



Municipal Infrastructure Support Programme

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Antecedents



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This Annex summarizes some antecedents of this Green Paper, as mandated by the Terms of Reference of the MISP Project. Excerpts from three antecedent documents are attached as Appendices to this Annex:

- Appendix 1: Conclusion of the Standing Conference of Towns and Municipalities, on the occasion of its XXXVI Assembly, dated December 3, 2007
- Appendix 2 Excerpts from the World Bank Terms of Reference for “Advisory Support to the working group designing a reform strategy for public utility companies”
- Appendix 3 Excerpts from the “Conclusions and Recommendation” section of the MIASP report on “PUC Transformation in Serbia”, November 2007

The conclusions of the XXXVI Assembly of SCTM deal with principles and with the need for further studies/work/policy formulation. There are no recommendations for concrete measures in that document. However the document draws on the work of the MIASP Project which preceded the present MISP Project, and thus the preparation of this Green Paper; Salient excerpts of the conclusions and recommendation of the MIASP report on PUC Transformation are reproduced in Appendix 3.

Concurrently with the above activities during late 2007, the Ministry of Economy and Regional Development reached an agreement with the World Bank whereby the World Bank is to deliver technical support for to an inter-ministerial working group that was to be designated to design a reform strategy for PUC's. This Working Group was to be formed during early 2008.

The tasks of the World Bank Consultancy, which have been agreed by the ME&RD, include to

1. “propose and discuss and agenda for working group sessions /i.e of the interministerial working group/ and to assist in formulating relevant problems for its deliberations”
2. “present a few relevant case studies”
3. “take stock of the available data on municipal and PUC finances and performance ...”
4. “advise on the basic sectoral issues and dimensions ... of PUC reform options”
5. “participate in working group meetings”
6. “at the end of /the/ assignment, indicate their professional opinion what are the key issues requiring further investigation and what are the likely main roadblocks on the way forward”

Appendix 2 reproduces in full the sections of the World Bank's Terms of Reference which define (i) the key issues to be addressed (ii) the objectives of the advisory service and (iii) the scope of work to be performed by the Consultants (as summarized in the above six points).

What emerges from this is that there are (i) close complementarities between the work going into this Green Paper and the tasks of the World Bank (ii) both aim at addressing issues and options but stop short of comprehensive recommendations for a “Strategy” for reforming the PUC sector. Cognizant of this, at a meeting between the ME&RG, the SCTM and MISP dated March 29th it was agreed that the preparation of the MISP paper will be closely coordinated with



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the World Bank's Work, and MISP will have an observer status to the deliberations of the Interministerial Working Group.

Though the Green Paper and the World Bank Consultancy practically have a similar purpose, i.e. to provide inputs to the Government's Strategy for PUC reforms there are differences in that

- (i) while the World Bank's consultancy is a short term engagement with no certain follow-up MISP's Green Paper is the first phase of a two year involvement, with the Green Paper followed up by position papers and strategic recommendations to follow, finally leading to an Action Plan for the achievement of strategic objectives.
- (ii) the World Bank's Consultancy responds to the Ministry of Economy and Regional Economy, while MISP's work responds in the first instance to its Steering Committee and has a special brief to reflect views of the Standing Conference of Towns and Municipalities.

The intent to work closely together was confirmed at the working level between World Bank and MISP staff.

The World Bank's advisory Consultancy is expected to start its work once the inter-ministerial working group is formed.



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Appendix 1



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Conclusion of the XXXVI Standing Conference of Towns Assembly, dated December 3, 2007

Excerpts Relevant to PUC Transformation

Note: The referenced Assembly issued its conclusions under five headings, the last of which to address how to “develop local and regional infrastructure of towns and municipalities” . The three shaded points below are relevant to PUC transformation, highlighting the topics of regionalization, tariff policy, and policy on private sector participation in municipal services.

The Conference concluded to

- “Indicate that sector strategies at the national level should be developed in the close cooperation and through socio-economic dialogue with the citizens within local self-government; so that they would be generally accepted and applicable;
- Point out that all-inclusive strategic planning is necessary for directing sustainable and balanced socio-economic development at the local level;
- Indicate that local initiatives and municipal investments in the infrastructure should lead to better management and increase quality of services provided by the local and regional utility companies; as well as towards the implementation of EU directives;
- Point out that joint planning of several municipalities, identification of individual projects of the same kind and their linking, should serve as a base for sustainable infrastructure development, cost reduction, efficiency increase, easier access to financial resources, increase of service quality and approaching EU standards;
- Indicate that strengthening statistical-information base of planning is a ground for reliable planning and funds allocation; with the development of statistical classification in line with the EU standards; all this is a guaranteed road to success;
- Point out that during the project preparation, units of local self-government have to, besides the technical questions, take into consideration organizational, economic and financial criteria;
- Indicate that it is necessary for donors to cooperate among themselves and with the SCTM on the capacity improvement of the units of local self-governments, in terms of project development, tasks division and more efficient use of the resources;
- Point out that it is necessary to strengthen consulting capacities of the SCTM and institutionalize their cooperation with the other competent institutions, especially at the central level, in order to increase the capacity of the units of local self-government for project development;
- Indicate that it is necessary to systematically define methodology of price formation for the products and PUC services, which will take into account the principle of covering all operational costs; and enable development of communal sector and investment in local and regional infrastructure. This approach means passing supporting measures of social policy at the local level that will enable households with lower income to access the basic communal products and services;
- Believe that central and local authorities should establish guidelines and procedures for optimal use and possible combining of financial support from different sources (NIP, IPA,



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Fund for environmental protection, loans from International Financial Institutions, etc.) for the development of local and communal infrastructure;

- Point out that optimal planning of future investments in the infrastructure should first and foremost be directed towards adhere to energy efficiency measures and reduction of the most obvious and most prominent causes of expenditures, such as technical losses on the network and excessive consumption of electric energy in the process of providing communal services;
- Indicate that a better framework for financing should be established, including loans at the local level , for investments in the infrastructure which are reducing costs, have high degree of recovery of invested funds, and have positive impact on the quality of services;
- Point out that it is necessary , when formulating strategy and model for transformation and/or PUC privatization , for institutions in charge to strategically decide and suggest principled attitude and legal act on vital communal infrastructure according to activities, i.e. infrastructure which remains in public ownership and about activities which can, and which cannot be the subject of ownership transformation, in planned stages;
- It is necessary, in the cases of opting for partnership with the private sector or PUC privatization, that the first step should be preparation of the strategy and guidelines, followed by the preparatory activities and defining preconditions, such as obligatory and transparent procedures and criteria, legal security, public control of the contract, regulation of the market conditions and responsibilities, etc;”



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Appendix 2



Excerpts from the World Bank Terms of Reference for “Advisory Support to the working group designing a reform strategy for public utility Companies”

The following are the excerpts of the above TOR which define

- The key issues
- The objectives, and
- The tasks of the advisory service

“Key Issues

- *Governance.* Typically, there are unclear governance arrangements between the founders (municipalities) and the utility companies, such that performance expectations and criteria for satisfactory delivery of services, universal service obligations, and internal use of resources are not specified in contracts or performance agreements.
- *Financial relationships.* Similarly, financial transfers from the municipality to the PUC's are not specific to performance or based on clear parameters such as management of costs and revenues. For example, compensation to the utility for services delivered to “vulnerable” users who are unable to pay, or are formally exempt from payment, are not distinguished from financial losses due to inadequate tariffs or inefficient operation.
- *Tariff regime.* The procedures for tariff review are rigid and cumbersome, as proposals for tariff increases must be reviewed by as many as five ministries, and annual increases are not permitted to exceed the general inflation index. Tariffs at most reflect operating costs without provision for capital costs.
- *Political influence.* Influence of local political parties is pervasive, leading to frequent turnover of senior and middle managers and pressures for employment of unqualified staff in the PUC's.
- *Inability to mobilize investment finance.* The above issues, coupled with the unpredictability of the municipalities' own finances and the lack of transparent reporting and auditing of either municipalities' or PUC accounts, lead to a very poor environment for mobilizing funds from internal revenues or from external creditors to meet the extensive investment needs. Municipalities have not been permitted to guarantee commercial loans to PUCs or to provide property as collateral, and arrangements to provide alternative forms of security for municipal investment loans have been ad-hoc and time-consuming.

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Objectives of the requested advisory services

The objectives of the consultancy are:

- To assist the client (working group chair and members, on behalf of the MERD) in steering the working group for a structured and informed discussion yielding implementable recommendations
- To provide specific targeted inputs to working group discussions, focusing on (a) sectoral perspectives and (b) transformation process.
- To help the Government determine the extent and nature of informational, analytical, and institutional steps required to fully elaborate and implement a reform strategy. The consultant would advise the client regarding the kinds of inputs needed and a realistic timetable for implementation. On this basis, the consultant would also advise the Bank and PPIAF regarding the potential demand for further external assistance to the reform process.

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Scope of work - The consultants will have the following tasks:

- Propose and discuss an agenda for working group sessions and assist in formulating relevant problems for its deliberation.
- Present a few relevant case studies of how other national governments in the region or western Europe have managed the process of municipal enterprise transformation—the specific role of national privatization agencies or concession offices, local governments, sectoral experts, external advisors, etc. The focus of case studies would not be on specific examples of particular PPP forms, but rather on the role of central governments and other parties in the transition, and lessons learned. It is expected that such case studies would not involve original research and could draw in part on the consultants' own experience.
- Take stock of the available data on municipal and PUC finances and performance, as have been or will be collected by working group partner agencies. The consultant would not be expected to produce significant quantitative analyses, but to propose and comment upon analyses as may need to be done by the working committee or others.
- Advise on the basic sectoral issues and dimensions (in water and sanitation, solid waste, district heating, public transport) of PUC reform options, based on discussions with key sectoral stakeholders, and review of the available data and other available documentation. The consultant's role would be to ensure that the working group takes account of the major sector-specific performance issues and implications for institutional and policy reform priorities. This analysis would not report on individual PUC's in any depth, but rather give broad sectoral diagnoses and indicate the nature of follow-up work needed.
- Participate in working group meetings for the purpose of the tasks above.
- At the end of their assignment, indicate in their professional opinion what are the key issues requiring further investigation and what are the likely main roadblocks on the way forward."



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Appendix 3



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Excerpts from the “Conclusions” Section of the SCTM/MIASP Report “PUC Transformation in Serbia” November 2007

The main problem issues in the functioning of PUC's, as a consequence of inherited and circumstances in the last 15 or so years are :

- Inadequate ownership and usage rights solution of the previously government now public property issue and based on that the administrative and political influence on the PUC operations.
- Fragmentation of functions and accumulation of resulting unresolved issues
- Increasing expenses and inadequate tariffs for complete expense coverage
- Low level of payment collection, large debt write-off, low liquidity and outstanding obligations.
- Inefficient operations, lower quantity and quality of services, indifference towards and impossibility to satisfy consumer needs
- Worn-out and obsolete equipment and infrastructure
- A chronic lack of funds for reconstruction and capacity enlargement
- Non compliance with environmental standards
- Lack of regulated performance indicators

When considering the main problem issues in PUC functioning, the most current one that burdens PUC operations is the issue of tariff levels and the procedure of approved limited price increases (annually, from previous year's statistic data) that is not based on realistic cost coverage parameters, but rather on administrative influence on PUC economics. The communal sector has for some time now indicated the need for defining a methodology system of tariff setting based primarily on realistic cost coverage and investment needs. When the issue of tariff setting is raised on the central and institutional level, a parallel process should include performance indicators, quality and responsibility, but also the protection of the public interest from sudden price increases and monopolistic behavior.

Based on the present level of living standards or consumer purchasing power, with a more or less acceptable increase in tariffs as a short term measure, it is probably possible to raise a part of funds necessary for covering all expenses, but not for the necessary level of needed investments. Long term measures such as: price policy definition, payment collection increase, reduction of losses in the network, could to some extent soften the long term price increase blow, but the problem of providing funds for infrastructure reconstruction and adaptation to standards will remain open.

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The main obstacle for long term satisfaction of public needs for quality communal services is the now for some time chronic lack of funds for modernization and communal infrastructure



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expansion. As a commonly known fact, the financial position of PUC's/LSG does not make it very probable that some can self finance even 25% of necessary larger investments, so they will most probably need to rely on donations and loans.

Proposed recommendations

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In the process of defining the strategy of transformation the relevant government authorities should separately deal with PUC and separately with Public Enterprises.

Within the strategy for PUC transformation, it is necessary to observe each sector separately (water, district heating, communal waste) according to their specifics and public needs.

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It is necessary to perform an inventory and property registry (utility and land cadastre) and realistic evaluations of property to which PUC have usage rights.

- *Potential positive effect of recommendation*: a reliable property registry is established and a "fair" value of property is determined as a sound basis for determination of property shares.

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The first steps toward PUC reorganization and transformation could be the development of proceedings and measures aimed at more effective operations of PUC's:

- To the most possible extent relieve the PUC of political influences on management issues, organization and income capabilities, but with necessary government control for the responsibility in performing basic functions and standards application.
- Formulate obligatory government principles for the methodology of price policies and parameters that will enable rational covering of all expenses with minimal administrative and political influence. In the first phase, of application it is necessary to formulate measures protect the public interest from sudden price increases and monopolistic behavior. At the same time the PUC need to intensify activities on revenue generation by increasing receivables and eliminating network losses.
- Examine the options for formulating strategic priorities for inter municipal communal systems, regional PUC's, on a functional principle. The regionalization strategy should be primarily focused on local problem issues, as a measure to improve operations and economic position, and access to external sources of financing. .
- Define the basis for the establishment and application of a system of efficiency indicators (benchmarking) by communal sectors for the purpose of establishing realistic and



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comparable parameters for current situation evaluation and for future needs for indicators in the functioning and transformation of PUC's.

Potential positive effect of /above/ suggestion ...:

- Decreasing the influence of current politics on efficiency
- Increasing role of regulatory institutions in standard application control and quality improvements
- Regulation of tariff policies without administrative influence on operations.
- Based on regional projects, easier access to sources of financing, especially in small and less developed regions.
- Establishing realistic and comparable parameters for current situation evaluation and for future needs for indicators in the functioning and transformation of PUC's.