I. Project Context

Country Context

The water supply and sanitation utilities in the countries that form part of the Danube basin are located in one of Europe's largest cross-boundary river catchment area spanning over 19 different countries with strong transnational regional ties. Those countries are Albania, Austria, Bosnia and Herzegovina, Bulgaria, Croatia, Czech Republic, Germany, Hungary, Italy, FYR Macedonia, Moldova, Montenegro, Poland, Romania, Serbia, Slovakia, Slovenia, Switzerland, and Ukraine. The river Danube drains large parts of Central and South Eastern Europe before flowing into the Black Sea. A wide range of water sector knowledge is available in these countries, developed and maintained over the years through a historic relationship of knowledge exchanges between upstream and downstream countries, particularly between Austria and the South-East European (SEE) countries. However, technical, operational, and managerial skills vary broadly among those countries, along with differing levels of institutional and regulatory capacity.

Representatives from water and wastewater utilities in the target countries have expressed the need for institutional strengthening and capacity building to address those shortcomings. Consultations undertaken by the Bank as part of scoping missions in preparation of the Austria-World Bank Urban Partnership Program (UPP) and interviews carried out by the International Association of Water Supply Companies in the Danube River Catchment Area (IAWD) among its member utilities confirmed this demand and specific country needs. To address this issue, the World Bank and the Ministry of Finance of Austria have discussed possibilities to provide Technical Assistance to the water and wastewater sector in the Danube river catchment area, including for institutional strengthening, regulatory and policy review, and utility-level capacity building. However, to be effective within the limited available resource envelope, geographic coverage of the proposed Program would need to be narrowed based on highest capacity building needs. A group of up to eleven countries would be included in the Program, namely Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Kosovo, FYR Macedonia, Moldova, Montenegro, Romania, Serbia, and Ukraine. Since capacity levels differ across countries, further sub-groups of countries might be identified based on specific priorities. Additional countries could be included once funding from other donors becomes available.

Austria maintains traditional links with the countries in the Danube region and has been an important development partner during the transition period. Particularly after Austria's own accession to the European Union (EU) in 1995, Austrian institutions have been actively involved in capacity building activities in the water sector and beyond to support institutional strengthening in view of EU accession of neighboring countries, including in the Czech Republic, Hungary, Slovakia, Slovenia, and later also Bulgaria and Romania. The proposed Danube Region Water and Waste Water Sector Capacity Building Program seeks to build on those close regional links.

II. Sectoral and Institutional Context
Urban centers in Eastern and South Eastern Europe (SEE) are undergoing a process of rapid modernization which requires adequate response in the provision of urban infrastructure and services, including water supply and wastewater. Large efforts have been put on capital investments and infrastructure upgrading, often with significant donor support, including from EU accession and pre-accession grant funding. Significant resources were allocated to the water supply and wastewater sector, including under the Instrument for Pre-Accession (IPA) and other funding programs. For example, the financial allocation for investments in environmental infrastructure, including water supply and waste water treatment under the 2011-13 IPA funding period for the seven Western Balkan countries totals EUR361.44 million. Romania and Bulgaria, as EU members, have allocated EUR4.1 billion under the Operational Program Environment (2007-13) for water supply and waste investments, but struggle to absorb those funds. However, investments in infrastructure upgrading have not been matched consistently with required institutional support for appropriate operation, maintenance and management competencies to keep up with the dynamic changes. Incentives for cost reduction and performance improvements are low. As a consequence, in many cases the newly built infrastructure is not run fully efficiently. Often, investment decisions lack strategic perspective and lead to short lifespan of assets which make it difficult to reverse the trend of increasing operating and re-investment costs, rising environmental risks and, finally, shrinking consumer satisfaction.

As a result, water supply and sanitation utilities in many countries in the Danube region lack adequate technical equipment, apply inefficient technologies, and suffer from physical decline of fixed assets that lead to a high network accident rate, poor quality of water and wastewater treatment, and excessive current cost levels. For many years it has been conventional to assume hydraulic projects would be the solution to address the main challenges of water management and water service delivery. The physical extension, operation and maintenance of water infrastructures received highest attention and absorbed a significant share of public resources. However, while such an approach works well to tackle water supply management issues, it fails to address the multiple dimensions of water demand management.

Authorities in the SEE region now recognize that there is a need for a new approach to ensure efficient service delivery and long-term sustainability in the water supply and wastewater sector. A new perspective on sustainable and secure water services has to embrace the legal, regulatory, institutional, financial, organizational and managerial dimensions of the sector. New skills and knowledge are required to ensure cost-efficient delivery of water services, mobilize additional sources for investment funding, seek partnerships with the private sector, and provide incentives for better performance. Many public utility companies in the SEE region suffer chronic problems of overstaffing, poor financial performance, low collection rates, poor service quality, and tariff structures that fail to recover costs. Only few of the more successful utilities have been able to attract funding beyond traditional sources from the municipal budget, reform their management practices, improve billing and collection procedures, and improve accountability to their customers. Reforming utility management, better targeting subsidies to low income groups, restructuring tariffs, professionalizing staff, and improving cost recovery are key ingredients for sustainable water and wastewater service provision.

However, achieving these goals will depend on solid analytical work, gap analysis and adoption of service and performance standards that are more in line with EU comparators, but also learning from through knowledge exchange and benchmarking of good practice. In addition, it will require strong political commitment to accelerate market reforms, develop adequate sector policies and provide incentives for performance improvements and cost reductions. In addition, the water and wastewater sector will need adequately qualified management personnel with the competence and skills beyond proper technical execution of current tasks, such as water supply, sanitation, wastewater treatment, and utilization of residual matter. Today, the required skills include establishing management systems that motivate service quality improvements, modernizing and developing water supply and wastewater systems with the use of more efficient technologies, creating incentives for higher capital investment effectiveness, and increasing operational efficiency through reducing per unit expenditures for labor, materials and energy.

III. Project Development Objectives

The Development Objective of the proposed Danube Region Water Supply and Waste Water Sector Capacity Building Program would be to support institutional capacity building and the development of regulatory and policy instruments in the water supply and waste water sector in participating countries in the Danube Region. The program would support (i) development of regulatory and policy instruments, and (ii) training and capacity building.

IV. Project Description

Component Name
Component 1 (Bank executed): Policy, Regulatory and Implementation Support
Component 2 (Recipient executed): Water Supply and Waste Water Utility Capacity Building

V. Financing (in USD Million)

<table>
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<th>For Loans/Credits/Others</th>
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VI. Implementation

The program will be implemented through a hybrid Trust Fund, aiming for lean implementation arrangements that avoid duplicating existing structures, strengthen established supra-national institutions in the Danube region, and leverage the comparative advantage of key stakeholders. It is expected that the World Bank and the Austria Ministry of Finance would be in a position to sign the Administrative Agreement (AA) for the proposed Trust Fund in February 2012. The Grant Agreement (GA) between the World Bank and IAWD, as recipient, would be expected to be signed before the end of the first quarter of 2012.

The World Bank has extensive experience in providing analytical support and advice to policy making and regulatory reforms in the water and wastewater sector in a wide range of member countries. Given the large Bank’s expertise in the sector, Component 1 (policy and regulatory support) would be implemented by the World Bank. Component 2 (capacity building) would be implemented by IAWD. As past experience shows, one of the key challenges of capacity building programs is to retain trained staff in their respective institutions and it is crucial to create strong ownership among Program beneficiaries. One of the key design features of this Program is to support capacity building through implementation arrangements based on a member driven approach: capacity building activities would be implemented by an institution owned by committed member utilities which are anchored in the target region. Selection criteria considered were the following. The implementing agency should (i) be based and anchored in the sub-region, but not located in (or biased toward) any of the beneficiary countries; (ii) maintain recognized sector knowledge, legitimacy, and strong ownership among beneficiaries; and (iii) have long-term engagement in the region and viability to ensure Program sustainability.

The IAWD is a non-profit association of water and wastewater utilities in the Danube river catchment area. IAWD has been established in 1993 under the Austrian Association Law with the objective to promote joint national and international efforts to avoid and reduce water supply risks, such as from pollution and other types of harms to the condition of the Danube, its tributaries (Danube River Catchment Area) and related groundwater resources. Although IAWD has been established under the Austrian Association Law, it is a transnational organization founded by water supply and wastewater utilities from 10 different countries in the region. The current president of the IAWD is Vladimir Tausanovic, former director of the Belgrade Water and Waste Water Utility (Vodovod Beograd). IAWD is funded by membership contributions. Among other activities, IAWD supports its members in all questions concerning water supply. IAWD has more than eighteen years of experience in knowledge-sharing and capacity building and would be best suited to implement activities under Component 2 (capacity building activities). IAWD is headquartered in Vienna, Austria, hosted by one of its founding members, Vienna Water Works. The association acts through its members and staff, and currently does not have own employees. IAWD’s daily operational function is hosted by the Vienna water and waste water utility (Vienna Waterworks), which is owned by the City of Vienna.

IAWD would host a Secretariat with technical, coordination, and fiduciary functions for administering Component 2. The Technical Secretariat would be established with support under Sub-component 2.3 of the Trust Fund. IAWD will maintain the overall responsibility for implementation of Component 2 and detailed roles, responsibilities, authorization process amongst project participants shall be described in the project operational manual, including a financial management section. The Secretariat would be staffed with a Program Coordinator that would be selected internationally on a competitive basis and report directly to the IAWD Secretary General. Procurement and financial management could be outsourced to a company; additional technical and/or coordination support may be staffed as needs arise, including on a part-time basis. IAWD will receive support from its members, namely Vienna Waterworks in establishing the Technical Secretariat, including handling initial procurement/ or firm or individual contracts.

A Program Steering Committee would be established to provide a facility for regular coordination between the World Bank, the Austria MoF, and IAWD. Furthermore, the steering committee would comprise representatives from other donors that may join the program later during implementation. The committee’s responsibilities will include discussing the annual work program, receiving annual progress reports, and reviewing overall implementation progress. The committee will convene once per annum but function virtually throughout the year. Additional meetings may be called if deemed necessary by at least two of the members. The Director of the Technical Secretariat hosted at IAWD would be responsible for regular reporting to the steering committee.

Program implementation arrangements will apply highest standards of transparency to ensure legitimacy of the proposed Trust Fund and avoid any perceived or real conflict of interest. The Trust Fund would be governed by standard World Bank rules and regulations. Selection of funding proposals under the competitive grant window (Sub-component 2.2) would follow clear and transparent criteria agreed with the World Bank and the MoF, and would be subject to post review based on the agreed annual work program. All key staff positions financed by the Trust Fund would be tendered internationally and awarded on a competitive basis.

VII. Safeguard Policies (including public consultation)

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</table>
VIII. Contact point

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