Summary of the Operation Performance Evaluation Review (April 2007)

THE PROJECT

In 1998, the Bank approved a sovereign guaranteed loan of US$ 20 million to the capital city of one of its countries of operations, for improvements to the municipal solid waste management system. The request from the government came about after the EBRD contacted the city to indicate its interest in working together on municipal projects. The city then approached the EBRD and another international development bank with a request for assistance. At that time, the company was loss-making, had old obsolete equipment and lacked the capacity or resources to cope with demand. The two banks developed a joint project to respond to the city's request.

While both banks negotiated in parallel, their approaches were slighly different. The other bank's loan was approved in 1998 and was a 20-year sovereign loan to the Ministry of Finance, who on-lent the funds to the municipality for the first ten years. At the time the loan was approved, it was assumed that the EBRD would lend approximately US$ 20 million and the government would contribute US$ 10 million. Additionality and the potential for privatisation were key questions. The EBRD loan was approved in 1998. The EBRD lent directly to the city for 10 years, with a sovereign guarantee. Privatization was one of the key project objectives.

The project was implemented through a Project Implementation Unit (PIU) which was paid for by the municipality with technical support coming mainly from the EBRD-administered Japanese and Dutch grant funds. The primary client and beneficiary of the project was the municipal service company responsible for solid waste management in the city. The loan was administered by the Department of Investment within the municipality, but also required approval from the Ministry of Finance. Indeed, from 2004, all amendments to the EBRD loan had to be approved by the Ministry of Finance as guarantor. This effectively increased the paperwork and added to delays in obtaining extensions, amendments, and so on.

PROJECT RATIONALE

By the mid-1990s the situation for the municipal service company had become intolerable: waste handling equipment was old and obsolete and illegal dumping had become a major problem. In contrast, today, one is impressed by the cleanliness of the streets, new collection trucks are out and visible, collection points are safe and there is much confidence in the system.

The other bank took the lead on the technical side, while the EBRD took the lead on the institutional (via TC) and commercial side. The EBRD brought two important transition impact (TI) features to the project. The EBRD's major focus was on sector reform, achieving real tariff increases of 50 per cent, and promotion of privatisation by contracting out at least 50 per cent of the waste collection services. Thus the EBRD's focus was, rightly, on transition. Through these two key covenants, the EBRD hoped to introduce a more private sector orientation to solid waste management. The EBRD was also able to offer significant TC support to the PIU.

ACHIEVEMENT OF OBJECTIVES

This evaluation rates fulfilment of objectives as *Satisfactory* for the reasons explained below. This rating is primarily based on the successful rehabilitation of the equipment and company facilities and the less than successful privatisation and tariff increases.

The main project objectives were to:

- Promote the corporatisation and improvement of the operational and financial performance of the municipal service company. Rating: *Partly accomplished*

- Encourage private sector participation in the provision of solid waste services. Rating: *Not accomplished*
- Restructure the city municipal service board. Rating: *Partly accomplished*
- Rehabilitate and update the municipal solid waste collection and disposal system. Rating: *Accomplished*

To support the project objectives, it was decided to employ technical assistance in order to mitigate a number of factors which had contributed to the inefficiency of the system, as identified during project preparation. To help the city to implement measures addressing these shortcomings, four separate consultancy assignments were included with the project. Support for the PIU was one of the assignments. By all accounts the TC objectives were achieved. There were, however, initial problems with the municipality not fulfilling some of the requirements in the contract. Project implementation has in general been slow. From the perspective of the PIU, this can be attributed to the complicated international competitive bidding procedures, a bureaucratic municipality, repeated loan extensions and the associated paperwork, and so on. The objectives of the TC assignment were very relevant and indeed essential for the success of the project as a whole. Without the consultants' support, the PIU would not have been able to implement the project in such a successful manner, since they lacked the necessary skills and knowledge, especially of the lenders' procurement, disbursement, and reporting requirements.

OVERALL ASSESSMENT

The project is rated *partly successful* overall as compared with the Expanded Monitoring Report (XMR) rating of *successful*. Transition impact and financial performance are rated *marginal*. Fulfilment of objectives is rated *satisfactory*. Environmental performance is rated *satisfactory*, while environmental change is rated *outstanding*. Additionality is *verified in all respects*. Overall implementation of the TC is rated as ***successful*.** However, EvD arrives at a fundamentally different assessment on project ratings, as compared with the banking team,[1] for the following reasons:

- The Bank's primary focus was, rightly, on transition impact with its primary objective being privatisation. While local privatisation was happening, the banking team focused on international privatisation, which in EvD's opinion was an unrealistic objective, reflected in the fact that this objective was abandoned early in the project.
- The project structure underestimated the time required for implementation, thus requiring constant, costly, and unnecessary delays in implementation, as project agreements were updated annually. Too much of the banking team's time and effort was spent on updating the project agreement rather than on implementing it, and cost savings were cancelled rather than reprogrammed.
- There was also an initial failure by the city to provide promised counterpart funding on time, which delayed the start of the consultant's work and therefore of the project. Later delays in providing counterpart funding for district garages, meant that equipment purchased under the project was left in containers. Further, there were delays by the city and state in responding to simple legal documentation. As a result, the EBRD (Credit department and banking team) became increasingly reluctant to consider extending the project, and the relationship soured from both sides.
- While the project has resulted in significant positive institutional and environmental change, the environmental objective – to raise environmental performance to EU levels –

[1] The XMR rates transition impact, financial performance and fulfilment of objectives as *good*.

was also unrealistic.

While some of the “blame” can be attributed to the deteriorating political and investment climate in the country, the problems of this project are primarily internal to the project. There were significant positive development impacts coming out of this project, specifically the new equipment and upgrades to the solid waste system, but without a tariff increase financial sustainability remains an issue. The EBRD works in transition countries. As it moves further east there are potentially several projects of this nature with obvious development outcomes but with limited transition impact. There is an issue of timing. Restructuring an organisation has obvious development impacts. A key lesson learned from one of the Bank’s most successful MEI projects is that restructuring is a *precondition* to successful privatisation.

The project presents a fundamental challenge to the EBRD. In a developing country like the one in question, if the primary objective of the Bank remains one of transition impact rather than Development, which organisation – the EBRD, Asian Development Bank (ADB) or the World Bank – is best placed to take leadership? Should the EBRD be more willing to take on a broader development focus in these countries?

TRANSITION IMPACT AND BANK'S ADDITIONALITY

If measured on development outcomes, the project would most likely be rated successful, although there is a serious risk of lack of sustainability. However, the Bank’s focus is on transition impact. EvD rates transition impact as *marginal*. From the EBRD’s experience in other sectors, public utilities follow a transition event timeline: first the state or municipally owned company needs to be restructured, made more efficient, its equipment upgraded and put on a strong financial footing via a tariff regime that is both affordable and transparent. This allows the company to achieve full cost recovery and make a reasonable profit. Once this process is complete, various forms of privatisation and PPPs become more viable.

The municipal service company was clearly located at the beginning of this event timeline. It was necessary to upgrade the equipment and restructure the company. The technical objectives of the project have been met, but the company remains a municipally owned loss-making company. Early in the project the Bank abandoned its target of 50 per cent private ownership. Perhaps the mistake was in the assumption that private ownership equated to foreign private ownership, as the initial tender was structured to encourage the latter. Foreign sponsors are unlikely to be attracted to an environment where currency convertibility remains an issue and it is difficult to export earnings. For public utilities, perhaps starting with local ownership and proving the viability of such an approach is an important first step, although, there may be integrity issues associated with local sponsors.

There have been changes in the law that facilitate corporatisation and allow for private ownership of utilities and there has been one successful privatisation. In fact, just as the project is closing down, the company is at a point where real transition could happen. Financial restructuring and privatisation are much more reasonable objectives today than they were in 1998. In this respect the project can be said to have achieved some transition if not its originally planned objectives.

The Board paper argues that the case for additionality is based on (1) the need for IFIs to undertake such investments, and (2) the push for sectoral reform, specifically led by the EBRD. Both the World Bank and the ADB offer better terms for sovereign lending, and the World Bank can fund up to 95 per cent of any project, whereas the EBRD is limited to 50 per cent for sovereign loans. Indeed, at one point, the EBRD considered withdrawing from the project.

Thus, while the Evaluation Department agrees that such projects can only be funded via IFIs and local resources, it is not clear that the EBRD’s financing was critical. However, the EBRD offered grant funding for TC, which was essential. The Bank defined its unique role in this project as pushing for sectoral reform, tariff restructuring and privatisation of services all of which were important design and functioning attributes, even if not fully accomplished. Additionality is therefore rated *verified in all respects.*

BANK HANDLING

Bank handling is rated as *satisfactory*. Both clients (municipality and director of the municipal service company) described the EBRD as being "more bureaucratic and slower" than the other bank. This was a striking comment as the Bank is normally recognised as being quicker and more efficient than the other multilateral development banks. While this comment partly reflects the changed political reality and distancing between the EBRD and the government of the country, this comment had much to do with deal structuring; the EBRD's unwillingness to programme the remaining funds at the end of the project, even though the EBRD had previously approved the tenders and bids had been received; and a different approach to project monitoring.

MAIN OPER ISSUES AND LESSONS LEARNED

Restructuring public utilities will usually involve tough tariff decisions. To achieve its transition impact objectives, the Bank needs to ensure that the government is committed to making the necessary tariff adjustments. Without these, the utility will remain loss-making and therefore will not be an attractive privatisation target. Also, in this case, the municipal rules only allowed for collection of fees from registered residents whereas the company collects waste from all residents. Allowing for collection of fees from all city residents would go a long way to achieving profitability, as demonstrated by the one local private operator.

In a difficult investment environment, local privatisation may be a good first step. A local entrepreneur, and previous district manager, established his own firm to provide solid waste services in the city's largest district. His secret of success was obvious – cut costs and increase revenue. His success provides a demonstration to others. As his company grows and is financially successful, it will be an obvious takeover target for potential international operators once the investment climate improves.

Project objectives should be achievable within the life of the project. EvD would argue for establishing clearly stated and realistic objectives. For example, both management and the Board should have questioned the appropriateness of EU environmental standards for solid waste management in the region, and the likelihood of international privatisation.

Project implementation duration needs to be realistic. EvD would argue that project implementation should reflect realistic time estimates for international procurement. Allowing for extra time will save on contract amendments, and projects that are able to respond quickly (two to three years) will perform better than projects that take the same time but require multiple amendments.

Monitoring of public sector projects requires a more structured approach. The Bank needs to take a more structured approach to monitoring of public sector projects, particularly when there are multiple stakeholders.

Maintain flexibility in funding decisions. The Bank's response to cost savings was to reduce disbursements accordingly. As this was a sovereign guaranteed loan, an alternative approach could have been to expand other procurement packages and provide additional equipment. While the debt burden on the company might have exceeded prudent limits, it could be argued that, as the municipality continues to support the company, this would have better met the specific needs of the client, while maintaining the EBRD's profitability. The EBRD took one approach – to limit disbursements – while the other bank took the other approach – to reprogramme the funds.

Joint evaluation may prove difficult to coordinate. Both the EBRD and the other bank worked in good faith to carry out a joint evaluation, but because of timing and procedures this proved difficult to achieve. The EBRD would have had to delay the evaluation by a second year. What may prove equally interesting in certain circumstances to the donors may be to compare two separate and independent evaluations reflecting each organisation's objectives and evaluation structures.

The final three recommendations are specific to the TC assignment

Demands on the client should be realistic. It is perfectly reasonable to ask for a contribution from the client in order to show his commitment, but if it is known that certain items are difficult in practice for the client to finance, it may be preferable to include them in the loan agreement or TC budget rather than spending much time and energy on convincing the client to live up to their obligations.

Don't change a winning team. If the relationship between the client and the consultant is good, the consulting firm should be encouraged to keep the particular consultant in place for as long as possible.

Have sufficient funds ready for possible extensions. If it can be expected that a loan agreement will have to be extended (for example due to procurement procedures), it may be prudent to identify in advance possible sources of funding for extending the associated TC so that these funds can be mobilised quickly in case the TC indeed needs to be extended as well.