest, Hungary; Tallinn, Estonia; and Bucharest, Romania.

- The EBRD also imposes a de facto conditionality of PSP through its Multi-Project Facility (MPF) schemes. MPFs are funds set up under an agreement between the Bank and a specific private sector company to cover several projects on a wholesale basis. Such schemes are exclusively available to the private sector – in particular to large multinationals such as Suez and Veolia⁵⁰ – and give a competitive advantage to these companies. This can create a structural bias in favour of large multinationals which can bring pre-arranged EBRD finance to a project, compared to other companies or public sector options which will need to find alternative sources of finance. The provision of MPFs has also involved some personal relationships between the Bank and its private sector clients. In June 1995, just one month before the agreement on the multi-project facility to

⁴⁶ <http://www.cordis.lu/nanotechnology/src/venture.htm>; http://www.eib.org/environment/docs/urbandev_en.pdf; http://www.ueitalia2003.it/NR/rdonlyres/A5597882-49CF-421C-A55C-6D037D0F11F7/0/A_European_Action_for_Growth.pdf

⁴⁷ EBRD, January 1999, *Municipal and Environmental Infrastructure – EBRD involvement to date in the MEI sector*, p. 10.

⁴⁸ *ibid*, p. 20.

⁴⁹ *ibid*, p. 3.

⁵⁰ For example, in 1995, the Bank provided Suez-Lyonnaise des Eaux with a US\$90m multi-project facility, which in 2000 it extended for a further 3 years. In 1997, the Bank issued a very similar-sized US\$89.5m MPF to Générale des Eaux (now Veolia). Source: PSIRU Database; 9th August 1995, “Lyonnaise agrees multi-project loan with EBRD”, Water Briefing, FT Bus Rep: Energy.

EBRD, “EBRD supports Suez-Lyonnaise des Eaux’s investments in municipal services in central and eastern Europe”, EBRD Press Releases, 15/02/2000. <http://www.ebrd.com/english/new/pressrel/2000/14feb11.htm>.

EBRD, “Projects signed in 1997 – At 31 December 1997”. <http://www.ebrd.com/english/opera/index.htm>.

Lyonnaise des Eaux, Thierry Baudon left his post as deputy vice president of the EBRD and joined Lyonnaise des Eaux as managing director, international project finance.⁵¹ The EBRD has also supported privatisation options through technical assistance favouring projects that support private ownership, not public ownership or public sector reform (e.g. helping to redesign Lithuania's concession law to make it more attractive to investors⁵²)

Despite the EBRD's strong financial support for privatisation, it has also been a significant funder of municipal water operations in CEE, particularly in states such as Poland where privatisation has proceeded much more slowly than in countries such as the Czech Republic and Hungary. In particular, where it has been satisfied with the financial soundness of the recipient municipal company, the EBRD has financed municipal water operations in CEE without requesting the backing of municipal or governmental guarantees. Following in-house restructuring and/or public-public partnerships (PUPs) entered into with Nordic municipally-owned water companies, a number of municipal water companies, particularly in Poland and the Baltic states, have benefited from such loans. By issuing loans without requesting government guarantees, the EBRD was contributing to relieve public finances so that more resources would be available for public investments in non-revenue sectors such as housing, education and roads (see sections below).

See Annex C for examples of EBRD lending to publicly owned water operations in eastern Europe.

2.4.3 HELCOM Helsinki Commission

The Helsinki Commission (HELCOM) is a collaboration set up at the start of the 1980s between all the countries adjacent to the Baltic Sea. These included EU countries – Sweden, Finland and Germany – and transition states such as Poland and the Baltic states. A key part of its activities was a Baltic Sea Joint Comprehensive Environmental Action Programme (JCP), which identified problem 'hot spots' needing wastewater treatment in all the river basins draining into the Baltic, and channelled technical and financial resources to deal with these as common issues. A review process in 1998 reconfirmed the soundness of the basic approach and concluded that it should largely be maintained as the framework for this regional environmental programme.⁵³

The JCP

"provides an environmental management framework for sustained cooperation among the Contracting Parties to the Convention, other governments within the region, international financial institutions, and nongovernmental organisations for the long-term restoration of the ecological balance of the Baltic Sea, through a series of preventive and curative actions to be undertaken in a phased manner in the region."⁵⁴

The JCP has worked in particular through identifying pollution 'hotspots' in the Baltic basin, and directing financial and technical resources to solve the problems in those and other places, especially in water and wastewater systems. The result has been an international programme of capacity-building and investment throughout the basin: in Lithuania, there have been major projects to develop wastewater plants at Kaunas, funded by the EBRD, and advised and assisted by public sector bodies from Finland (the Finnish Environment Institute) and twinning arrangements with Stockholm Water. Similar twinning arrangements

⁵¹ "People: European Bank for Reconstruction and Development", Financial Times, 27/06/1995.

⁵² In July 2003 the EBRD announced it had helped Lithuania revise its concession law to make it more flexible and attractive to foreign investors, after not a single concession had been granted since the introduction of the law eight years earlier. (Source: EBRD, 30 July 2003, "EBRD helps improve concession law in Lithuania" <http://www.ebrd.org/new/pressrel/2003/101July30.htm> (PSIRU Source ID: 8279))

⁵³ Baltic Sea Environment Proceedings No: 72 (March 26, 1998) HELSINKI COMMISSION The Baltic Sea Joint Comprehensive Environmental Action Programme: Recommendations for Updating and Strengthening <http://www.helcom.fi/pitf/bsep72.html> - Beyond the JCP Updating

⁵⁴ Baltic Sea Environment Proceedings No: 72 (March 26, 1998) HELSINKI COMMISSION The Baltic Sea Joint Comprehensive Environmental Action Programme: Recommendations for Updating and Strengthening <http://www.helcom.fi/pitf/bsep72.html> - Beyond the JCP Updating

were made between other Swedish municipal companies and water authorities in Estonia, Latvia and Lithuania.⁵⁵ A review in 1998 concluded that this approach had worked well:

International funding in the form of loans, soft loans, grants and other types of assistance has been important in accelerating the rate of JCP implementation in the countries in transition. The programme has found that there is great effectiveness in “cofinancing that blends loans from IFIs and grants from the European Union and bilateral donors” – this helps make investments more affordable for countries in transition and reduces project preparation and supervision costs. It also allows projects to be larger, allowing greater impacts and reducing the effective cost; and the use of grants reduces the impact of adjustments to tariffs for services to project beneficiaries, thus decreasing potential adverse impacts on populations with low or fixed incomes.

Reviews and evaluations of these processes have been consistently enthusiastic, whatever their critical observations on specific aspects. The SIDA review of its overall municipal twinning programme described it as “a successful experiment” ; the review of the Kaunas experience in 1998 described it as “overwhelmingly positive” ;⁵⁶ the review of the Riga twinning set out a striking summary of major technical, environmental, financial, managerial and governance achievements:

“SWC [Stockholm Water Company] has assisted RW [Riga Water] in the preparation and implementation of an investment programme (RWEF) for improving the city’s water supply and wastewater treatment. The RWEF has promoted/will promote environmentally sustainable management and improved municipal infrastructure in the Baltic region. The effluent load from Riga to Daugava River, and further to the Baltic Sea, has been essentially reduced. As a direct result of the project, the quality and reliability of water supply and wastewater services has improved in Riga. The twinning arrangement has essentially stimulated and supported the process of transforming RW into an autonomous, self-financing and self-governing enterprise. There is a better understanding and appreciation on a political level of the requirements for arriving at an administratively and financially independent water company. RW is very satisfied with the twinning arrangement and wishes to continue close cooperation with SWC beyond the current twinning agreement. RW currently complies with all the covenants of the financiers.”⁵⁷

2.4.4 Aarhus Convention

"Although regional in scope, the significance of the Aarhus Convention is global. It is by far the most impressive elaboration of principle 10 of the Rio Declaration, which stresses the need for citizen's participation in environmental issues and for access to information on the environment held by public authorities. As such it is the most ambitious venture in the area of 'environmental democracy' so far undertaken under the auspices of the United Nations."

Kofi A. Annan, Secretary-General of the United Nations

The objective of the Aarhus Convention signed under the auspices of the UN Economic Commission for Europe (UNECE) at Aarhus, Denmark on 25 June 1998,⁵⁸ is “to contribute to the protection of the right of every person of present and future generations to live in an environment adequate to his or her health and well-being”. To that avail, “each Party shall guarantee the rights of access to information, public participation in decision-making, and access to justice in environmental matters in accordance with the provisions of this Convention” (Article 1).

The three pillars of the Aarhus Convention are:

⁵⁵ HELCOM News (newsletter of the Helsinki Convention) 4/96, www.helcom.fi/news/news496.html.

⁵⁶ Sida Evaluation 98/19, “Twinning Cooperation between Kaunas water Company, Lithuania and Stockholm Water Company”, August 1998

⁵⁷ Sida Evaluation 00/7, “Twinning Cooperation between Riga Water Company and Stockholm Water Company”, May 2000

⁵⁸ The full text of the Convention can be found at <http://www.unece.org/env/pp/documents/cep43e.pdf>

- the public right of access to environmental information;
- the public right to participate in decision-making processes;
- ensured access to justice for the public.

Public access to environmental information is addressed by Article 4 of the Convention, and lays down that governments and authorities shall make environmental information available upon requests from the public. The respective wording of Article 4 shows a strong influence by some signatory states with historically clandestine government authorities – even a “customary practice” of keeping internal communications of public authorities secret can be used as a justification to turn down an information request (Article 4.3.c). The recently adopted EU Directive on public access to environmental information has however strengthened and clarified the respective obligations of public authorities (see below).

It is important to note that the definition of the term “public authority” is in fact very wide, and potentially extends the responsibilities of the Convention to water supply and waste water companies, both private and publicly run. Article 2.2.c includes in the definition of a public authority “natural or legal persons having public responsibilities or functions, or providing public services, in relation to the environment”. The view that this extends to the water sector is further supported by the fact that the definition of “environmental information” specifically mentions “the state of human health and safety” (Article 3.2.c). Hence data on groundwater and reservoir quality, on drinking water and on the state of waste-water discharged by waste-water treatment plants would have to be made publicly accessible on demand (UfU, 2003).

The European Union has adopted on 28 January 2003 a European Parliament and Council Directive 2003/4/EC on public access to environmental information. This directive basically transposes the stipulations of the Aarhus Convention into European Union legislation. Member States will have to bring into force adequate national legislation by 14 February 2005.

The second pillar of the Convention is to make sure that whenever decisions are taken by governments or authorities on permits for any of the activities listed in the Convention’s Annex I, the public shall be involved. To that avail, signatory states shall ensure that the public is informed timely and adequately (Article 6.2), that public participation is invited while all options are still open (Article 6.4), that full access to information relevant for the decision-making process is granted (Article 6.6), that the public can submit any comments, analyses and opinions it considers relevant (Article 6.7), that due account is taken in the decision of the outcome of the public participation (Article 6.8), that upon decision the public is promptly informed and that text, reasons and considerations concerning the decision are made accessible to the public (Article 6.9).

Annex I lists virtually any activity with a potential to pollute or to otherwise impair the environment. The water sector may be directly affected in the following cases:

- Waste-water treatment plants with a capacity exceeding 150 000 population equivalents;
- Groundwater abstraction or artificial groundwater recharge schemes where the annual volume of water abstracted or recharged is equivalent to or exceeds 10 million cubic metres;
- Works for the transfer of water resources between river basins where this transfer aims at preventing possible shortages of water and where the amount of water transferred exceeds 100 million cubic metres per year;
- In all other cases, works for the transfer of water resources between river basins where the multi-annual average flow of the basin of abstraction exceeds 2 000 million cubic metres per year and where the amount of water transferred exceeds 5% of this flow;
- Transfers of piped drinking water are excluded from the scope of the Convention;
- Dams and other installations designed for the holding back or permanent storage of water, where a new or additional amount of water held back or stored exceeds 10 million cubic metres;
- Any other activity where public participation is provided for under an environmental impact assessment procedure in accordance with national or supranational (i.e. European Union) legislation.



Due to this reference, the potential field of application is considerably wider than indicated by the above list.

The European Union has adopted on 26 May 2003 a *Directive providing for public participation in respect of the drawing up of certain plans and programmes relating to the environment* (2003/35/EC)⁵⁹ to transpose the Aarhus Convention's second pillar into EU law. Member States have been given until 25 June 2005 to incorporate the directive into national law.

The convention further foresees that public participation should be extended to all "plans, programmes and policies relating to the environment" (Article 7).⁶⁰ This aspect of the Convention has been transposed into EU legislation by the Directive on Strategic Environmental Assessment (SEA Directive). Organisational changes in the water sector having an impact on the environment are normally covered by both the Aarhus Convention and the SEA Directive.

The third pillar of the Aarhus Convention is access to justice: Any person who considers that his or her request for environmental information has been "ignored, wrongfully refused (...) or inadequately answered should have access to a review procedure before a court of law or another independent and impartial body established by law" (Article 9). There is a substantial limitation however in Article 9.2 reserving access to justice to "members of the public *concerned* having a *sufficient interest*". Some Member States are likely to interpret this provision as a limitation of access to justice in environmental matters to established environmental organisations.

So far, the Commission has not tabled a proposal for the third pillar of the Convention regulating access to justice. The respective documents (one addressed at Member States, one at EU institutions) have been in interservice consultation, but no proposals for directives has been published yet.

This delay reflects the hesitation with which the Aarhus Convention is met in EU institutions and Member States. Although during the negotiations, some signatory parties to the Convention have succeeded in considerably weakening the text (and thus the rights granted to the public), so far only five Member States have ratified it (Belgium, Denmark, France, Italy and Portugal), as well as the majority of Accession States (Estonia, Latvia, Lithuania, Poland, Hungary). The European Community can only ratify the Convention when all legislation in Member States as well as in EU institutions is consistent with the Aarhus provisions. Reservations are still strong in some signatory states to ratify the Convention. For instance, Germany noted upon signing that "the text of the Convention raises a number of difficult questions regarding its practical implementation in the German legal system which it was not possible to finally resolve during the period provided for the signing of the Convention. These questions require careful consideration, including a consideration of the legislative consequences, before the Convention becomes binding under international law." Germany finally signed the Convention with several months delay, but still hasn't ratified it. The Federal Republic of Germany obviously fears that current German efforts to deregulate, accelerate and streamline administrative procedures may be compromised by integrating the rules of the Aarhus Convention into German law.

As regards the water sector, the Aarhus Convention can be expected to increase public accessibility of data, for instance on surface and groundwater quality, on substances discharged into rivers by industries and public waste water treatment plants and on water

⁵⁹ For full text of the directive see: <http://europa.eu.int/eur-lex/>

⁶⁰ Article 7: Public Participation concerning Plans, Programme Each Party shall make appropriate practical and/or other provisions of plans and programmes relating to the environment, within a necessary information to the public. Within this framework, and which may participate shall be identified by the relevant public Convention. To the extent appropriate, each Party shall endeavour the preparation of policies relating to the environment.

Other European countries which were signatories but had not ratified the convention at the start of 2004 included: Austria, Croatia, Czech Republic, Finland, Greece, Iceland, Luxembourg, Netherlands, Slovenia, Spain, Sweden, Switzerland, United Kingdom.

Signatories who have ratified the convention include: Belarus, Belgium, Bulgaria, Cyprus, Denmark, Estonia, France, Hungary, Latvia, Lithuania, Macedonia, Malta, Moldova, Norway, Poland, Portugal, Romania, Ukraine.

Aarhus Convention website: [HYPERLINK "http://www.unece.org/env/pp/ctreaty.htm"](http://www.unece.org/env/pp/ctreaty.htm)
<http://www.unece.org/env/pp/ctreaty.htm>



infrastructure planning (dams, transfers, major groundwater abstractions, artificial infiltration). The increased transparency will doubtlessly also affect water supply and waste water operators. It remains to be seen to what extent the Convention's second pillar, the public right to participate, will have an impact on strategic decision-making in the water sector. Since a change of ownership or operator might well severely alter the environmental record of a water or waste water company, applying the principles of the Aarhus Convention to such decisions would seem reasonable.

3 Actors: water companies

3.1 Private water companies in a global context

Globally, water supply and sanitation services are provided by public sector for an overwhelming majority of users. Around 95% of the population connected to a water supply are served by a public sector operator: in Europe the figure is lower, but is still around 80%.⁶¹

This relative dominance of public authorities is not however visible at international level. Public authorities are by definition restricted to their own localities, and so the water service, whether provided through a departmental structure or a corporatised utility, remains a local operation. There are a few exceptions where public sector operators have tried to operate internationally by seeking contracts overseas, but usually this is a prelude to at least partial privatisation - as for example in the case of Amga or Acea (Italy) or Berlinwasser (Germany) – or of desired privatisation, such as the case of Nuon (Netherlands).

With these few exceptions the public water companies do not operate internationally, and so the private companies which do operate, very prominently, on an international level, are only occupying a tiny minority of their own market. The multinational water companies are thus very unusual compared with other sectors, even such as energy, where there is a higher percentage of private operators: it is more analogous to the private hospital sector, where private companies again represent a tiny fraction of provision compared with public sector hospitals.

They are also very unusual in that there is a small number, concentrated in one home country, France, with just two companies dominating around two-thirds of the global private market. Under these circumstances, it is unlikely that competition will be a powerful force in behaviour, and so, as argued in an earlier section (see

Water multinationals 2003. Source: Company reports, PSIRU estimates

⁶¹ Estimates range between 93% and 97%.

2.2), the main theoretical advantage of the market is much weaker. The international corporate actors in water are a small, homogeneous but vociferous minority.

3.2 Historical context

The number of private water companies with significant international water operations is rather small – less than a dozen. Of these, the largest two, Suez (whose water division is also known as Ondeo, or as Lyonnaise des Eaux) and Veolia (formerly Vivendi, and, earlier, Generale des Eaux) dominate the market: in 2002 they shared 60% of the 320m customers served by multinationals.

The largest water companies (as well as the fourth-largest, SAUR) are French for historical reasons.⁶² The wave of municipalisation of water systems that took place in Europe and the USA between the late-19th and mid-twentieth century failed to erode the (relatively limited) market base those companies had established in France. This then provided a stable base from which to expand. As a result, the three large French companies – Suez, Veolia, and SAUR – developed as the global leaders in private water supply, used to operating across a number of different public authorities, and with the size and capital resources to take advantage of the fashion for privatisation which started in the 1980s.

Prior to 1989 there were no significant competitors to Suez and Veolia in any other European countries. The biggest of the private Spanish water companies, Aguas de Barcelona, is effectively controlled by Suez; and another, Aguas de Valencia, was and is controlled by SAUR. Others were mostly owned by Spanish construction groups, such as FCC (now controlled by Veolia). There were a small number of private companies in Italy, a substantial part of which were partly owned by one or other of the French companies by 1990. The one significant private company in Germany, Gelsenwasser, still had a significant minority municipal shareholding, and operated in a similar fashion to municipal water operators.

The nearest competitors to the French companies arose in 1989 out of the political initiative of the Thatcher government, with the ten British regional water supply and sanitation authorities privatized overnight in 1989 by flotation on the stock exchange. (This was only possible because the UK, uniquely in Western Europe, had restructured its water sector 15 years earlier, so that all municipal operations had been merged into a small number of state-owned regional companies). The competition that the new UK private companies provided was however relatively ineffective, in particular because of their relative lack of experience in negotiating with public authorities to gain new contracts, and their relative lack of financial resources and political clout. However, the largest UK water company, Thames Water – which is now part of the German energy group RWE - has become the third largest global water company, and United Utilities remains active in a few concessions in central and eastern Europe.

3.3 Structure of the global water market

The water industry is characterised by high barriers to entry due to the capital intensive nature of operations, as well as a geographically dispersed capital structure which increases the asymmetry of information between incumbents and competitors. Capital costs are high enough to make duplication of infrastructure

⁶² The historical reasons which contributed to the insulation of France from the municipalisation wave included: a) the concept of a private operator running a service for a public authority was deeply rooted in French administrative and political culture and thus unquestioned (concessions found their historical origins in France and the first private water concession dated back to the 16th century, when the Perrier brothers obtained a contract to provide drinking water to the city of Paris); b) the major private water operators, GdE and LdE, were set up by imperial decree in the second half of the 19th century and this might have contributed to a positive perception from central and local governments; c) throughout the period from 1850 to date, French law has provided for the municipality's freedom of choice between directly running water services under a municipal "régie" or delegating water operations to a private operator. It should also be noted that, while their potential foreign competitors were being nationalised or municipalized (e.g. the British in Berlin in 19th century), both GdE and LdE could develop their experience in terms of international water operations. For example, GdE held the concession for water supply in Venice for around a century, from the end of the 19th century to 1973. Conversely, between WWI and WWII the then SLEE (Société Lyonnaise des Eaux et de l'Eclairage) expanded its operations particularly abroad, that is in Spain, Morocco and Tunisia.

economically unviable in virtually all contexts, making the water sector a natural monopoly. Competition therefore takes the form of competition for the market (with long term exclusive contracts or concessions, of the order of 20 to 30 years) rather than competition in the market (i.e. multiple suppliers competing for the same set of customers).

Few new entrants	
Ruas	In France, Ruas, a relatively small company based in the south, has obtained 55 contracts covering 134,000 users.
RWE	In 2000 the German energy group RWE entered the sector by buying Thames Water (UK), strengthening its position by later taking over American Water.
E.ON	The other main German energy group, E.ON, stated ambitions in water, bought control of the German private company Gelsenwasser, and discussed a possible takeover of SAUR: but in 2003 it sold Gelsenwasser, and abandoned all interest in SAUR.
Enron	The USA energy group Enron created a new water company Azurix, based on the takeover of an existing UK water company, Wessex Water, but it collapsed in 2001 (before the general collapse of Enron).
YTL	Wessex Water was subsequently taken over by YTL, a Malaysian energy multinational.
Welsh Water	The Hyder group in the UK, which included Welsh Water, was taken over by a USA-based energy consortium, WPD, which did not want to retain a water operation. The infrastructure of Welsh Water was transferred to a specially created non-profit company; the operations were contracted out to another UK company, United Utilities.

Partly as a result of these inherent structural features of the sector, there have been few significant new entrants in the global water market in the last decade. The most prominent have been energy companies joining the 1990s fashion for multi-utilities, largely by takeover of or joint venture with existing water companies.

Attempts by Azurix – owned by US-based energy company Enron – to break into the market proved a failure, with Enron deciding to break up Azurix and sell its assets in April 2001,⁶³ a few months before Enron's accounting brought about its own collapse. One of the main reasons for Azurix' failure was the poor results obtained when bidding against the leading French-based water companies, Veolia and Suez, which could count on superior financial capacity and could accept initially lower profit ratios in order to win a tender. Tim Winter, a water analyst with St. Louis firm A.G. Edwards & Sons, summarised: "The French aren't as driven by profits as the U.S. investors are, so they're more tolerant of longer time frames". As a result, in January 2002 Azurix announced it would change strategy focussing on smaller projects which would appeal less to the French giants.⁶⁴

In order to establish itself as a global player on the water market, German conglomerate RWE had to take over UK-based Thames Water. RWE had established a number of joint ventures with the major water TNCs: the acquisition of a 49.9% stake in Berlin's water company Berliner Wasser Betriebe jointly with Veolia; an indirect participation in Budapest Municipal Sewerage Company FCSM through Berliner Wasser Betriebe, with Veolia as the other partner; and the acquisition of a 25% stake in Budapest Waterworks Rt jointly with

⁶³ Source: PSIRU database, News Item 4481 "Azurix to be broken up" (www.psiru.org/newsitem.asp?newsid=4481) ; Sophie Barker, "Wessex Water parent plans major surgery", *The Daily Telegraph*, 19 April 2001; Micheal Davis, "Water under the bridge; Enron will take Azurix private, sell its assets", *The Houston Chronicle*, 16 December 2000.

⁶⁴ Source: PSIRU database, News Item 3717 "Azurix and Wessex face problems of failing to capture water market" (<http://www.psiru.org/newsitem.asp?newsid=3717>); Jenalia Moreno, "Azurix testing the waters - Company competing against giant foes in Latin America market", *The Houston Chronicle*, 9 January 2000.

Suez-Lyonnaise des Eaux. It was only with the takeover of the already established UK-based water TNC Thames Water in September 2000 that RWE acquired a significant share of the world water market.⁶⁵

The limited number of major international water operators has certainly contributed to the low level of competition which is characteristic of the water sector. A number of factors further restricted competition in the global water market:

- a) privatised contracts and concessions were initially awarded without competitive tendering - this has been the case in France until 1993, but also in the early privatisations in CEE;
- b) the long duration of concessions and their automatic renewal;
- c) the high number of one-bidder tenders in developing countries but also in developed countries such as Italy (see the cases of Sarnese Vesuviano, Florence and Siciliacque)⁶⁶;
- d) a trend to create joint ventures between major water operators
- e) corruption and lack of transparency
- f) EBRD lending conditionality through Multi-Project Facilities.

3.3.1 Joint ventures

In France, where they control 85% of private water operations, Suez and Veolia have created joint subsidiaries in a number of towns and regions, with the effect of restricting competition in the French private water market. In July 2002, the French competition council (“Conseil de la concurrence”) ruled that Suez (Lyonnaise des Eaux - SLDE) and Veolia (Générale des Eaux - CGE) had been abusing their market dominance in France: a report by the Competition Council listed 12 joint ventures in France, including cities such as Marseilles and Lille – two of these joint ventures also involved SAUR, the third largest water company. The Competition Council recommended that the Ministry of Economy act to force CGE and SLDE to remedy the situation by dismantling their joint ventures (Conseil de la Concurrence, 2002).⁶⁷

This forming of joint ventures is not restricted to France. Figure 2 below shows a number of these joint ventures. It is striking that even the nearest competitors to Suez and Veolia – Thames, SAUR, and Anglian – have made partnerships with Suez and Veolia to establish themselves in the market. RWE/Thames for example are partners to Veolia on three of their major water operations – Berliner Wasserbetriebe, Budapest Sewerage (FCSM), and United Water in Adelaide, Australia, and its offshoots in New Zealand (Papakura) and Indonesia (Sidoarjo). RWE is also a partner to Suez in Budapest Water. SAUR has partnerships with Veolia in both the UK and the Czech Republic. Anglian is a partner of both Suez and Veolia in Aguas Argentinas, and separately of Veolia and Suez in the Czech Republic.

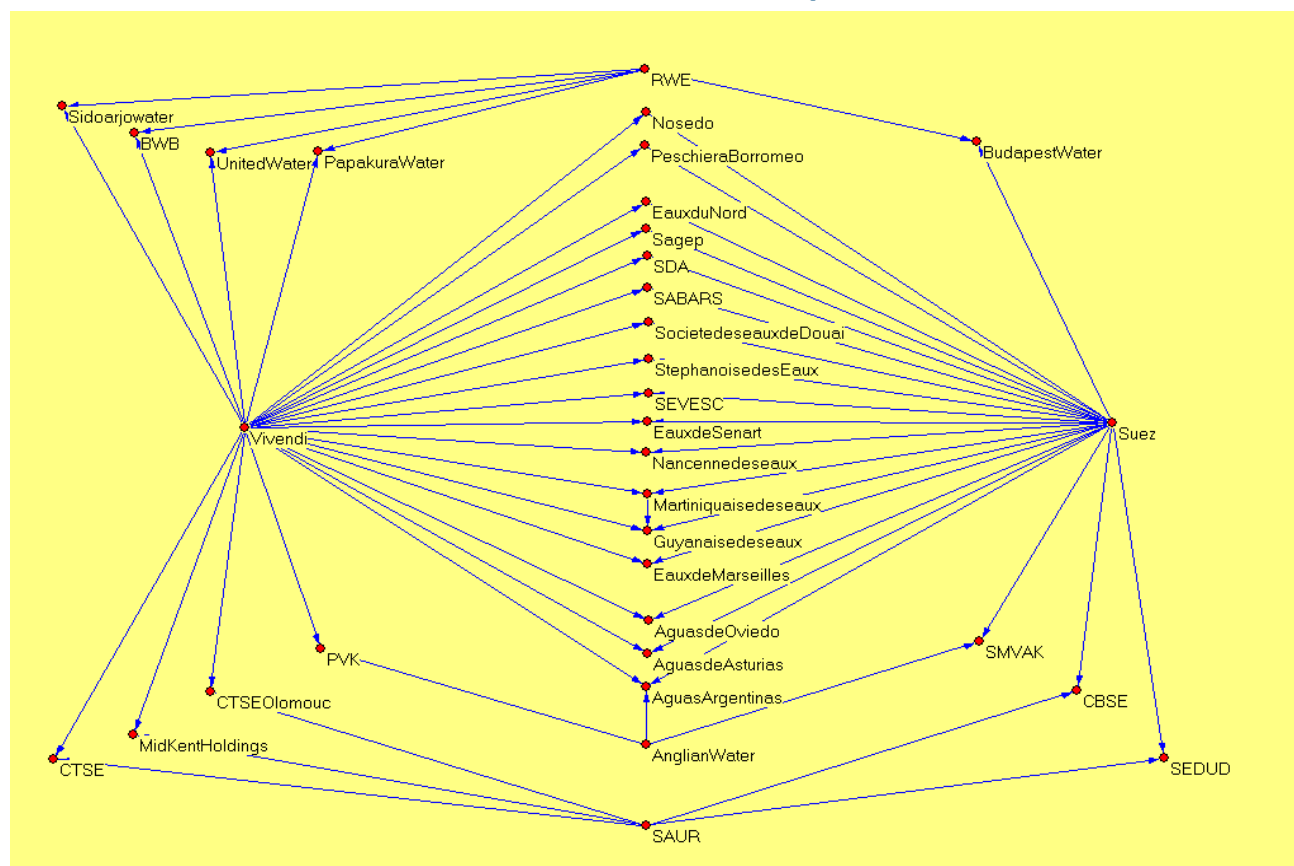
Figure 2. Joint ventures between leading water multinationals, 2002

⁶⁵ Source: PSIRU database, News Item 4416 “RWE to take over Thames Water”

(<http://www.psiru.org/newsitem.asp?newsid=4116>); Andrew Taylor & Uta Harnischfeger, “RWE acquires Thames Water in £4.3bn deal”, *The Financial Times*, 22 September 2000.

⁶⁶ “Sarnese-Vesuviano win”, *Global Water Report*, Issue 134, 26th November 2001, pp. 2-3; “Italy/Companies: Acea and Ondeo in third joint win in Florence”, *Global Water Report*, Issue 175, 18th July 2003, p. 5;

⁶⁷ See also Conseil de la concurrence, «Marché de l’eau: le Conseil de la concurrence demande au ministre de remettre en cause les filiales communes de la CGE et de la SLDE», Communiqué de Presse N. 22, 17th July 2002 (<http://www.finances.gouv.fr/conseilconcurrence/communiques/comm22.htm>); «Vivendi et Suez accusées de fausser le jeu de la concurrence», *La Tribune*, 18th July 2002.



Source: PSIRU database, 2002. Generated by Vladimir Popov, PSIRU using Social Network Analysis software.

3.3.2 Endless concessions

The sheer length of water concessions also limits competition, which can be observed in developed countries with a longer history of PSP in the water sector, such as France and Spain, as well as in developing countries. Other implications related to competition and the long-term duration of concession agreements, include the issue of whether and how a private water concession can ever be terminated, re-tendered, or brought back into public ownership.

Water privatisation in France and Spain has existed long enough to allow observation of the factors affecting the choice of the conceding public authorities on ensuring service provision once a long-term agreement expires. In France, until recently, concessions were frequently renewed without tendering, according to the Cour des Comptes, France's national audit body (Cour des Comptes, 1997: 95-97). It was only in 1993 that the so-called Loi Sapin, or anti-corruption law, provided for privatised concessions to be publicly and competitively tendered⁶⁸. In 1995, the Barnier Law limited the maximum duration of privatised water contracts at 20 years.⁶⁹ Several contracts were renegotiated and extended a few weeks or months prior to entry into force of the new legislation, sometimes before the contract expiry date (Cour des Comptes, 1997: 105-106). Although in future more concessions can be expected to be re-tendered, in many cases this will not happen before 2020 as contracts concluded before the new legislation became applicable escaped those provisions (Druin, 2002). In Nice, Générale des Eaux has managed water supply and sanitation under a concession contract since 1864.⁷⁰ Even when contracts are re-tendered, due to its superior knowledge of the

⁶⁸ Art. 38, Loi no 93-122 du 29 janvier 1993 relative à la prévention de la corruption et à la transparence de la vie économique et des procédures publiques, *Journal Officiel* n° 25 du 30 janvier 1993 (<http://www.legifrance.gouv.fr/WAspad/UnTexteDeJorf?numjo=PRMX9200148L>).

⁶⁹ Art. 75, Loi no 95-101 du 2 février 1995 relative au renforcement de la protection de l'environnement, *Journal Officiel* n° 29 du 3 février 1995, p. 1840 (<http://www.legifrance.gouv.fr/WAspad/UnTexteDeJorf?numjo=ENVX9400049L>).

⁷⁰ "Nice work cuts costs", *Global Water Report* 144, 19 April 2002, p. 3.

system, the incumbent remains at a competitive advantage in respect of competing companies and this strongly undermines the effectiveness of competition (Cour des Comptes, 1997: 98-99).

A clear example of the limitations to the effectiveness of competition when long-term concessions are re-tendered is provided by the case of Aguas de Valencia in Spain. In 1902, the city of Valencia awarded a water concession to a private company, AVSA. The contract specified that the monopoly would last for 99 years. And so in the late 1990s, for the first time since 1902, the city of Valencia began to draw up tender documents. At this point AVSA, now part of the SAUR-Bouygues multinational group, and advised by international accountancy firms Pricewaterhouse and Arthur Andersen, announced that if it lost the tender it would demand compensation of € 54m Euros for investments it had made in the system⁷¹. The tender proceeded, with a clause stating that the winner would have to pay € 54m to AVSA. Not surprisingly, there was not a single competing bid. AVSA, now part of a joint venture with the council itself, will enjoy the concession for a further 50 years. In 2050, the city of Valencia will have had 150 years of private water monopoly with not a single competitive bid.⁷² In Barcelona, Aguas de Barcelona has enjoyed an unbroken indefinite concession for 136 years, with no prospect of a competitive tender in the near future for the same reasons as in Valencia.

Few water concessions in developing countries have in fact lasted long enough yet to reach their appointed end. The most long-standing example, in the Côte d'Ivoire, was originally awarded without any public competitive tendering, and was later renewed and extended without any public or competitive tendering (Bayliss, 2001). There are already cases of Valencia-length concessions in Latin America. In 1998, a SAUR-led consortium also including Enron was awarded a 95-year water concession in Mendoza, Argentina.⁷³ In June 1999, a Suez-Lyonnaise des Eaux/Agbar consortium bought 42% of the shares of Santiago de Chile's water company EMOS (then renamed Aguas Andinas) for US\$ 957m. The private consortium was also awarded an unlimited duration concession to manage and develop the city's water and sewerage (Suez Lyonnaise des Eaux, 1999: 25).

3.3.3 Political economy of water corruption

The expected benefits of competition are made less likely because of the incidence of corruption associated with privatisation. The economic function of a bribe is to provide a financial inducement for an official, politician, or public authority to act in the interests of the company rather than the public interest which he/she/it is supposed to represent. Some payments which perform these functions may be legal under different national laws, notably on party political financing, and so illegal payments are only one category of such inducements (and illegal payments for which a company has been convicted are an even smaller sample).

Long-term water concessions provide large potential gains to offer inducements at the point of the award of the contract or concession. This has happened in France, where two of the water companies have been convicted of paying bribes to obtain water contracts. In Grenoble in 1996, a former mayor and government minister and a senior executive of Lyonnaise des Eaux (now Suez-Lyonnaise des Eaux) both received prison sentences for receiving and giving bribes to award the water contract to a subsidiary of Lyonnaise des Eaux; in Angoulême, the former mayor was jailed in 1997 for two years, with another two years suspended, for taking bribes from companies bidding for contracts, including Générale des Eaux; and executives of Générale des Eaux were also convicted of bribing the mayor of St-Denis (Ile de la Réunion) to obtain the water concession.⁷⁴ The same groups - Suez-Lyonnaise and Veolia, together with Bouygues - have been investigated in France for corruption practiced by their construction divisions, in a scandal described as 'an agreed system for misappropriation of public funds'. The companies ran a corrupt cartel over building work

⁷¹ "Informe De Pricewaterhousecoopers Valencia Pagara A Avsa 54 Millones Si Rescata La Concesion", *Expansion*, 17 January 2001.

⁷² Alfonso, J. (2001) "Aguas de Valencia gana el concurso de suministro local", *Cinco Dias*, 3 October 2001, p. 6.

⁷³ "Enron preferred bidder for Mendoza: Argentina/Project", *Global Water Report FT Bus Rep: Energy*, 26 May 1998.

⁷⁴ Hall, D. (1999), "Privatisation, multinationals, and corruption", in *Development in Practice* 9(5): 539-556.

for schools in the Ile-de-France region (around Paris) between 1989 and 1996. Contracts worth FF2.8 billion (about US\$500m) were shared out by the three groups.⁷⁵

The economics of corruption are not specific to the water industry, or to France, but operate in relation to all public procurement, national or international. This is borne out by experience in Europe. In the UK, for example, the police have said that: “the overwhelming majority of corruption cases in Britain are connected to the award of contracts. Compulsory contracting-out in local government, and the new Private Finance Initiative have produced an explosion in the number of such deals.”⁷⁶ UK multinationals adopt the same approach to overseas contracts, as emerged in 1999 when former government minister Aitken was jailed for lying to cover up a meeting to broker such bribes: UK multinational GEC had agreed to pay a commission worth 10 per cent of the value of possible sales into an account controlled by Aitken’s solicitor.⁷⁷

The extension of private water concessions thus acts to increase the opportunity and incentive for corruption. The actual incidence is a matter for empirical study.

3.4 Multinationals’ strategies

Although water multinationals’ strategies vary according to different managerial styles and the way companies have developed historically, it is possible to attempt a generalisation of factors contributing to shape multinationals’ expansion strategies. Growth takes place through takeover of existing companies or acquisition of new operating contracts and concessions, and depends on a number of tactical considerations, with factors including:

- a) consolidation and expansion of domestic markets;
- b) identification of national markets providing a favourable environment and promising opportunities (possibly including action to facilitate the creation of such a favourable environment);
- c) action aimed at influencing local decision makers;
- d) reactions to changes in the local environment by taking advantage of an established position;
- e) alliances with international and local actors aimed at excluding other competitors, facilitate local market penetration and leverage existing resources and mitigate risk;
- f) exploitation of a local monopoly position to boost the profitability of the whole group through subcontracting to vertically integrated subsidiaries.

3.4.1 Consolidation and expansion of domestic markets

In the 1990s, private water companies’ prospects for domestic growth appeared limited both in France and England and Wales. In France, the major operators (CGE, LdE and SAUR) consolidated and expanded their markets through takeover of smaller competitors (e.g. SAUR buying CISE in 1996, LdE buying SDEI in 1992) so that by 1997 they had established an oligopoly and shared 70% of French water consumers. By 2002, Veolia and Suez served together 85% of consumers served by private water operators in France, while SAUR’s operations accounted for a further 13%. At present, the three private water operators are subjected to increasing competitive pressure due to the requirement for competitive tendering provided for by the so-called Loi Sapin. This has resulted in pressure on prices and profit margins but rarely in the success of an external bidder against the incumbent operator. According to the data provided by the "Observatoire de la Loi Sapin" from 1998 (creation of the observatoire) to 2002 (5 full years), only 27 services have switched from delegation to in-house management and only 106 contracts have been won by external bidders against the incumbent operators: 89% of the tenders have been won by the incumbent operators.⁷⁸

In England and Wales, opportunities for consolidation and expansion through takeover have been limited by the opposition of the national water regulator OFWAT and the government. OFWAT scrutinized takeovers

⁷⁵ Le Monde, 10 December 1998

⁷⁶ Guardian, 3 October 1996

⁷⁷ Guardian, 6 March 1999

⁷⁸ Source: Observatoire de la Loi Sapin, Engref, Montpellier, France: pers comm. Christelle Pezon

and made recommendations to the competition authorities. OFWAT accepted concentration in ownership of the smaller water-only companies, but has resisted mergers between the larger water and sewerage companies, including the takeover of these companies by groups who already own water-only companies, on the grounds of loss of comparators for regulatory purposes. In reaction to that, the regionally-based privatised water supply and sewerage companies have consolidated by taking over some of the smaller water-only companies. For example, Suez's Northumbrian Water acquired Essex and Suffolk Water in 2000, Kelda's Yorkshire Water bought York Water in 1999 and Anglian Water took over Hartlepool Water in 1997.

Both the French and the UK water multinationals saw the 1990s as an opportunity to expand abroad, in developed, transition and developing countries. In the event there was significant expansion into CEE in the early 1990s; limited expansion into other EU countries (except in Spain, where the private presence also grew during the 1990s, and more recently Italy which appears to be an extremely dynamic market); expansion into north America, mainly by takeover, in the late 1990s; and expansion in developing countries throughout the period. Attempts to expand in other countries within the EU have proved of very limited success, despite considerable marketing efforts, e.g. in Scandinavia or Germany.

3.4.2 Identification of promising national markets

Since the 1990s, water multinationals have expanded their operations internationally by identifying national markets providing a favourable environment in terms of profitability, regulation and risk management and opening up of further opportunities (either within the same country or in that region). This can explain how substantial expansion has taken place into CEE in the early 1990s and went on in the early 2000s. The fall of command economy systems in the late 1980s, together with the trend towards integration with the EU and multilateral intervention through lending and technical assistance, principally from the EBRD and EIB, produced a number of effects conducive to a favourable environment for water multinationals:

- the decentralisation of responsibility for water services provisions to municipalities
- the ensuing freedom of municipal authorities to retain water operations or delegate them to private operators (similarly to the French model);
- the rise to power at central and local level of liberal and market-friendly political parties;
- the availability of multilateral finance especially from the 'multi-project' facilities of the EBRD
- the scale of investment finance required to meet stringent EU quality standards, which represented an incentive for local authorities to resort to international water operators.

The two countries where the multinationals penetrated most rapidly were the Czech republic, whose water network was in relatively good condition, and Hungary. The Czech Republic underwent extensive privatisation of water in the 1990s, mainly through joint ventures between municipalities and Suez or Veolia, with a minor presence from the UK-based Anglian Water. Expansion into other CEE countries followed somewhat later and was more selective, focussing on capital and other major cities (e.g. Bucharest in Romania; Sofia in Bulgaria; Tallinn in Estonia).

In England and Wales, the 1989 water privatisation has visibly provided a favourable environment from the commercial point of view as well as from the regulatory and political points of view. Suez took over Northumbrian Water, while Veolia and SAUR bought stakes in many of the water-only companies. More recently, Veolia in 2002 divested its interests in Bristol Water and South Staffordshire Water in order to comply with regulatory requirements in its bid to take over the water supply and sewerage company Southern Water.

In Italy, the favourable environment has been provided principally by the 1994 Galli Law which reformed the whole water sector, providing for its liberalisation and rationalisation with the aim to attract investment finance. Although implementation of the Galli Law has been slow and remains partial to date, the major water multinationals have moved from their already established positions to take advantage of upcoming opportunities. Even in this case, although local partners have played a more substantial role, it is possible to observe the emergence of areas of influence, with Tuscany appearing like the preserve of Suez and its Italian partners and southern concessions being dominated by Veolia and its Italian partners.

3.4.3 Action to facilitate the creation of a favourable environment

Water multinationals, particularly the major ones, do not passively wait for business opportunities to develop depending on supranational and national policies. Rather, they have shown a proactive attitude to interact with key actors on the international, national and local arena in order to facilitate the creation of a favourable environment to PSP in water supply and sanitation.

The French water companies in particular have built a network of relationships with various international institutions. This builds on their presence in a number of French research and professional institutions. An analysis of the network of individuals and organisations behind the World Water Vision promoted at The Hague Second World Water Forum in March 2000 provides an example of how influential and well connected Suez was⁷⁹. At the WWFIII in Kyoto March 2003, a speaker from Veolia was introduced as being from Veolia “and also representing UNESCO”. Official documents presented at events as the World Water Forum and the related ministerial declarations are then referred to by national policy makers and key stakeholders in relation to specific issues such as pricing, financing, governance, regulation and PSP, not only in developing but also in rich countries. In July 2003, the Italian national water watchdog “Comitato di vigilanza sull’uso delle risorse idriche” repeatedly emphasised the recommendations issued at international events such as the Kyoto WWFIII in its annual report to the Italian Parliament.⁸⁰

At EU level, the water companies have engaged in systematic lobbying of the EU institutions, especially the EC. In the past, the French government has used its veto to oppose the extension of compulsory competitive tendering to the water sector, which thus remained excluded from the general principle of competition so that the practice of negotiated procedure traditionally adopted in the French water market could remain lawful. The French water companies, for example through Suez CEO Gérard Mestrallet, have also had a prominent part in the ‘European Round Table of Industrials’ (ERT), which is influential in EU policy circles.⁸¹

3.4.4 Action aimed at influencing local decision makers

Not only are water multinationals proactive in trying to shape the policy environment in order to facilitate their expansion strategies, but they also interact with local decision makers aiming to influence their decisions, for example on whether to delegate water services to the private sector or on what private operator to award a given concession. Water multinationals might approach municipal authorities and submit unsolicited bids, might engage in corrupt practices and bribe local politicians to induce the decision to go for the PSP option or to obtain the award of a concession without competition. Water multinationals might also take legal action against local authorities to affect and reverse their decisions.

One particular method used successfully in the past, e.g. in the CEE in the early 1990s, is unsolicited bids. The major companies (Suez and Veolia, and initially SAUR, Hyder, and Anglian Water) typically took the

⁷⁹ “A restricted number of organizations effectively participate in shaping the Vision, and all of these organizations are closely related to each other. The most important are: World Commission on Water (WCW); World Water Council (WWC); Global Water Partnership (GWP); Suez-Lyonnaise des Eaux; World Bank. Other bodies involved include the Water Academy; UNDP; UNESCO; and CIDA. The key positions in the whole process are firmly in the hands of very few people, holding positions in the various key organizations:

- Ismail Serageldin is Vice President of the World Bank, Chairman of WCW, Chairman of GWP and CGIAR, and campaigned for the leadership of UNESCO;
- René Coulomb, former director of Suez-Lyonnaise des Eaux, is Vice President of WWC, Member of the GWP Steering Committee and Member of the Water Academy (Specialists’ College);
- Ivan Chéret, Senior Advisor to the Chairman of Lyonnaise des Eaux, is also a member of the GWP TAC and the Water Academy (Specialists’ College);
- Margaret Catley-Carlson, WCW Member, is also Chairman of the Suez-Lyonnaise-sponsored Water Resources Advisory Committee and former President of CIDA”.

⁸⁰ “Relazione annuale al Parlamento sullo stato dei servizi idrici - Anno 2002”, Comitato di vigilanza sull’uso delle risorse idriche, Rome, July 2003 (http://www.minambiente.it/Sito/cvri/docs/relazione_2002.pdf).

⁸¹ “Gérard Mestrallet takes the place of Jérôme Monod on the European Round Table of Industrialists”, Waternunc Press Release, 30th May 2000 (<http://www.waternunc.com/gb/lyon56gb.htm>).

initiative of identifying likely cities, and concessions were agreed with the relevant local authorities, usually in the form of a joint public-private company, without competitive tendering in the majority of cases. In some cases there were allegations of corruption; in a number of cities the proposals were rejected. Unsolicited bids are potentially dangerous for local decision makers in that they do not allow for the transparency expected from competition, that is to say from the competitive assessment of alternative business plans. A local authority accepting an unsolicited bid might find out later on that it is paying too much for the service provided or that consumers are not getting the expected value for money.

3.4.5 Alliances with international and local actors

In entering a new market, the choice of partners to join forces with and present more credible bids is of strategic importance for water multinationals. The choice to set up joint ventures with other water multinationals might result in restricting competition, as noted in the section on joint ventures above. Joint ventures heighten the already high barriers to entry which are intrinsic to the water market. For example, in Buenos Aires, Argentina, the winning consortium was led by Suez-Lyonnaise des Eaux and also included water multinationals Veolia and Anglian Water. The only competitor was Thames Water, bidding alone. For water multinationals, strategic considerations in choosing to partner with other water multinationals usually aim at enhancing market dominance at national and global level, whereby success in accessing a national market is expected to secure a foothold for further expansion in the same country or region. However, such decisions might also depend on relatively short term, tactical considerations, such as the acknowledgment of the threat posed by a competitor in a given region leading to the decision of joining forces rather than facing potentially damaging competition.

Local authorities and decision makers have often proved unable to oppose the reinforcement of the oligopoly market structure typical of the water sector, and at times take initiatives contributing to strengthening the oligopoly market structure. For example, requirements contained in the call for tender for the concession in Arezzo, Italy reflected local authorities' desire to select a major water multinational as the operator of the system. Also, French competition authority Conseil de la Concurrence found out that in some cases French water multinationals had set up joint ventures to operate water services in specific cities upon the request of the city council. In December 1989 the city council of Vichy requested that Saur's subsidiary CISE and Lyonnaise des Eaux set up Bourbonnaise des Eaux/CBSE, a 50/50 joint venture that currently operates in the area (Conseil de la Concurrence, 2002).

Motivations behind multinationals' decisions to set up consortia with local partners (whether water operators or undertakings mainly active in other sectors, such as finance or construction) when bidding for a concession outside their established home markets vary from those observed above. More precisely, the main role of the local partner can be expected to be that of facilitating the penetration of a local market by contributing: a) their knowledge on the local market and familiarity with the underlying legal framework (in this sense, bidding together with a local partner will allow for the reduction of transaction costs associated with bidding in a foreign market); b) their network of contacts with national and local authorities and other key stakeholders (in this sense, one of the advantages of bidding together with a local partner is mitigation of regulatory and political risks). Once the penetration of the local market is completed and the water multinational has acquired an adequate familiarity with applicable regulations and established satisfactory contacts with local actors, the local partner might become unnecessary and the structure of the operating consortium revised.

Veolia (now known as Veolia Environnement) has developed another tactic aiming at mitigating risk exposure while enhancing its expansion in the Czech Republic, relying on the use of financial intermediaries to conclude deals without fully or directly assuming operational and financial responsibilities. In December 2001 Veolia won the tender for the long-term lease of regional water company VaK Zlin, via its control of privately owned, non-strategic vehicle Jizni Vodarenska – apparently purchased by Severoceske Vodovody a Kanalizace of the Veolia group a matter of days before the tender for Zlin was closed.⁸² Critics warned that

⁸² Hana Lesenarova, December 10, 2001, in Prague Business Journal, "Town halls warned they are getting into deep water through 'middlemen'" (PSIRU Source ID: 7680)

major utilities' use of middlemen for the ownership of companies or long-term leases could put water consumers at risk if the indirect investors couldn't, or wouldn't, comply with contractual conditions. One banker described the use of middle-men as "a way of presenting an irrationally attractive offer while still allowing the strategic investors to pull out."⁸³ Instead of having a foreign strategic investor as a partner, towns in the Zlin region – including the town of Zlin itself – would rely on commitments from Jizni Vodarenska, with base capital of just Kc 1 million (€30,000), to run their water supply over the next 30 years.⁸⁴ In Zlin, however, there was a twist in the tail, as at a meeting in April 2002 Vak Zlin's shareholders – primarily the municipalities in the region of Zlin – rejected a partial sale of VaK, voiding the linked lease contract. Veolia ultimately gained control through another intermediary, Austrian-owned savings bank Ceska Sportelna, when it purchased Zlin city council's 47% shareholding on behalf of Veolia.⁸⁵

3.4.6 Subcontracting to vertically integrated subsidiaries

Vertically-integrated water TNCs have a vested interest in purchasing equipment from and subcontracting services to their own subsidiaries in order to maximise profit from water and wastewater operations to the benefit of shareholders. Private operators' ability to pass the entire costs of subcontracting on to local consumers or, as a last resort, taxpayers and to preserve the so-called economic and financial equation of the concession may give rise to such a vested interest. Similar practices affect competition in the acquisition of external services and goods, undermine the operator's incentive to achieve efficiencies and may have a significant impact on operating and capital costs. The implications of privileged or exclusive access to subcontracting can be observed in France (Hall & Lobina, 2001), as well as in transition and developing countries.

⁸³ *ibid*

⁸⁴ *ibid*

⁸⁵ Slovak brokerage firm Stredoevropsky Maklersky Dum Bratislava paid over Kc 23 million for 39,777 publicly traded shares at Kc 580 each and Ceska Sportelna acquired 448,596 publicly traded and untraded shares for Kc 71.7 million, or Kc 160 per share. The Slovak brokerage is believed to have been acting on behalf of Ceska Sportelna. Sportelna admits it purchased the shares for a new strategic partner for VaK Zlin, which should be French utility company Vivendi Water. (Vladimir Kuchar, June 17, 2002, Prague Business Journal, "Zlin towns battle to reverse city council's sale of water company shares" - PSIRU Source ID: 7681).

4 Actors: international institutions

4.1 Introduction

4.1.1 Ideology and liberalisation and privatisation

Since 1980 there has been a significant shift in global political ideology, sometimes referred to as the Washington Consensus. This has affected Europe, and the water sector, as it has affected everywhere else. The consensus advocates liberalisation and privatisation on a broad scale to solve perceived problems, with participation and accountability through market competition rather than social-democratic political structures. This approach was originally identified with the leadership of Margaret Thatcher in the UK and Ronald Reagan in the US. Key elements of the Consensus derive from a particular view of the different incentives which public and private institutions face. In particular, competition and the profit motive are thought to animate private companies to greater efficiency and customer service.

Overall, the Washington Consensus continues to influence the thinking of many international institutions – foremost the World Bank and IMF, and with its increasing presence in services, also the WTO (through GATS in particular). Increasingly, the EU has also moved in this direction, with liberalisation directives for electricity, gas, telecoms, rail and other sectors, and discussion of replicating this liberalisation approach for water through a variety of mechanisms (see above).

4.1.2 Fall of the communist bloc

This ideological climate was reinforced in Europe by the fall of the communist bloc in 1989-1991: the collapse of these states discredited the state itself as an economic agent, at least in the former communist countries. These economies have undergone a rapid restructuring to transform the role of the state, with the principle of privatisation being central in moving ownership of industry out of the hands of the state into the hands of individuals and companies. This principle has been generalised, so that even services which are normally in the public sector in western countries, including water and sanitation, have been subject to this idea. The restructuring has also involved the devolution of powers from central government to strengthened local authorities (a process also sometimes referred to as ‘privatisation’, simply because it also removes power from the central state). Water has invariably been included in this devolution, and so the issues of investment, maintenance and financing of water services have become the responsibility of municipalities. These in turn have been susceptible to the idea that the private sector can be a better way to run this service.

4.1.3 Role of international financial institutions

This ideological climate, favouring the extension of the private sector and markets into areas previously run by the state, has been translated into concrete limitations on decision-making through the policies of national governments, of the EU (see above section), and on a wider scale through the policies of the international financial institutions. The impact is made through a range of promotion and advisory activities, but most importantly by conditionalities attached to aid and investment finance. The two key global agents are the International Monetary Fund (IMF) and the World Bank (WB). Similar policy effects have also been created by the regional development banks: in Europe this has meant the EBRD and the EIB (both are covered in the separate section on the EU).

4.2 IMF

4.2.1 Lending conditionality

The IMF has always applied conditionality, focussing on macroeconomic fiscal and monetary policies. Typical IMF conditions included removing exchange controls, removing multiple exchange rates, withdrawing state intervention in foreign trade, and demands for deflationary policies, aimed at stabilising the currency. Elsewhere in the world these conditions continue to have major impact, but in Europe in recent years there have been no such IMF programmes. EU countries have avoided the IMF since the UK's 1976 standby arrangement, which included onerous conditions requiring cuts in public expenditures, including

many popular social programmes, together with the announcement of fiscal and monetary targets, and a promise not to impose import controls. Since then IMF loan facilities have been used exclusively by developing countries and post-communist transition countries.⁸⁶

These countries have as a group continued to rely on IMF borrowing, whilst the scope of the conditions attached has widened since the 1970s, in particular in connection with new instruments such as the Structural Adjustment Facility. Typical conditions include large parts of a reform agenda based essentially on liberalisation and privatisation.⁸⁷ Between the 1987-1990 period and 1997-99, the proportion of IMF structural conditions that related to privatisation rose from 4% to 16%; while the proportion of conditions relating to the IMF's original remit, the exchange and trade regime, fell from 30% to 8%.⁸⁸ As Budhoo Davison, who resigned as senior manager at the IMF in 1989 after 12 years service, put it:

"President Reagan effectively told us to go out and make the Third World a bastion of free-wheeling capitalism... Everything we did from 1983 onward was based on our new sense of mission to have the 'south' privatize or die; towards this end we created economic bedlam in Latin America and Africa in 1983-88."⁸⁹

The proximate justification for the privatisation/liberalisation demands is that the various services and subsidies provided by the state are often a heavy burden on it, and the removal of many of those burdens would ensure that the state would be able to keep up interest and principal payments to the IMF and other creditors. In addition, privatisation and liberalisation have to a certain extent functioned as a proxy for broader economic development concerns, simply because they are easily monitored. The underlying philosophy is to create a small, regulatory state, with freedom of cross-border movement for goods, services and capital, and with the free reign of market forces.

Transition countries are eastern Europe, former Soviet Union, and Mongolia.
Source: *Conditionality in Fund-Supported Programs—Overview*, 20/2/01,
www.imf.org

Any lender might reasonably impose conditions on a borrower to ensure that there is every prospect of repayment, but the conditionalities relating to privatisation have developed beyond this objective, and may be seen as undermining the sovereignty of the borrowing countries, as a prominent (conservative) US economist, Martin Feldstein, noted:

"The fundamental issue is the appropriate role for an international agency and its technical staff in dealing with sovereign countries that come to it for assistance. The legitimate political institutions of the country should determine the nation's economic structure and the nature of its institutions. A nation's desperate need for short-term financial help does not give the IMF the moral right to substitute

, London: Zed Books
and World Bank Conditionality', HWWA

Discussion Paper 165. Available at: www.hwwa.de.

⁸⁸ IMF, 20 February 2001, *Conditionality in Fund-Supported Programs—Overview*,
<http://www.imf.org/external/np/pdr/cond/2001/eng/overview/>

⁸⁹ Budhoo Davison, 10 January 1989, 'Open Letter of Resignation from the staff of the IMF'. In Martin, Brendan, 1993, *In the Public Interest? Privatization and Public Sector Reform*. London: Zed Books

its technical judgements for the outcomes of the nation's political process..."⁹⁰

4.2.2 Undermining sovereignty

From the perspective of the Watertime project, this process reduces the decision-making capacity of a country's political structures and transfers some of it to an international institution dominated by a group of countries. This is quite separate from the equally important issue of whether the policies imposed through these conditionalities fulfil their intended purpose (there is considerable debate, and evidence that they are often counterproductive even on their own terms⁹¹), and whether the social (and indirect economic) costs are justifiable⁹². As Feldstein points out, "[i]mposing detailed economic prescriptions on legitimate governments would remain questionable even if economists were unanimous about the best way to reform the countries' economic policies".⁹³

4.2.3 Gatekeeper to international finance

Whilst conditionalities attached to loan funds may be the most prominent and most controversial form of IMF power, the IMF's function as the effective gatekeeper to international finance is equally important – not least because it often gives it considerable influence over countries who are not drawing funds from it. This gatekeeping function takes the form of "cross-conditionality", where lenders and donors (World Bank, EU, regional development banks, bilateral donors) make disbursement of funds conditional on a country being "on track" in an IMF or IMF/World Bank programme.⁹⁴ Commercial creditors and financial markets also pay close attention to this "stamp of approval" given by the IMF. Indeed, since the mid-1970s, many banks have provided in their loan contracts that the loss of this approval (e.g. through the premature termination of a standby arrangement) would constitute a default.⁹⁵

This cross-conditionality also applies to debt relief – both through the relatively recent HIPC process and through the much longer-established "Paris Club" debt rescheduling. The former is based around the IMF's PRSP process,⁹⁶ whilst in the latter case, creditor nations agreeing debt relief almost invariably attach an "IMF clause" requiring stabilisation programmes monitored by the IMF. Whilst in principle creditor nations could negotiate conditions directly with debtors, doing so through a supposedly universal institution (actually controlled by the same group of developed lending nations) provides an air of legitimacy for the required restrictions of sovereignty – as well as deflecting criticisms of the conditionalities involved towards the Fund.⁹⁷

⁹⁰ Feldstein, Martin (1998), "Refocusing the IMF", *Foreign Affairs* March: 20-33

⁹¹ One author wrote "Good performance in meeting rescheduled debts was not valued as highly as faithful submission to IMF demands which actually worsened future debt service capabilities." Payer, Cheryl (1991), *Lent and Lost: Foreign Credit and Third World Development*, p55

⁹² Collier and Gunning (1999) note that very little data is available to assess the distributional impacts of policies, in order to effectively mitigate, or at least take into account, negative impacts on the poor. The IMF in particular lacks in any case the kind of micro-economic expertise needed to evaluate such data, e.g. from household surveys. (Paul Collier and Jan Willem Gunning 1999, "The IMF's role in structural adjustment", *Economic Journal* 109)

⁹³ Feldstein, Martin (1998), "Refocusing the IMF", *Foreign Affairs* March: 20-33

⁹⁴ UNCTAD (2000), *The Least Developed Countries 2000 Report*, New York: United Nations

⁹⁵ Bernal, R (1982), "Transnational Banks, the International Monetary Fund, and External Debt of Developing Countries", 31:4 *Social and Economic Studies* 71

⁹⁶ "In principle, PRSPs are supposed to be country-driven. In practice, the participation involved leaves much to be desired in most cases, and policies continued to be driven by IFI priorities – which accounts for the remarkable consistency of PRSPs across diverse countries, and the continuity with previous IFI policies. As one finance minister has said of his country's Poverty Reduction Strategy: 'We do not want to second guess the Fund. We prefer to pre-empt them by giving them what they want before they start lecturing us about this and that. By doing so, we send a clear message that we know what we are doing – i.e. we believe in structural adjustment.' " (cited in "Policies to Roll Back the State and Privatise? Poverty Reduction Strategy Papers investigated", WDM, April 2001, www.wdm.org.uk/cambriefs/debt/rollback.pdf). "In any case, even with PRSPs the IMF continues to only provide financing 'if those policies that are essential to the purposes of the Fund continue to be implemented.' " (ibid, p11)

⁹⁷ Pahuja, Sundhya (2000), "Technologies of Empire: IMF Conditionality and the Reinscription of the North/South Divide", *Leiden Journal of International Law* 13, 749-813

The other major instrument through which the IMF exercises influence is through an annual process of surveillance of its members' exchange rate policies within the overall framework of their economic policies, in what is known as an 'Article IV consultation'. This surveillance originated as a support for the IMF's original role as the upholder of the world's system of (substantially fixed) exchanged rates. The surveillance has survived the collapse of this exchange rate system in the 1970s, and is now a means for the IMF to publicise its support for economic policies which it believes will lead to stable exchange rates and a growing and prosperous world economy.⁹⁸ In particular it provides a unique opportunity to comment on the policies of developed countries, and to encourage structural adjustments including privatisation and liberalisation, as can be seen in the recent case of Italy. For example, , In June 2000, the IMF assessment of the Italian situation following Article IV consultation included the following statement: "Executive Directors commended the authorities for pursuing stability-oriented policies that had achieved a remarkable reduction of the fiscal deficit and a sharp decline in inflation, and for initiating far-reaching structural reforms, including privatization".⁹⁹ In August 2001, the preliminary findings of the IMF Mission on Italy read: "The government's program requires major adjustments in spending, including: · *Public sector and public employment reform*. Notwithstanding considerable progress in recent years, there is clearly major scope to enhance efficiency. ... a withdrawal of the state from commercial activities, including at the local level, could rapidly improve efficiency and save resources."¹⁰⁰

4.3 World Bank

In 1983 the World Bank was still able to maintain that the "factor determining the efficiency of an enterprise is not whether it is publicly or privately owned, but how it is managed. In theory it is possible to create the kinds of incentives that will maximize efficiency under any type of ownership".¹⁰¹ Within the space of a few years, however, the growing trend towards promoting the "Washington Consensus" on privatisation and liberalisation took full root, and the number of associated conditionalities blossomed.

By the beginning of the 1990s, and ever more so throughout the decade, the World Bank as part of its general movement towards privatisation and liberalisation adopted an increasingly strong position in favour of privatised water. This policy preference was promoted in various ways, through Bank reports, support for joint initiatives (such as the GWP, WWC) with the water multinationals, and through a range of types of conditionalities. For example, the Private Sector Development (PSD) Strategy that was approved in February 2002, makes it clear that the Bank will continue to pressurise countries to privatise through the use of 'policy-based lending'¹⁰² – a euphemism for conditionality.^{103 104} These had less influence in Europe than elsewhere, because the World Bank's remit relates to developing countries: but the WB has directly influenced events in Europe.

One way was through loans financing water developments in CEE. These were not notable for their conditionalities, and in fact a number of the Public-Public Partnerships (PUPs) in the Baltic states and Poland were financed by WB loans. There were later exceptions, and now, especially in the NIS, the WB appears to be using widespread but subtle forms of conditionalities favouring privatisation in one form or another.¹⁰⁵

⁹⁸ Peet, Richard (2003), *Unholy Trinity: The IMF, World Bank and WTO*, London: Zed Books, p63

⁹⁹ IMF Public Information Notice 00/40, 13 June 2000, "IMF Concludes Article IV Consultation with Italy", <http://www.imf.org/external/np/sec/pn/2000/pn0040.htm>

¹⁰⁰ 3 August 2001, "Italy -- 2001 Article IV Consultation: Preliminary Conclusions of the IMF Mission", <http://www.imf.org/external/np/ms/2001/080301.htm>

¹⁰¹ Cook, Paul and Colin Kirkpatrick, 1995. "The distributional impact of privatization in developing countries: who gets what and why". In V.V. Ramanadham, ed., *Privatization and Equity*. (London: Routledge), pp. 1-34.

¹⁰² See the Implementation Matrix, Annex I, 'Private Sector Development Strategy – Directions for the World Bank Group' April 9, 2002

¹⁰³ 'Private Sector Development Strategy – Directions for the World Bank Group', April 9 2002

¹⁰⁴ Unsustainable conditions – the World Bank, privatisation, water and energy", Kate Bayliss and David Hall, 07 August 2002

¹⁰⁵ Hall, David; Lobina, Emanuele; and de la Motte, Robin (2003), "Water in CEENIS", PSIRU, March 2003, <http://www.psir.org/reports/2003-03-W-CEENIS.doc>

The second was very specific, when a small WB team visiting Germany in 1995 submitted a well publicised report which was highly critical of the German water service, and which provoked considerable discussion in Germany. The report suggested among other things that the leakage rate in Germany was too low (sic), and implied that the former east German system was more efficiently organised and that changes after reunification had led to “the proliferation of hundreds of small, uneconomical municipal companies which provide poor quality services at very high costs.”¹⁰⁶

In July 2003 World Bank officials were quoted in the press saying that the bank was now ‘agnostic’ on water privatisation and engaged in soul-searching.¹⁰⁷ A new review of policies on infrastructure¹⁰⁸ acknowledges problems with the WB’s focus on private sector and its lack of attention to the actual needs of countries, and that the private sector cannot deliver investment expected by political objectives such as the millennium development goals. However, the specific policies remain overwhelmingly oriented to improving the climate for private operators, for example creating a new Department for Private Participation and Finance. The WB has a research project on the potential of the public sector in water, as part of the World Bank-Netherlands Water Project, which started in 2002 (project 033),¹⁰⁹ but even this is focussed on the role of the private sector as contractors or partners of public sector water authorities, with 7 out of 11 of the ‘public sector’ case studies in the project including private sector involvement through management contracts or other forms of PSP (e.g. BOTs)¹¹⁰. It is also being carried out in cooperation with the Suez-funded UNESCO-IHE Institute for Water Education.

4.3.1 Conditionality

In the course of the 1980s and 1990s both the IMF and the World Bank have increased the number and scope of the conditionalities attached to their funds, as well as the strictness of the conditions (e.g. through dividing loans into tranches, and making later disbursements conditional on implementation of agreed policies).¹¹¹ The two institutions have also worked more closely together, and the conditionalities imposed become more explicitly complementary, with the World Bank focussing on microeconomic policies (i.e. privatisation and liberalisation) intended to support the IMF’s macroeconomic policies of inflation control, exchange rate stability and budget sustainability. Loan conditions requiring or encouraging water privatisation and cost recovery have been widely used by international donors, especially in Africa, and in the most indebted developing countries.¹¹²

However, the importance of conditionality can be overstated, with a number of studies finding that conditionality is relatively difficult to impose successfully in relation to any given loan. For example Killick et al’s (1998) review of 21 countries concluded that governments typically only comply with IFI conditionalities when they perceive this as in their own interests. Killick et al concluded that conditionality

¹⁰⁶ John Briscoe, *The German Water and Sewerage Sector: How well it works and what this means for developing countries*, (Washington, DC: The World Bank, October 1995), [http://wbln0018.worldbank.org/ESSD/essdext.nsf/18DocByUnid/37FD92E040C12CCE85256B500069284F/\\$FILE/TheGermanWater&SewerageSector.pdf](http://wbln0018.worldbank.org/ESSD/essdext.nsf/18DocByUnid/37FD92E040C12CCE85256B500069284F/$FILE/TheGermanWater&SewerageSector.pdf)

¹⁰⁷ Wall Street Journal, 21 July 2003, “The World Bank as Privatization Agnostic”

¹⁰⁸ Informal Board Meeting, 8 July 2003, “Infrastructure Action Plan”, [http://wbln0018.worldbank.org/UrbanCalendar/urban.nsf/0/b009a39793dc8ca885256d5c00789761/\\$FILE/ATTNKULV/Infrastructure%20Aciton%20Plan%20-%20June%2019.doc](http://wbln0018.worldbank.org/UrbanCalendar/urban.nsf/0/b009a39793dc8ca885256d5c00789761/$FILE/ATTNKULV/Infrastructure%20Aciton%20Plan%20-%20June%2019.doc)

¹⁰⁹ See <http://wbln0018.worldbank.org/bnwp/portfolio.nsf/0/891f0691ad4c23a285256c14007b2e6d?OpenDocument>

¹¹⁰ For a discussion of this see “Secret Reports and Public Concerns - a Reply to the USAID Paper on Water Privatisation ‘Skeptics’”, section 5.2 <http://www.psir.org/reports/2002-08-W-Skeptics.doc>; for an economist’s overview across a number of sectors, see Willner, Johan (2001), ‘Ownership, Efficiency, and Political Interference’, *European Journal of Political Economy*, vol. 17, no. 4, pp. 723-748. doi:10.1016/S0176-2680(01)00053-2

¹¹¹ Tony Killick, Ramani Gunatilaka, and Ana Mar (1998), *Aid and the Political Economy of Policy Change*, London: Routledge

¹¹² Sara Grusky, *Multinational Monitor*, September 1, 2001, “Privatization Tidal Wave: IMF/World Bank Water Policies and the Price Paid by the Poor.”

can sometimes tip the balance towards reform, but found relatively few examples.¹¹³ Indeed, of 100 World Bank adjustment programmes, only 25% of second and third tranche disbursements were made on schedule, with the rest delayed (and 8% cancelled) due to lack of implementation. Haggard (1985) found that of 30 IMF Extended Fund Facilities, 24 were “renegotiated, had payments interrupted, or were quietly allowed to lapse”.¹¹⁴ Collier and Gunning (1999) note examples of IFIs being ‘sold’ the same reforms several times, after failing to implement them repeatedly – e.g. the government of Kenya sold the same agricultural reforms 5 times in 15 years. Another problem facing imposers of conditionality is due to the phenomenon of fungibility, where money provided for specific projects and programmes simply frees up funds to be spent elsewhere.¹¹⁵ Dollar and Svensson (1998) conclude that domestic political variables largely explain whether reforms are carried out.¹¹⁶ The ability to fulfil conditions cosmetically, or to execute countervailing actions (particularly after funds are disbursed) further limits the effectiveness of conditionality.

Collier and Gunning attribute eventual policy changes more to “governments learning from the models around them”, including from IFI staff, than to incentives provided by conditionality. A broader conclusion would be that the immediate, short-to-medium term importance of specific conditionalities in particular cases may be less than it would appear, and that the longer-term influence of a relentless one-way street (‘ratchet effect’) towards privatisation and liberalisation is greater than it appears.

The World Bank’s annual development report for 2004 acknowledged these limitations:

“There is ample evidence today that conditions based on promises do not work well, because they undermine ownership of the reform programme. When policymakers are not encouraged to develop their own positions on, say, privatisation of water supply or other services, but rely on donor conditions in taking action, they can more easily deny responsibility for a later failure.”

4.4 WTO/GATS

The World Trade organisation’s rules on services, under the General Agreement on Trade in Services (GATS), have in principle an impact on the options available in Europe in water services. The GATS allows countries to request another country to open up specified sectors for trade. In 2002 the European Commission asked many other countries to open their sectors, and at the same time proposed a revision to the sectoral definitions, as under current definitions (Sept 2003) water services are not covered by GATS.

At present GATS rules contain two clauses which exempt much of the public services area. The first is the direct supply of services by government, as long as the services are “supplied in the exercise of governmental authority” and “supplied neither on a commercial basis, nor in competition with one or more service suppliers”. The second exemption – in article XIII – exempts government procurement, which includes contracts issued by public authorities for services of all kinds. Between them, they mean that in-house services and contracted-out work are so far not covered by GATS.¹¹⁷ This is however subject to pressure from business and governments to extend the coverage of the GATS, and to changing interpretations by the WTO of the applicability of the exemptions.

The GATS rules have implications for Europe itself in two possible respects. Firstly, if other countries make a request to the EU to open European water services, then this could require some form of restructuring for some countries. However, to date no such requests have been made,¹¹⁸ and are unlikely since there are no

¹¹³ Tony Killick, Ramani Gunatilaka, and Ana Mar (1998), *Aid and the Political Economy of Policy Change*, London: Routledge

¹¹⁴ Haggard, Stephan (1985), “The Politics of Adjustment”, *International Organization* 39(3)

¹¹⁵ Christopher Gilbert, David Powell, and Andrew Vines (1999), “Positioning the World Bank”, *Economic Journal* 109

¹¹⁶ Dollar, David, and Svensson, Jakob (1998), “What Explains the Success or Failure of Structural Adjustment Programs?”, World Bank Policy Research Working Paper no. 1998, Washington DC: The World Bank

¹¹⁷ Hall, David (2001), “EU competition policies and public services”, PSIRU: Greenwich, www.psiru.org

¹¹⁸ Statement by DG Trade negotiator Ulrike Hauer at Unctad conference on environmental services, Geneva, July 2003

significant non-European water multinationals. Secondly, GATS was referred to in the EC's green paper on services of general interest,¹¹⁹ as one of four 'policy instruments' which would provide the framework for European public services, possibly through a 'framework Directive' on public services. This could imply that GATS rules on burdensome regulation – which could limit the public service obligations permitted under the GATS regime – could become generally applicable to European public services.

International rules which give multinationals rights that explicitly or implicitly eliminate policy options or very significantly raise the cost of pursuing them (e.g. investment chapter of NAFTA;¹²⁰ or the WTO's rules on "least trade-restrictive" policy options interpreted by non-transparent dispute settlement bodies; GATS' interpretations of public services etc¹²¹).

4.5 United Nations

The role of the UN in the water sector mainly consists of influencing policy through conferences, resolutions and reports, as the organisation has no financial (in particular, lending) power. The greatest influence however has come from three UN declarations, each of which has had a significant impact on global perception of policies and economic and political objectives in the water sector, in differing ways.

4.5.1 Dublin/Rio principles: 'water is an economic good'

The first was the decision of the 1992 Rio conference,¹²² which endorsed the principles agreed at Dublin in 1991, including the statement that "Water is an economic good". This both enshrined the environmentalist rule that users and polluters should carry the full costs of their own consumption and pollution of resources, and the simple truth that the delivery of drinking water involves various economic inputs such as labour and materials (e.g. networks of pipes).

The principle also then became an endorsement of the commercialisation of the function of water supply. It did so by validating the practice of charging people for the water they consumed, and basing the prices on the economic costs of providing it, including capital costs as measured through the commercial measure of depreciation, as well as operating costs of labour, materials etc. A development of this view was the concept of "full cost recovery", under which users of water should pay an amount equal to the total cost of all factors of production. These approaches in turn undermined the more traditional view that a clean water supply is an essential service the use of which should not depend on ability to pay: it should therefore be provided free at the point of use and paid for through taxation, or charges based on household resources rather than consumption.

Dublin and Rio coincided with the beginning of the international expansion of the private water companies. Since the private companies had no problems about charging according to the commercial criteria, they could present themselves as the most suitable vehicle for implementing the Dublin principles.

"The mainstream position in favour of creating private property rights as the basis to foster private sector involvement in water and sanitation became well established and legitimated by the Fourth Principle of the Dublin Declaration adopted at the UN Conference on Water and the

¹¹⁹ European Commission, Green Paper On Services Of General Interest COM(2003) 270 Final
Europa.Eu.Int/Comm/Secretariat_General/Services_General_Interest/Docs/Com_2003_270_Fi_En.Pdf

¹²⁰ This prevented Canada banning a harmful petrol additive in 1996, as its maker threatened to sue for expropriated profits under NAFTA, and the government was advised it would lose. Similarly, a Mexican municipality was successfully sued for refusing permission to a US multinational for a toxic waste dump on ground vulnerable to groundwater contamination. These are just two of many examples of NAFTA's effects on local decision-making. (Source: Simon Retallack, 25 August 2003, New Statesman, "Blueprint for a screwed-up world")

¹²¹ See Markus Krajewski's article on GATS and public services "Public services and trade liberalization - Mapping the legal framework" (Watertime/WP1frame/Countries & Intl Context/ GovernmentalServicesJIELRevised.doc) due to be published in the Journal of International Economic Law (JIEL) 6 Issue 2 (2003).

¹²² United Nations Conference on Environment and Development (UNCED), Rio de Janeiro, 3-14 June 1992. Informal name, The Earth Summit.



Environment (January 1992), which stated that “water has an economic value in all its competing uses and should be recognized as an economic good” (UN, 1992b). The relevance of the Dublin Declaration for the process of market expansion in the water sector should not be overlooked.”¹²³

4.5.2 Millennium Development Goals (MDGs): water supply as developmental objective

The second was the articulation through UN conferences of the 15 Millennium Development Goals (MDGs), two of which relate to water and sanitation: specifically, to reduce by half the proportion of people without sustainable access to safe drinking water, by 2015. These were endorsed at the Johannesburg World Summit on Sustainable Development in 2002. These have had an effect on policy developments by requiring policy-makers to justify their proposals in terms of how they will help achieve the MDGs.

This in turn has altered the perception of the roles of public and private sector: since private provision of water covers only 5% of the existing population, it is not possible for the MDGs to be achieved wholly or even mainly through expansion of the private sector, a point made to the World Bank and others by the private companies themselves. This has reinforced the effect of the private sector’s decisions, for reasons of risk and profitability, to cease expansion and withdraw from developing countries.

The relevant MDGs (see box right) are unlikely to produce a significant direct impact on the provision of water supply and sanitation services in industrialized countries in Europe, except in some eastern countries where networks are significantly underdeveloped: the greatest impact is expected to be in developing countries. The main impact of the MDGs in Europe has been the perception of them as creating a business opportunity for EU water companies in extending service coverage in transition and developing countries, as exemplified in the EU Water Initiative for example¹²⁴.

4.5.3 Ecosoc: Water as a human right

A separate initiative came from the United Nations Committee on Economic, Cultural and Social Rights in 2002, when it issued a statement declaring access to water a human right and stating that water is a social and cultural good, not merely an economic commodity. The Committee stressed that the 145 countries to have ratified the International Covenant on Economic, Social and Cultural Rights were now obligated to progressively ensure access to clean water, “equitably and without discrimination”.¹²⁵ This statement highlights the responsibility of governments to meet the demand for water and sanitation, and thus reinforces a ‘political’, rights-based view of water, rather than its economic or environmental role.

4.5.4 Other

Privatisation conditionality was rejected by the inter-governmental International Conference on Freshwater in Bonn in December 2001, where the delegates declared in their ‘Recommendations For Action’ that “Private sector participation should not be imposed on developing countries as a conditionality of funding”¹²⁶. However, the practice remains widespread in developing countries. These conditionalities may take various forms: see section 3 below for accounts of the impact of such conditionalities in Europe.

The United Nations Economic Commission for Europe (UNECE) adopted the Aarhus convention on participation in 1998 (see below), and in March 2002 took the initiative to establish the Public Private Partnership (PPP) Alliance. The Alliance’s objective is to promote private sector participation and alternative finance schemes by bringing together representatives from the private sector, international financial institutions (such as the EBRD), the donor community and the public authorities of the countries of operations.

¹²³ José Esteban Castro, PRINWASS report, October 2002, p8

¹²⁴ Or as exemplified in the UK government’s announcement in June 2004 that it would.

¹²⁵ Gustavo Capdevila, 27 November 2002, InterPress Service, “UN: Water Deemed As Public Good, Human Right”

¹²⁶ “Bonn Recommendations for Action”, December 2001,

http://www.water-2001.de/outcome/BonnRecommendations/Bonn_Recommendations.pdf

A number of UN agencies have played a role in influencing global water policy, including UNDP, UNCTAD, UNESCO¹²⁷, UNICEF and the WHO. Some reports may have an impact: for example, a 1980 study¹²⁸ advocated the adoption of full cost recovery.

4.6 Other actors

4.6.1 ISO

The adoption of new standards concerning water supply and sanitation is currently being discussed within the ISO¹²⁹. Such standards would not be binding for governments, but ISO standards have always been influential and governments might decide to introduce them into their national legislation. Concerns have been expressed by some civil society groups, such as the USA-based Public Citizen, who fear the ISO standards may become a ‘Trojan horse’ for privatisation by setting requirements which are significantly easier for private companies to meet. ISO standards could also come to have the same relationship to the General Agreement on Trade in Services (GATS) as do Codex Alimentarius standards to the Sanitary and Phytosanitary Agreement. That is to say that in the absence of a domestic standard, the international standards could become ‘default’ standards. The GATS Treaty (Art 6) lays down that ‘account shall be taken of international standards of relevant international organisations’.¹³⁰

4.6.2 OECD

Although not strictly a global actor, the OECD’s membership includes high and middle-income countries around the world, and represents the interests of most of the world’s leading nations, in economic and political terms.

The OECD is active in influencing governmental policies in water supply and sanitation, in particular by producing studies such as its annual *The Price of Water: Trends in OECD Countries*.¹³¹ A range of OECD publications exist specifically on reforming water services in CEENIS countries.¹³² The OECD broadly advocates full cost recovery and is supportive of private sector participation (PSP) in water, through many publications and events including:

- “Guiding Principles for Reform of the Urban Water Supply and Sanitation Sector in the NIS” (2000)¹³³
- “Private Sector Participation in Municipal Water Services in Central and Eastern Europe and Central Asia: Conference Write-Up” (2002)¹³⁴
- “Improving Water Management: Recent OECD Experience” (2003)¹³⁵

¹²⁷ United Nations (2003), “The UN World Water Development Report: Water for People, Water for Life”.

<http://www.unesco.org/water/wwap/wwdr/index.shtml>

¹²⁸ United Nations (1980), “Efficiency and Distributional Equity in the Use and Treatment of Water: Guidelines for Pricing and Regulations”, Natural Resources/Water Series No. 8. United Nations: New York, NY.

¹²⁹ A new technical committee, ISO/TC 224, was set up in 2002.

<http://www.iso.ch/iso/en/commcentre/isobulletin/articles/2003/pdf/watersupplies03-09.pdf>

¹³⁰ Robin Simpson, of Consumers International (2003), *Consumer* 21, 2003

¹³¹ OECD (various), *The Price of Water: Trends in OECD Countries*, OECD: Paris. www.oecd.org

¹³² OECD website (2003), section Environment in Emerging and Transition Economies, subsection Urban Water Management: http://www.oecd.org/departement/0,2688,en_2649_34343_1_1_1_1_1,00.html

¹³³ OECD (2000), “Guiding Principles for Reform of the Urban Water Supply and Sanitation Sector in the NIS”, <http://www.oecd.org/dataoecd/45/56/1895432.pdf>

¹³⁴ OECD (2002), “Private Sector Participation in Municipal Water Services in Central and Eastern Europe and Central Asia: Conference Write-Up”, Parts 1 and 2, <http://www.oecd.org/dataoecd/43/47/1942161.pdf>, <http://www.oecd.org/dataoecd/43/49/1942204.pdf>

¹³⁵ OECD (2003) “Improving Water Management: Recent OECD Experience”, <http://www.oecd.org/dataoecd/10/40/2499227.pdf>

- “Public-Private Partnerships in the Urban Water Sector - Why are policy makers interested in Public-Private-Partnerships?” (2003)¹³⁶

4.6.3 International finance capital

In the early 1990s there was a general increase in the willingness of international finance capital to seek investments in developing and transition countries. These were seen as a potential source of relatively high returns, based on continuing rapid growth rates, at a time when returns on investments in OECD countries were sluggish. These investments took place in a range of infrastructure sectors, including water. Private financial institutions were more ready to invest with a European MNC involved, and so privatisation was seen as a way of accessing international capital. In the last few years, a strong trend of involvement of financial institutions or financial consortia in the water sector has emerged, particularly when water companies have wanted to sell assets to reduce debts. Examples include private equity investors buying Suez's Nalco, and parts of Veolia's US Filter; the Royal Bank of Scotland's takeover of Southern Water; SAUR's South East Water, sold to Australian bank Macquarie Bank; and Anglian Water's Esval, in Chile, going to a Chilean pension fund. (And even the takeover of Gelsenwasser by the cities of Dortmund and Bochum is billed as a financial investment.) This trend replaces the previous wave in the 1990s of energy companies buying water assets in an attempt to join the then-fashionable trend for multi-utilities.

Also to be considered part of the international finance arena are the various consultancies, such as PriceWaterhouseCoopers, which have had a general impact on policy environment not least through the ideologies and institutional cultures they frequently bring. In some cases asking for their involvement virtually ensures a particular recommendation, frequently seeming to be photocopied from the previous report. Reasons may include ideology of the consultants; their lack of experience of the real-world long-term outcomes of their policy prescriptions; their working towards the recommendations desired by their clients; and the social and political networks in which they are involved, linking them with the water companies and governments involved in privatisation and PSP, including through business organisations such as Global Water Partnership (GWP), World Water Council (WWC), World Commission on Water for the 21st Century, Eureau, European Round Table of Industrialists.

4.7 NGOs

The most notable types of NGOs influencing international processes are environmental groups, development NGOs, consumer organisations, and international associations of trade unions. The form of influence can be divided into two categories: participatory, through their involvement in official international procedures for setting new rules and regulations, and campaigning, using political methods and mechanisms.

Environmentalist organisations have been actors and initiators of legislative and policy changes at EU and international level. These initiatives have altered the framework for decision-making on the public/private role in water systems, globally through the promotion of Rio's declaration of “water as an economic good”, (originating from a sustainability perspective, but seized on by multinational water companies and other advocates of private-sector participation - see section above on UN). At European level, environmentalist pressure was also the mainspring for EU environmental directives in the 1980s and early 1990s, culminating in the Water Framework directive itself, which was heavily influenced by environmentalists (see section above on EU).¹³⁷

The general activity of development NGOs has been to influence donor country and IFI policies. Their greatest effect has thus been on developing countries, not Europe. Campaigning activities internationally have focussed in recent years on the privatisation issue. Various NGOs have been involved, including

¹³⁶ OECD (2003), “Public-Private Partnerships in the Urban Water Sector - Why are policy makers interested in Public-Private-Partnerships?”, <http://www.oecd.org/dataoecd/31/50/2510696.pdf>

¹³⁷ Erik Swyngedouw, Ben Page and Maria Kaika, “Governance, water, and globalisation: a political-ecological perspective”, PRINWASS International Conference Oxford, 24-25 April 2002
<http://www.geog.ox.ac.uk/~prinwass/Swyngedouw.PDF>



development NGOs, some environmentalists groups, and international trade union organisations, which have been active at international meetings such as the World water Forums. Their greatest impact however has probably been through providing support and publicity for the national campaigns which have been taking place in various countries. The greatest impact of these campaigns has been in developing countries, not in Europe.

5 Conclusion

A range of factors and actors at European and international levels influence and constrain local decision-making. The actors wield great political and/or economic power, in pursuit of political and/or economic goals. The effect of this activity is transmitted to the local context in a variety of ways, including the creation of a particular ideological background, local proposals initiated by international actors, and specific legal demands or financial incentives that require or encourage particular policies or institutional frameworks.¹³⁸

As a result, the ability of local stakeholders, citizens and decision-makers to control their own destiny may be in practice highly constrained by the influence of these larger agencies, both directly in particular local contexts and indirectly via intermediate actors such as national governments. This also raises questions, which the case studies address, of the nature of the decision-making process in which participation is being evaluated. Participation in local processes and institutions may not be sufficient to deliver participation in the total processes which contribute to the outcome of decisions.

Table: International actors

Actor	Type	Level	
EC	PE	EU	
EC-DG-Environment	PE	EU	
EC-DG-Markt	PE	EU	
EC-DG-Comp	PE	EU	
EC-DG-Regio	PE	EU	
EC-DG-Trade	PE	EU	
Helcom	PE	EU	
UN-ECE	PE	EU	
EBRD	FA	EU	
EIB	FA	EU	
IMF	FA	International	
WB	FA	International	
WTO	PE	International	
ISO	RA	International	
OECD	PE	International	
UN	PE	International	
Finance	MNC	International	
Consultancy	MNC	International	
Suez	MNC	International	
Veolia	MNC	International	
RWE-Thames	MNC	International	
Bouygues-SAUR	MNC	International	
Anglian	MNC	International	
AqBar	MNC	International	
UnitedUtilities	MNC	International	
PSI	SU	International	
EEB	SEV	EU	

¹³⁸ The most direct effect felt at local level may often be from EU directives, perhaps most significantly the financial demands arising from the Urban Wastewater Treatment Directive. The need to meet these demands has in some cases been a significant driver of changes in institutional structures, some of which have involved public sector reforms and others, private sector participation.



Annex A: Private operators in CEE, NIS and the Balkans

Following the fall of the communist bloc in 1989-1991, a large amount of political and economic restructuring was necessary in eastern Europe. These changes provided a unique opportunity for multinationals to enter into virgin territory, with no strong private domestic competitors and a public sector needing reform and investment. As economic, political and legal frameworks became more favourable to foreign private investment in utilities, including water, the leading water multinationals in particular were able to develop a presence in a range of CEE countries, most comprehensively in the Czech Republic and Hungary.

By way of illustration of the scale of the multinationals' advance across the former Soviet bloc in just over a decade, the following table lists privatised water and sewerage concessions in central and eastern Europe, the Balkans, and NIS countries, as of December 2003. Note that in one case – the three International Water/United Utilities joint ventures in Sofia, Tallinn and Bielsko Biala – one of the original partners, International Water, withdrew in autumn 2003. Its stakes were acquired by its partner, United Utilities, with funding support from the EBRD.¹³⁹

Country	Concession	Company	Multinational	% owned	Year
Albania	Durres, Fier, Lezhe, Saranda		(unknown private operator – management contract)		2003
	Elbasan	Elber S.p.A.	Berlinwasser (BWB) – 30-year concession	95	2000
	Kavaja	U.K. Kavaja sh.a	AquaMundo (4-year management contract)		2002
Armenia	Yerevan	Acea & Company Armenian Utility S.c.a.r.l.	Acea (management contract)	55	2000
Bulgaria	Sofia	Sofiiska Voda AD	International Water/United Utilities	50	2000
Croatia	Zagreb	Zagrebacke Otpadne Vode doo	RWE Aqua / Berlinwasser (BWB) BOT	97	2000
Czech Republic	Prague	Prazske vodovody a kanalizace (PVK)	Anglian Water	100	2001
	Brno	Brno VaK	Suez-Lyonnaise	31	
	Ostrava	Ostravke VaK	Suez-Lyonnaise	40	
		Jihomoravske VaK	Suez-Lyonnaise	34	
	Karlsbad	Vodarny Karlovy Vary	Suez-Lyonnaise	49.8	
		Severomoravske VAK	Suez-Lyonnaise	45	
		Severomoravske VAK	Anglian Water	53.4	1999
	South Bohemia	VAKJC	Anglian Water	92.7	(1999)
		Ceske Budejovice	Veolia (via 1. JVS) – concession until 2018		

¹³⁹ Hall, David; Lobina, Emanuele; and de la Motte, Robin (2003), "Public solutions for private problems? - responding to the shortfall in water infrastructure investment", PSIRU: Greenwich, p9. www.psiu.org



	North Bohemia	1.JVS	Veolia	50	1999
		SCVK	Veolia	43	1999
		Aqua Servis	Veolia (via SCVK)	27.2	1998
		VaK Kladno-Melnik	Veolia (via SCVK)	17.7	1998
		VaK Kladno-Melnik	Veolia	51.2	2002
		VaK Mlada Boleslav	Veolia (via SCVK)	22.9	1998
		SVS	Veolia	100	1998
		Vodospol Klatovy	Veolia (via 1.JVS)	100	2002
		Příbram	OMI (with Anglian Water support)	n/a	2002
		VOSS Sokolov	Veolia	100	1998
		Termo (Decin)	Veolia (contract to extract water from Termo)	n/a	2002
	West Bohemia	Vodohospodarsky servis Dobruška	Veolia (via 1. JVS)	100	2002
		Chevak Cheb	Gelsenwasser	49	1998
	Pilsen	Vodarna Pilsen	Veolia	98	
	Olomouc		Veolia		2000
	Sumperk	Sumperska Provozni Vodohospodarska Spolecnost (SPVS)	Suez	82	2001
	South Moravia	VaK Zlin	Veolia	47	2002
		VaK Breclav	International Water (25-year lease)		2002
Estonia	Tallinn	Tallinna Vesi	International Water/United Utilities	50.4	2001
Hungary	Kaposvar	Eaux de Kaposvar	Suez-Lyonnaise	35	
	Pecs	Pecsi Vizmu	Suez-Lyonnaise	48	
	Budapest	Budapest Water	Suez-Lyonnaise/RWE	25	1998
	Budapest	Budapest Sewerage	Veolia/Berlin Wasser	25	1998
	Szeged	Szegedi Vizmu	Veolia	49	1994
	Borsod	GW-Borsodviz	Gelsenwasser – 20-year concession	49	2001
	Hódmezővásárhely, Mindszent, and Szekesfehervar	Zsigmondy Béla Rt.	Berlinwasser (BWB)	47	1997
Kazakhstan	Almaty	Almaty Sui	Veolia - 30-year concession	majority-owned	2000
Kosovo	Gjakova	Hidrotemi Radoniqi Gjakova	Gelsenwasser (management contract)		2002
Macedonia	Skopje		(unknown private operator – lease contract)		2001
Montenegro	6 coastal municipalities: Herzeg Novi, Kotor, Tivat,	MonteAqua	AquaMundo	48	2002

	Budva, Bar, Cetinje				
Poland	Gdansk	SAUR Neptun Gdansk	SAUR	51	1992
	Bielsko Biala	Aqua SA	International Water/United Utilities	25	1999
	Dabrowa Gornicza	PWiK Dabrowa Gornicza	RWE-Thames	34	2002
	Glogow	PWiK Glogow	Gelsenwasser	46	2002
	Tarnowskie Gory and Miasteczko Slaskie		Veolia	33.85	2001
Romania	Bucharest	Apa Nova Bucuresti SA	Veolia	100	2000
	Ploiesti	Apa Nova SRL	Veolia	80	2000
	Timisoara	Aquatim	Suez-Lyonnaise	51	2000
Russia	Butowo		Berlinwasser (BWB) – 12.5-year BOT	100	1996
	Zelenograd		Berlinwasser (BWB) – 12.5-year BOT	100	1998
Slovakia	Trencin	TVS (Trencin)	Suez-Lyonnaise – 20-year concession	51	1999
Slovenia	Maribor (BOT)	Aquasystems d.o.o	Suez-Lyonnaise/Steweag	100	1998
	Bled		Berlinwasser (BWB) – 25-year concession		2002
Tajikistan	Dushanbe		(unknown private operator – management contract)		2002
Turkey	Adana		Serco consortium 3-year BOT		1999
	Antalya	Antalya Water Operations (ANTSU)	Suez (10-year operation & maintenance contract)		1997
	Cesme-Alacati		(unknown private operator)		1998
	Izmit		RWE-Thames (15-year BOT)		1999
Uzbekistan	Bukhara and Samarkhand		Suez and Safège consortium (4-year management contract)		2002

Source: PSIRU database

Annex B: World Bank documents

Selected comments from World Bank (and some IMF) documents for European countries. The role of the World Bank means the countries covered are largely the poorer eastern European and NIS countries.

Abbreviations:

CAS: Country Assistance Strategy
 EFSAL: Enterprise and Financial Sector Adjustment Loan
 ESAF: Enhanced Structural Adjustment Facility
 FIAS: IFC's Foreign Investment and Advisory Service
 FY: Financial Year
 IMF: International Monetary Fund
 PRSP: Poverty Reduction Strategy Paper
 PSAL: Private Sector Adjustment Loan
 SAP: Structural Adjustment Program
 WB: World Bank Group (IBRD, IDA, IFC, MIGA)

Institution	Source	Date	
ALBANIA			
WB	CAS	28-5-02	“The Bank, in close cooperation with other donors, is taking the lead in helping the government tackle policy reforms, focusing on cost recovery and private sector and community participation. The government is preparing, with Bank assistance, a Water Supply Action Plan and a comprehensive Water Supply and Sanitation Strategy (FY03). The Municipal Water and Wastewater Project (FY03) will test private sector participation in water supply and sanitation through a management contract for four cities-Durres, Fier, Lezhe, and Saranda. The management contract will contain specific provisions to improve water supply to the poor, who are receiving less than two hours of water per day. The project will include a rural water component to pilot the government's Rural Water Supply and Sanitation Strategy, which is based on community participation. If the pilot is successful, a planned Rural Development/Water Project (FY05) will scale it up.” p22
WB	CAS	28-5-02	“Policy and institutional reforms necessary for improved sector performance, privatization, and sustainability will be a central component of all infrastructure projects. The Bank will design operations to include public participation and disclosure activities that instill transparency and accountability in the use of public funds, providing opportunities for citizens to increasingly hold their government and representatives accountable for using public funds effectively.”
WB	CAS	28-5-02	“While MIGA is not currently underwriting any projects in Albania, it stands ready to provide coverage for investments in private sector projects, particularly in supporting the process of privatization.” p25
IMF	PRSP	Nov 2001	“The priority measures in these sectors will be: (i) investments for the improvement and expansion of the water supply system and for the improvement of water quality; (ii) rehabilitation of the sewage network; (iii) cost recovery through better management of the service, the regulation of the tariffs, the accurate measurement of water consumption, the reduction of the illegal connections, the improvement of the payments; (iv) decentralization of the investments, the decision making process, and the control that is presently exercised by the central authorities; (v) use of alternative forms for the management of water supply systems, such as contracts for management or with concessions, and the general privatization; and (vi) transfer of ownership of water supply infrastructure and sewage from the central to the local government. In the context of the decentralization process, special attention will be attached to increasing the participation of the community in the projects for water supply and sewage improvement by applying schemes, which have already proved to be successful. The implementation of the program with the aforementioned measures will be

			supported by relevant changes in the existing legal framework and by putting into operation the structures specified in the legislation.” p81
IMF	Appendix B to Interim PRSP ¹⁴⁰	3/5/2000	“Measures to be taken” foresees “Develop a plan for energy sector regulatory reform, restructuring and eventual privatization.” and more generally “Develop plan for privatizing utilities.”
IMF	Staff Report for 1999 Art IV Consultation ¹⁴¹	June 1999	“While privatization is a longer-term objective for the public utilities, stemming losses and improving the performance of the state-owned electricity company, KESH, has become a priority.” p17
IMF	ESAF Policy Framework Paper for 1999–2001 ¹⁴²	28/5/99	“The privatization of electricity and water companies will start in 2000–2001.”
WB	CAS	1998 (still valid 00-02)	[one of three priorities] “ <i>Promoting sustainable private sector growth</i> (restoring macroeconomic stability in conjunction with the IMF-supported program; reforming the financial sector and privatizing enterprise; sustaining agricultural growth; improving infrastructure provision with an emphasis on private sector participation ; and promoting environmental sustainability);”
WB	CAS	1998 (still valid 00-02)	“28. <i>Water</i> . Improving access to safe drinking water-through water sector investments and policy reforms, especially cost recovery and private sector participation -will continue to be an important element of our poverty alleviation strategy. The Government has made progress since 1998 by lifting the tariff cap, establishing a Water Regulatory Commission, and taking first steps toward the corporatization of water and wastewater companies and the transfer of assets from the central Government to municipalities. The planned Water Privatization Project (FY01) was canceled because the Italian Government is addressing water supply in Tirana. The Municipal Water and Wastewater Project (FY02) will support the implementation of a management contract for four cities-Durres, Fier, Lezhe, and Saranda. A Water Supply Urgent Rehabilitation Project, approved by the IDA Board on February 24, 2000, will ensure a minimum quantity and quality of water, and will also help lay the foundation for the Government's medium-term water supply strategy.”
ARMENIA			
WB	CAS	2001	“The Bank's existing municipal development credit is helping improve the reliability, quality and cost-effectiveness of water service by shifting management of Yerevan's water company to an international private operator, and the Bank will help introduce similar management contracts in other cities across Armenia under the planned Municipal Water and Sanitation Sector Credit (FY02).” p18
AZERBAIJAN			
WB	CAS	April 2003	“Other High Case triggers would include reduction of implicit subsidies to electricity, gas and water beyond the 30 percent reduction target in the SAC I1 program, satisfactory progress in privatization of downstream gas and water distribution, and adoption of an integrated trade and business development agenda. SAC I1 is supporting the adoption of strategies and time-bound agendas for 2003-08 for wide-ranging utility restructuring, including separation of regulatory and operational functions, the drafting of a modern regulatory framework, private sector participation in distribution,

¹⁴⁰ I-PRSP: <http://www.imf.org/external/np/prsp/2000/alb/01/050300.pdf>

Appendix B: <http://www.imf.org/external/np/prsp/2000/alb/01/index.htm#3C>

¹⁴¹ IMF (1999), “Albania: Staff Report for the 1999 Article IV Consultation...”, IMF Staff Country Report No. 99/50 <http://www.imf.org/external/pubs/ft/scr/1999/cr9950.pdf>

¹⁴² IMF (1999), “Albania: Enhanced Structural Adjustment Facility Policy Framework Paper for 1999–2001”. <http://www.imf.org/external/np/pfp/1999/albania/index.htm#II>



			and improved tariff policies. Government receipt of bids for private participation in gas and water distribution would indicate important progress towards implementing the strategies and action agendas, and would thus be a trigger for the High Case. ” p26-7
BOSNIA			
WB	CAS	2000	Program Matrix, under PSD, one strategy/action is: “Continue corporatization measures in utilities (including coal mine restructuring in power sector), establish regulatory arrangements, begin plans for privatization”
BULGARIA			
WB	CAS	April 02	“Local governments constitute a weak link”, one reason being that “private sector provision of infrastructure services is non-existent, mainly because the regulatory framework does not exist for concessions and the business environment (tariffs, collection, financing, etc.) is not attractive.”
WB	CAS	April 02	“29. Private participation in the management of water companies is needed. Despite a 90 percent coverage of the population, service efficiency is low. Unaccounted-for water at 50 percent is very high, bill collection at 75-80 percent is low, and tariffs - kept low for social reasons - at US\$0.25/m3 cannot cover rehabilitation needs that are very substantial due to decapitalization of most water companies over the last decade. Efforts thus far to modernize the sector include harmonization of national standards with EU requirements, but it would cost some US\$300 per capita, which is fiscally unaffordable over the medium-term. A comprehensive Water Sector Strategy is being completed by the Government and a regulatory framework is being prepared which will permit Regional Water Companies (RWCs) to award concession contracts to private operators; the first concession contract for water and wastewater services in Sofia has been awarded and others are in preparation for the Varna and Shumen RWC's.”
WB	CAS	April 02	“A Bank-supported FY05 <i>Municipal/Community Social Services Project</i> would help develop institutional capacity at the local level for, <i>inter alia</i> , building fiscal autonomy, raising and allocating resources, managing expenditures and monitoring local government performance. It would also continue ongoing technical assistance in water and waste water sector for developing regulations, advising on fair and transparent transactions for private sector involvement and setting service standards and tariffs.” p18
WB	CAS Annex B9 [note: under heading “improving the business climate and accelerating private sector led growth”, not “poverty reduction” as might be expected]	April 02	Water Sector Objectives/Issues: Assist water utilities to be financially viable to better serve the consumers, especially the poor Diagnosis: Sector assets deteriorated due to lack of funds to rehabilitate and maintain them - Service efficiency is low because of a lack of incentives - Institutional capacity at utility level is lacking - Cost of meeting EU requirements not affordable (US\$ 300 per capita) Strategy/Actions: 1. Involve private sector in operations as quickly as possible - a) Enact Water Act; b) Approve concession contracts for Regional Water Companies (RWC) of Varna and Shumen; c) Approve concession contracts for three other RWCs 2. Create a regulatory framework to facilitate private participation while ensuring that the interests of the consumers, including the poor are protected Benchmarks: Concession contracts, between municipalities and international operators, effective development of regulations (economic, and technical) for the water sector
CROATIA			
WB	CAS	1999	Program Matrix. Under heading “Supporting Sustainable Growth”, strategy/Action “ Develop a strategy for privatization of energy, oil,



			chemicals, tourism, shipping, broadcasting, railways, water supply and publishing.” Under “Infrastructure Development...”, strategy/action “A regulatory framework to encourage private sector involvement is needed.”
LATVIA			
WB	CAS	02-04-2002	“50. Investments in physical infrastructure are needed to increase the efficiency of local service delivery and improve the environment for enterprise entry. The Bank had planned to finance a new program providing resources for investments in local infrastructure, especially in smaller, poorer towns. However, the Government halted preparation of this due to availability of financing sources from the EU, Nordic Investment Bank (NIB) and European Investment Bank (EIB). In the longer run, municipalities will need to reduce the call on their financing for infrastructure investments by increasing private participation, and restructuring, commercialization and privatization of municipal enterprises will help increase enterprise efficiency. For this to take place, an effective regulatory framework and capacities for municipal utilities and infrastructure will be required. The Bank plans to continue dialogue on these matters.”
WB	CAS	02-04-2002	“Slower-than-planned progress in privatization and completion of divestiture of mostly privatized companies reflects that gaining consensus in Government over the timing and ways of privatization is difficult and time-consuming. Reflecting the slower progress, the scope of the proposed PSAL 2 has been adjusted and the size of the loan reduced to US\$20 million. Restructuring, commercialization and eventual privatization of municipal enterprises are in very initial stages. Following the Government's request, the Bank will continue to provide technical advice on privatization of infrastructure companies in the context of the PSAL-supported program.”
WB	CAS	02-04-2002	One of the Performance Benchmarks in the Country Program Matrix is that an “increased number of municipal enterprises have advanced towards (i) corporatisation and (ii) privatization.”
LITHUANIA			
WB	CAS	19-04-99	Country Program Matrix (FY99-02), Country Strategy/Key Actions under “Enhancing Competitiveness” includes: “Rapid completion of recently accelerated privatization program, including plans for divesting strategic stakes in utilities, infrastructure companies, and continued sale of minority stakes” Country Program Matrix (FY99-02), Country Strategy/Key Actions under “Upgrading infrastructure...to meet EU stds” includes: “Improve functioning of mechanisms, funds and programs for financing public and private investments in sub-national infrastructure and environment, including mechanisms for blending tax, loan and grant financing” and “Reform, strengthen financial and commercial management of municipal utilities; implement maintenance investment and restructuring/ upgrading programs; speed privatization where appropriate, create needed regulatory framework”, and a Country Performance Benchmark is “ Significant share of municipal infrastructure firms at least partially privatized, better managed and regulated ”
POLAND			
WB	CAS	13-11-02	“Possible areas for IFC participation in privatization include the financial sector, chemical plants and refineries, municipal infrastructure and other infrastructure sectors where private investor interest might be limited, such as railroads.”



WB	CAS	13-11-02	“Promoting public-private partnerships in health and education. Private participation in both of these sectors is nascent, although growing. IFC is in a good position to promote socially responsible, efficient private participation in these sectors by strongly capitalized and well-managed strategic investors, within the framework of an evolving policy and regulatory environment under discussion with the Bank. IFC has recently made two health-related investments in Poland.”
ROMANIA			
WB	CAS	2001	In the High-case scenario (rapid structural reform): “IFC will complement the Bank's efforts in private sector development by focusing on four key areas: restructuring of municipal infrastructure, marshalling financing for post-privatization restructuring; ...” Key triggers for the high-case lending scenario are progress on various privatization fronts.
WB	CAS	2001	“Support for the restructuring of municipal infrastructure enterprises could be achieved through the use of the concession model and funding mobilization already used by IFC in the contract for the Bucharest Water Supply Company.” (p25)
WB	CAS	2001	<i>How the Bank sees itself and other donors:</i> “82. The Bank's comparative advantages relative to other development partners active in Romania lie mainly in (i) policy advice and financial support for structural and sector policy reform (e.g., strengthening of the social safety net, governance, enterprise unbundling, institution building, regulatory frameworks, privatizations and enabling environments for private sector participation), ... Other partners such as the EU and bilaterals (e.g., USAID and DFID) are better suited to finance technical assistance, training, and public information activities, while the European Bank for Reconstruction and Development (EBRD) and European Investment Bank (EIB) are best placed to invest directly in large-scale activities (e.g., some municipal services) shifting from the public sector to the private sector... ” (p29)
WB	CAS	2001	<i>Constraints facing the Bulgarian government: IFIs could withdraw support, debt limits alternative options</i> “The proposed Bank Group assistance strategy faces risks. The most important risk is political, and stems from potential divisions within the Government that would delay the articulation and implementation of a reform program, and SOE privatizations in particular. Such delays could erode the support of IFIs and access to credit markets, as well as trigger a steep deterioration in economic performance and, possibly, external financing difficulties. The new Government's room to manoeuvre is much more circumscribed than in the mid-1990s because of the external debt build-up and the depletion of the country's human and capital stock.” (p31)
WB	CAS	2001	“Local Government Capacity Building” includes strategy/action “Liberalize market, adopt competitive industry structure, strengthen regulatory framework, seek/expand private sector participation in electricity, oil, gas, telecoms, railways; Improve conditions for private sector involvement in delivery of local public utility services” and benchmark “Increase efficiency of service delivery through the private sector”
WB	CAS	2001	The World Bank set itself the benchmark that it should “Promote policy changes that will increase the role of the private sector in the provision of municipal services; Create a framework that would promote private sector participation and sustainable municipal financing”
SLOVAKIA			
WB	CAS	2001	“a proposed Enterprise and Financial Sector Adjustment Loan (EFSAL in FY01) for about US\$300 million”... to support cost of bank privatization, enterprise restructuring and improved corporate governance / legal framework, and “would also help prepare for utility privatization and market liberalization . The IFC program would also focus on the financial



			sector, through participation in bank privatization transactions. IFC would consider opportunities to invest in privatized utilities.” piii
WB	CAS	2001	<i>How conditionality works</i> “Based on the Government’s current performance and commitment to reforms, the program is evolving beyond the base case toward a high case scenario. This could lead to a lending program closer to US\$765 million, with the EFSAL followed by policy-based lending linked to utilities and infrastructure restructuring and privatization, and to significant reforms in social service financing and delivery and/or social assistance, e.g. comprehensive pension reform.” The high case lending program would include a Utilities and Infrastructure Adjustment Loan in FY02.
WB	CAS	2001	During the 1994-1998 govt, “Nearly all utilities and infrastructure services remained in the public sector and the development of a regulatory framework lagged.” (p10)
WB	CAS	2001	<i>WB and EU in harmony</i> “The Public/Private Infrastructure Advisory Facility (PPAIF) will provide advice on the regulatory framework for public utilities. The Bank program would provide further technical support for privatization and liberalization in the energy sector, which would promote Slovakia’s efforts to meet the requirements of the acquis in liberalizing energy markets.” (p18)
SLOVENIA			
WB	CAS	2000	“While the Bank worked with the Government to develop a strategy for state asset management and privatization, the lack of political consensus restricted the Government’s ability to implement fully this strategy during the CAS period.” p6 The Bank remarks later that due to “pockets of diverse interests”, “privatization progress remains disappointing, although the private sector has invested in some municipal waste water projects” p9-10
WB	CAS	2000	“With respect to the benchmarks for developing the private sector, IFC’s Foreign Investment and Advisory Service (FIAS) provided strong analytical support for a more dynamic role for the private sector in infrastructure and examples of private financing of infrastructure have emerged, particularly related to municipal investments in waste water treatment.” p6
WB	CAS	2000	“In 1997-98, an intensive dialogue between the Slovene authorities and the Bank Group, including FIAS, identified options for improving asset management and privatization, emphasizing the latter.” p9
WB	CAS	2000	<i>EU influence</i> “in this rather unsupportive environment, the Government did succeed in putting in place the legal and institutional framework to support privatization in the future, when the tradeoff between privatization and EU accession will become more explicit.” p10
WB	CAS	2000	“During the second half of 1997, FIAS examined the institutional, legal, and regulatory framework for attracting private investment in infrastructure. The FIAS report on “Private Investment in Infrastructure” found that there were substantial investment requirements in various sectors (electricity, telecommunications, transportation and water and waste) which traditional public funding sources were unlikely to cover. Through the report as well as a government workshop and investor roundtable, FIAS provided four sets of recommendations to: (i) develop a clear strategy for private sector involvement in each sector; (ii) set up a BOT (build, operate, transfer) unit to facilitate implementation of BOT/concession projects; (iii) draft a concession law to provide a comprehensive legal framework; and (iv) establish a cross-sectoral regulatory framework, allowing for the future supervision of private sector operations in these sectors. To facilitate implementation of the recommendations, FIAS and the Government held a follow-up workshop in February 1998 and the Government has committed to develop a step by step implementation strategy for each of the four areas.” p10

WB	CAS	2000	“46. IFC, through the Foreign Investment Advisory Service, has provided technical assistance and advice on the role of the private sector in infrastructure investments and has also worked with the Bank in advising the Government on how best to resolve the issue of state owned assets. The Government has been particularly appreciative of FIAS' advisory services as these have helped to clarify policy options for subsequent Cabinet and parliamentary decisions. While the CAS indicated that IFC would be keen to support the privatization process through the provision of advisory services to potentially viable enterprises and through direct investment in post-privatized companies, the availability and pricing of alternative sources of financing precluded a role for IFC. Future areas of cooperation would be limited to those areas where IFC would bring additionality with respect to privatization of education and health services, certain "high-tech" projects where strategic investors could be required, and in catalyzing the growth of private pension funds.” p14-15
TURKEY			
WB	CAS	October 2003	“Some aspects of infrastructure management have been improved, but the results of the limited introduction of private operators in municipal water have been mixed.” (Retrospective Review, CAS FY01-03)
WB	CAS	October 2003	“25. Effective decentralization through greater empowerment of municipalities will lead to improved services. Governance of the increasingly complex urban economies must shift from reliance on central government micro-management to municipal administrations accountable to their citizens. Greater local revenue generation would both heighten citizen oversight and reduce municipal dependence on the central government budget. Coupled with enhanced financial accountability, and improved monitoring and public reporting of municipal performance benchmarks, decentralization will foster the sustainable provision of services such as water supply, and wastewater treatment, urban transport, road maintenance and solid waste management.”
WB	CAS	2003	“Participation improves policy effectiveness. Greater engagement of civil society in Turkey’s development-for designing strategies and implementing programs-will raise the effectiveness and relevance o f the government’s efforts in the eyes of its citizens.” p13
UKRAINE			
WB	CAS	2000	Two main conditions are specified for Ukraine to remain in the low-case for lending, of which the first is that it “would have to demonstrably help civil society increase its voice for better government and social services provision, or provide tangible benefits in globally sensitive areas.” In order to move up to base-case, it would have to implement an IMF macroeconomic program. This illustrates the strength of the CAS’s unusual emphasis on civil society: the current funding can be kept without the IMF program, but not without civil society engagement.

Annex C: EIB/EBRD funding for public sector water

5.1 EIB

5.1.1 Poland: Lodz Water gets EIB funding

In March 2001, Lodz Water obtained a EUR 31m loan from the EIB (European Investment Bank) to finance improvements in the water and wastewater networks. Granted for 20 years, the loan would support a 5-year municipal investment programme also including the extension of a wastewater treatment plant and several

collectors and road works. The EU Commission would contribute further investment finance through its pre-accession grant programme ISPA¹⁴³.

5.1.2 Poland: EIB finances Szczecin water projects

In January 2001, the EIB decided to issue a EUR 20m, 20-year loan to the city of Szczecin (400,000 inhabitants) to upgrade water supply and wastewater networks. The EU would also contribute finance through its pre-accession grant programme ISPA. Szczecin has been identified by HELCOM (Helsinki Commission for environmental protection in the Baltic Sea, see below) as one of the hot spots for action.¹⁴⁴

5.1.3 Poland: EIB finances Torun water

In June 2000, the EIB decided to issue a EUR 20m, 20-year loan to the city of Torun in north western Poland (200,000 inhabitants) to upgrade water supply and wastewater networks. The EU would also consider whether to contribute finance through its pre-accession grant programme ISPA.¹⁴⁵

5.1.4 Poland: EIB finances Zywiec communes syndicate

In February 2000, the EIB issued a EUR 20m loan to the "Association of Communes for Ecology" of Zywiec on the Czech and Slovak border (with a total 200,000 inhabitants) to upgrade and extend sanitation infrastructure including a wastewater treatment plant. The Association was one of the first syndicates of municipalities to be set up to tap investment finance for water infrastructure.¹⁴⁶

5.2 EBRD

5.2.1 Poland: Krakow gets EBRD funding ("sound financial standing and management")

In December 2000, the EBRD decided to issue a EUR 20m, 12-year loan to Krakow municipally-owned water company MPWiK (Miejskie Przedsiębiorstwo Wodociągów i Kanalizacji w Krakowie S.A.) to finance the extension and modernisation of an existing mechanical wastewater treatment facility and construction of a biological wastewater treatment facility. The EBRD loan would be provided to MPWiK without any municipal guarantee, as the municipal company enjoyed sound management and good finances. "The EBRD has carried out an extensive financial assessment of MPWiK. In view of its sound financial standing and management, the Bank is willing to take the full commercial credit risk of the company". As a result, Krakow city council would be in a position to invest more resources in non-revenue sectors such as housing, education and roads. Interestingly, the EBRD loan was to be provided in two currency, respectively PLN 45.5m and € 10m – to reflect MPWiK's financing requirements.

In addition to the EBRD loan tapped by MPWiK, Krakow city council obtained a complementary EU ISPA grant of some € 55m.¹⁴⁷

5.2.2 Poland: Bydgoszcz gets EBRD funding

In January 2000, the EBRD decided to issue a PLN 108m (EUR 21m), 15-year senior corporate loan to Bydgoszcz municipally-owned water company MWiK (Miejskie Wodociągi i Kanalizacja w Bydgoszczy Sp. Z o.o), to help finance an ambitious investment programme with a total cost of PLN 294m (EUR 56m). This would include "modernisation of water intakes, upgrading water treatment facilities, water supply network

¹⁴³ EIB Press Releases, Luxembourg, 8 March 2001, "Poland: EIB finances water schemes in Lodz", <http://www.eib.org/pub/press/2001/pa006.htm>.

¹⁴⁴ European Report, January 24, 2001, "EIB finances water projects in Szczecin".

¹⁴⁵ EIB Press Release, 29 June 2000, "EIB finances water schemes in Torun, Poland" (<http://www.eib.org/pub/press/2000/pa019.htm>).

¹⁴⁶ EIB Press Release, 25 February 2000, "EIB finances water schemes in Southern Poland" (<http://www.eib.org/pub/press/2000/pa006.htm>).

¹⁴⁷ EBRD Press Release, 28 December 2000, "EBRD financing to improve Krakow waste-water treatment and help reduce river pollution".

and pumping stations, intercepting sewer discharges to the Brda River, and extending the sewer network”. The loan was the first to be issued by the EBRD in zloty and would be provided without a financial guarantee from the city council, in order to enhance the latter’s capacity to fund investments in non-revenue sectors, such as housing, education or roads. This was also the first EBRD project in Poland expected to be co-financed by the EU pre-accession grant programme ISPA, as the Polish Ministry of Environment had applied on behalf of the city council for complementary grant financing for upgrading sewerage.

MwiK was established under municipal ownership in 1992 and, as of 2000, employed 600 workers. The capital of the Kujawsko-Pomorskie region, Bydgoszcz is Poland’s eighth-largest city and has been identified by HELCOM as one of the “hot spots” to direct action at and fight pollution of the Baltic Sea.¹⁴⁸

5.2.3 Latvia: EBRD finance Riga water on non-sovereign basis and twinning with Stockholm Vatten

In November 2000, the EBRD decided to issue a EUR 39m loan to the municipally-owned Riga Water Company, which became the first Latvian utility to receive a direct corporate loan from an international financial institution. The loan was provided without any financial guarantee from the city council, in the light of Riga Water Company’s ability to self-finance its operations. Instead, the loan was supported by a limited municipal undertaking, “including the city’s adherence to agreed tariff schedules and other key obligations of the municipality towards the utility”.¹⁴⁹

Riga Water Company would use the loan to finance the construction of sludge deposits for its wastewater treatment plant, installation of water meters to consumers and extension of water supply and sewerage networks. Also, the loan would allow Riga Water Company to re-finance outstanding sovereign-guaranteed debts, which the company used to finance upgrading of its wastewater treatment plant and rehabilitation of the sewer network under a twinning arrangement with Stockholm’s municipally-owned water company Stockholm Vatten.

Stockholm Vatten started its cooperation with Riga Water Company in 1992. In 1996, a twinning agreement was signed aiming to turn Riga Water Company into a “modern, self-financing public (water) supply and sewerage company. The project was financed by the EBRD, EIB, the Finnish Ministry of Environment and Sida to the tune of US\$ 115 million”.¹⁵⁰

5.2.4 Lithuania: Kaunas water gets EBRD finance on non-sovereign basis - twinning with Stockholm Vatten

In July 2001, the EBRD decided to issue a EUR 14.7m loan to Kauno Vandenys (Kaunas Water Company) to help finance an ambitious EUR 41.3m investment programme. This was the first loan to a local utility in Lithuania to be provided without any sovereign or municipal financial guarantee and the EBRD expected it would “demonstrate to other cities and banks that it is possible to finance well-run municipal services without such guarantees”.¹⁵¹

The project was designed to remove iron from the main water supply, support the rehabilitation and extension of the water pipeline system and finance secondary wastewater treatment facilities. The project, known as Phase Two as it followed another loan provided by the EBRD in 1995 to upgrade Kaunas water supply and sanitation, would be co-financed by Kauno Vandenys and the city council applied for funding from the EU’s pre-accession instrument ISPA. In October 2001, the EU Commission approved a EUR 15.96m ISPA grant to finance a water purification plant, which would allow to increase the degree of purification of the Nemunas river, the biggest river in Lithuania, from 70% to 95% as required by EU

¹⁴⁸ EBRD Press Release, “EBRD’s first long-term zloty loan improves water services in the city of Bydgoszcz in Poland”, 12 January 2000..

¹⁴⁹ EBRD Press Release, “EBRD renews commitment to Riga Water in Latvia”, 20 November 2000.

¹⁵⁰ Stockholm Vatten, Environmental Accounts and Annual Report 2000, p. 40.

¹⁵¹ EBRD Press Release, “EBRD brings cleaner, safer water to Lithuania - €14.7 Bank loan supports Phase Two of the Kaunas water and waste-water project”, 20 July 2001.

legislation. The total cost of the purification plant was estimated at EUR 28.2m, with Kauno Vandenys obtaining a EUR 9.57m EBRD loan and the Lithuanian government contributing EUR 6.38m.¹⁵²

Like with Riga Water Company, in the case of Kauno Vandenys a partnership between public sector water companies has apparently acted as a catalyst for investment finance. Kauno Vandenys had entered a twinning agreement with Stockholm Vatten, which enhanced the company's capacity and led to the completion of Marveles, the first wastewater treatment plant in Kaunas, in September 2000. "The international sources of finance, EBRD, NEFCO and EU-PHARE, the Finnish Ministry of the Environment and Sida invested US\$ 50 million and the Lithuanian government, the City of Kaunas and Kaunas Water guaranteed the equivalent sum"¹⁵³. In 1999, Stockholm Vatten noted that "Kaunas Water Enterprise has developed positively and is now largely self-financing"¹⁵⁴. In July 2001, the EBRD was also "helping to raise donor funds to assist with institutional development for the Kaunas Water Company and the city of Kaunas".

5.2.5 Russia: Kaliningrad gets EBRD and aid funding and support from Swedish and Danish water companies

In July 1999, the EBRD decided to issue a EUR 16.5m loan to the Russian Federation which would be on turn on-lent to Kaliningrad's municipally-owned water company Kaliningrad Vodokanal, as part of a EUR 63m, 4-year project to overhaul the company's water and wastewater infrastructure and build capacity.

The loan would finance the upgrading of a groundwater treatment plant, completion of a wastewater treatment plant, as well as rehabilitation of pumping stations, wastewater collectors, water mains and the water supply network. In addition, it would finance technical services provision and help to finance the installation of meters to consumers.

The project, which would run from 2000 to 2003, would be co-financed by SIDA (Swedish International Development Agency), DEPA (Danish Environmental Protection Agency), NIB (Nordic Investment Bank), NEFCO (Nordic Environment Finance Corporation).

As the EBRD noted, "An important component of the project is a comprehensive institutional strengthening and capacity building programme. This will improve the financial and operational performance of Kaliningrad Vodokanal and strengthen the city's capacity to administer and regulate the sector. It will also help the city to review its tariff policy for water and wastewater services, which is needed to ensure a sustainable basis for the provision of services"¹⁵⁵.

Since June 2000, Stockholm Vatten is contributing to Kaliningrad Vodokanal's institutional development and capacity building. More precisely, within a project jointly organised by Swedish Water Development (an international development vehicle set up by Swedish municipally-owned water companies), Danish Water Services and the ÅF Group, Stockholm Vatten is responsible for project management and economic expertise¹⁵⁶.

5.2.6 Russia: St Petersburg gets EBRD funding and technical assistance from Finnish and Swedish water companies

In July 1997, the EBRD decided to issue a DM 127m (ECU 65m), 10-year loan to the municipally-owned water company St. Petersburg Vodokanal to help finance a DM 300m investment programme to overhaul the city's water supply and sanitation system. This was the first loan provided ever by a multilateral financial institution to a municipal utility without on a non-sovereign basis, without any backing from a state or commercial bank guarantee. The loan was instead guaranteed by the city council as well as being "backed up by a separate project support undertaking from the Russian Government".

¹⁵² Agence France Presse, "EU grants Lithuania 15.96 million euros for water purification project", October 25, 2001..

¹⁵³ Stockholm Vatten, Environmental Accounts and Annual Report 2000, p. 40.

¹⁵⁴ Stockholm Vatten, Environmental Accounts and Annual Report 1998, p. 37.

¹⁵⁵ EBRD Press Release, "Kaliningrad to enjoy cleaner water with EBRD assistance", 8 July 1999.

¹⁵⁶ Stockholm Vatten, Environmental Accounts and Annual Report 2000, p. 40.

The EBRD came to the decision to issue the loan on such basis, in the light of the company's operational performance and sound management, as well as the city council's international financial standing.

"Vodokanal's operational performance, the quality of its management and the strong support it has from the City of St Petersburg allow the EBRD to rely solely on Vodokanal's financial strength to repay the loan".

The EBRD loan would finance "the construction of a water purification plant; the supply and installation of consumer and network water meters; the rehabilitation of the sewerage and water supply network; and the connection of open sewage discharges to the waste-water treatment plant". Also, "The project will improve Vodokanal's creditworthiness, strengthen its financial and operational performance and create the right conditions for the company to embark on its long-term investment programme on a financially sustainable basis".

The remaining DM 173m worth of investments were to be partly self-financed by Vodokanal and also financed by a NIB loan and contributions from the Danish, Finnish, German and Swedish governments and NEFCO¹⁵⁷.

In August 1998, a project started under the auspices of the EBRD aiming to support St. Petersburg Vodokanal's restructuring and capacity building, improve water supply and sanitation and ultimately reduce the St Petersburg-derived pollution of the Baltic Sea. Technical assistance was provided by two Nordic municipally-owned water companies - Stockholm Vatten and Helsinki Water and Wastewater Works – and the UK privatised water company Severn Trent.

Stockholm Vatten was responsible for developing an IT policy and a plan for introducing IT in the Russian utility, carried out a study of leakage in the distribution network and contributed to the preparation of a plan for demand management aiming to reduce water consumption. Helsinki WWW contributed to improving the personnel and financial administration, while Severn Trent was responsible for the development of tariff systems, invoicing, economy and reporting¹⁵⁸.

The project, which cost a total GBP 3.5m and was financed by the Finnish Ministry of the Environment, the UK Department for International Development (DfID) and Know-How fund, and SIDA (Swedish International Development Agency),¹⁵⁹ was completed in August 2000. It was then being considered whether to continue providing technical assistance to St. Petersburg Vodokanal.¹⁶⁰

Annex D: Factors Overview

Source: Adapted by Esteban Castro (2002) from a literature survey carried out by Morales-Reyes (1993).

¹⁵⁷ EBRD Press Release, "St Petersburg improves water supply and waste-water services with EBRD financing", 17 July 1997.

¹⁵⁸ 28 Aug 1998, "St Petersburg tackles pollution", Global Water Report FT Bus Rep: Energy.

¹⁵⁹ Stockholm Vatten, Environmental Accounts and Annual Report 1998, p. 37.

¹⁶⁰ Stockholm Vatten, Environmental Accounts and Annual Report 2000, p. 40.

FACTORS THAT PROMOTE PRIVATIZATION	FACTORS THAT DISCOURAGE PRIVATIZATION
Economic-financial ○ The economic and financial needs of the country in the face of scarce resources and increased demand ○ Reducing the financial burden of the public sector ○ Capacity to attract foreign loans ○ Increased productivity gains expected from introducing competition ○ Promotion of economic growth expected from private investment ○ Assistance to development of capital markets ○ Generating resources that can be applied in cross-subsidization to fund other projects (e.g. network expansion, wastewater treatment, etc.) ○ Reduction of taxes through raising revenue from water Technical-environmental ○ For expanding the service to unserved areas ○ For quality improvements (e.g. new water treatment technologies, etc.) ○ Tackling the increased complexity of water supply activities and their environmental impacts Policy-organizational ○ Reducing the administrative burden and direct responsibility of the public sector ○ Improvement of the capacity for response to local needs ○ Transparency of information (on funding sources, guarantees, risks, conditions) ○ Increased private sector confidence inducing investment and repatriation of capitals Political ○ Pressure and conditioning from multilateral financial institutions ○ Pressure from powerful interest groups that may benefit from privatization ○ Expected enhancement of the government's credibility	Economic-financial ○ Lack of interested and reliable investors ○ Unreliable economic environment (e.g. inflation, volatile exchange rates threatening returns on investment, etc.) ○ Poorly developed capital markets ○ Prospect of price increases or excessive profits ○ Potential creation of monopolies ○ Difficulties in collecting water payments, uncertainties on levels of return to be achieved ○ Higher than average rates of return requested by the private investors ○ Fiscal deficits that limit financial capacity Technical-environmental ○ Unreliability or inadequacy of resources availability, geographical obstacles, etc. Policy-organizational ○ The complexity of the preparatory work (legal, institutional, economic, political, etc.) ○ Legal or constitutional prohibition ○ Inadequate or unpredictable institutional and policy environment ○ Inefficient or inexistent regulatory structures ○ Political interference ○ Low motivation of the staff, salary problems ○ Corruption Socio-Political ○ Weight of tradition (government as provider) ○ Government interest in keeping control over services (for social, political or economic reasons) ○ Uncertainty about privatization prospects in the face of inconclusive evidence ○ The scope of the changes involved ○ The protection of social equity aspects (distribution issues, etc.)

José Esteban Castro (Report Coordinator), “Arguments underlying current programmes promoting private participation in water and sanitation services”, PRINWASS project, School of Geography and the Environment, University of Oxford, October 2002

Morales-Reyes, Javier I. (1993), “Privatization of water supply”, in Institutional development Series #2, Loughborough: Water, Engineering and Development Centre (WEDC).



6 Notes