1. HISTORY AND BACKGROUND OF THE BANK’S OPERATIONS IN MUNICIPAL AND ENVIRONMENTAL INFRASTRUCTURE IN ROMANIA

Sector overview. In the early 1990s, the Romanian water utility sector (supply and sewerage/waste-water treatment) was faced with important structural issues. After 1989, investments in the sector were virtually frozen.

The 1991 Law on Local Public Administration awarded the autonomy and responsibility for water supply and sewerage services to local/municipal governments through their fully owned public enterprises, namely water utility companies. Despite this, the local governments were confronted with significant financial constraints on investments in water infrastructure for two major reasons: (i) revenues depended substantially on central government budgetary support, while the level of local taxes was also determined by central government; and (ii) the local government’s own revenues were low. Moreover, investment planning was conducted on an annual basis, therefore lacking a long-term perspective. As a result, the municipal infrastructure was mainly financed from earmarked transfers from the central government.

Inadequate investment exercises and lack of financing aggravated the status of water infrastructure, particularly for sewerage and waste water. Major problems that emerged were intermittent supply, significant water leakage, over-consumption due to absence of individual metering, inadequate facilities for sewage in urban areas, poor state of waste-water treatment facilities, etc. The quality of services and physical facilities largely lagged behind EU standards. Further, water utility companies urgently needed to improve accounting, financial and budgeting practices including cost control. Appropriate tariff-setting mechanisms appeared to be necessary.

The Bank’s involvement in the sector dates back to 1995. The first investment was Municipal Utilities Development Programme (MUDP I) consisting of a US$ 28 million sovereign loan for on-lending to regional water companies in five major cities. The total project cost was US$ 60 million including US$ 1 million grant-based technical assistance from the EU-PHARE. The objectives were to (i) introduce cost recovery principles in the sector; (ii) promote corporatisation and decentralisation of the sector; and (iii) improve the water service quality in accordance with the Black Sea and Danube River Basin Environmental Programmes.

With the grant-based assistance, the Financial and Operational Performance Improvement Programme (FOPIP) was developed by a team formed of operational and financial experts from a privatised UK water utility company. The primary objective of the FOPIP was to define the operational and financial target for institution-building in water utility companies, thereby concurrently improving the service quality to users. The Bank’s loan was approved at the end of 1994. The loan became effective in September 1995. However, it took long time for the conditions for the first disbursement to be satisfied.

Due to the delay in disbursement of MUDP I, the Bank swiftly formulated and approved the Regional Water and Environment Programme in July 1996. This facility was expeditiously disbursed in June 1997 following the loan conditions being met in December 1996. The original commitment was US$ 25 million, which was later reduced by a cancellation of US$ 16 million when MUDP disbursements began in August 1996 and the upcoming MUDP II was made available for the same objectives. This facility served as a transitional instrument to meet urgent needs in the sector.

MUDP I provided some valuable lessons with respect to implementation, loan administration and monitoring of the multi-borrower parallel-financed sector facility. For example: (i) monitoring of the multi-borrower programme was difficult and exhausting for Bank staff; (ii) there were insufficient resources and capacity in central government for monitoring and implementation of the complex facility; (iii) physical implementation to international standards was difficult despite established Romanian engineering practices; and (iv) the FOPIP worked effectively and helped the water companies to improve their financial performances. Incorporating the lessons learned from the
implementation of MUDP I, MUDP II involved a loan administration bank, which was expected to serve as an interface between the Bank and the water companies.

MUDP II was formulated and approved by the EBRD in July 1997. MUDP II comprised a US$ 75 million sovereign loan for 15 years with an on-lending scheme to water companies in various cities (10 different cities for water supply and five different cities for waste-water and sewerage upgrading). Given the extensive coverage of the project and monitoring activities, two Romanian banks with experience in the Bank’s investments were selected as the loan administration banks.

The EU-PHARE provided US$ 33.8 million in grant funds coupled with US$ 6.4 million in grant-based assistance for implementation support. The Dutch government and USAID also assisted MUDP II in TC. The TC aimed to support the water companies in various areas including preparation of tender documents, procurement, monitoring, reporting, construction supervision and financial administration. Continuation of the FOPIP was included in the scope. Assistance to the loan administration bank in capacity building for monitoring as well as to the government in necessary legislation and institutionalisation of municipal credit was also provided.

In November 1998, the Evaluation Department (EvD) conducted a mid-term review of MUDP I including part of the preparations for MUDP II and, in March 1999, and assessed it as successful indicating that it had the potential to be highly successful if the cost-recovery principle could be integrated in the sector through future financing.

In October 2000, the Bank’s sovereign exposure to the sector for 16 water utilities companies reached €136.5 million in commitments and €90.1 million in disbursements. The following month, the Bank approved its third intervention in the sector, an €80 million municipal environmental loan facility (the MELF), for 15 years including a four-year grace period. The MELF was parallel-financed by the EU’s Instrument for Structural Policies for Pre-Accession (ISPA), which committed €150 million in grant funds. The Bank and ISPA jointly aimed to advance the momentum generated under MUDP I and II: and to (i) improve the physical facilities and the quality of water supply and waste-water services up to EU standards; and (ii) develop utility-based lending — a stand-alone financing capacity without sovereign guarantee, thereby requiring cost recovery in the water supply and waste-water services.

In December 2003, ISPA provided €7 million in grant-based assistance for customary implementation support, legal advice for the direct agreement structure and carrying out of the ongoing FOPIP. In January 2004, the Dutch government committed €800,000 in TC finance to support monitoring of physical and financial implementation, compliance with covenants and financial reporting to the donor and the Bank.

The EBRD’s long-standing policy dialogue with the central government came to fruition. The country’s laws were amended to enhance the local government’s guaranteeing ability, which enabled them to introduce a new aspect into the MELF: the Bank’s direct lending to water companies under the respective local government’s financial guarantee and project support undertaking. The central government still took part of this project structure as the party which had a direct agreement with the Bank. As of the end of October 2006, nine water utility companies have benefited from the MELF.

**Market consolidation and regionalisation.** The Romanian water utility sector shows signs of competition and market consolidation. Each water company tries to expand its area of services beyond its administrative territory in order to increase customer numbers and revenues, thus competitiveness. The trend indicates that the outreach and coverage of water utility services is going to increase. There are about 200-300 water companies in total of which around 50 are large

---

1 The Bank provided US$ 0.2 million of TC under its loan for small ad-hoc consulting services.
firms. This number is likely to decrease to 12-15 through consolidation of the largest ones in the future.

**Sector financing.** For a decade, the Bank and the EU PHARE/ISPA have been the most prominent contributors to investments in the sector. The ISPA committed €1 billion in 2002-06 (now extended to 2010 for implementation) in environmental investment in beneficiary countries. Romania, allocated €250 million, was the second largest beneficiary after Poland. However, the disbursed amount has been lower than expected. The implementation of ISPA-financed projects appears to have been slow for various reasons. One of the reasons is the institutional capacity of the beneficiary water companies, particularly in finance, which needed significant improvements.

The ISPA has operated to enhance the financial capacity of the beneficiaries, to increase the absorptive capacity\(^2\) for funds and to exercise the solidarity principle. The financial and economic viability of each ISPA water infrastructure project is considered particularly vital and needs to be guided by the MRD (Maintenance–Replacement–Development) principle. The FOPIP was undertaken under such an initiative so as to introduce market-based management tools to water companies in Romania.

The ISPA in Romania was due to finish at the end of 2006 when the EU Cohesion Fund was due to take over. EU Cohesion Funds are not available, in principle, for municipalities that use a private sector company to operate their assets.\(^3\) This could have grave consequences for Romanian municipalities and water companies, which are still in need of grant-based finance. During 2006, discussions were held by the utility companies. Among the water companies participating in the MELF, the majority have chosen to refrain from private sector participation in order not to jeopardise their eligibility for the EU Cohesion Fund (also see transition impact).

### 2. THE PROJECT

**Project overview.** The Operation Performance Evaluation Report (OPER) primarily covers the Bank’s TC MELF Framework for €800,000, which was approved in December 2003. The TC was financed by the Dutch government on a bilateral basis.

**TC assignment and consulting services.** The TC objectives were to conduct regular monitoring of investment progress and to help the water companies in the implementation of projects, thereby strengthening each company’s in-built monitoring capacity.

Within these objectives, the purpose of hiring the consultants was defined as (i) assisting the water companies in satisfying the conditions of the MELF; (ii) reporting to the Bank on the physical progress, drawdown processing and planning, compliance with covenants, environment and financials; (iii) liaison with the Bank, the water companies, the central finance and contracting unit of the Ministry of Public Finance, and the ISPA; (iv) carrying on the FIPOP; and (v) developing the water companies’ institutional capacity and enhancing operational and financial performance. To build the monitoring capacity in each water company, training was expected to be carried out jointly with the Bank staff.

The selection and engagement of consultants was conducted in accordance with the Bank’s guidelines and rules. The tender for consultancy services was launched in February 2004. One of the three shortlisted consulting firms was selected in June 2004 and the consulting services

---

\^2 Absorptive capacity is defined as the size and scale of projects requiring the ISPA funds. In this sense, larger entities and projects are preferred as a larger water company can utilise the ISPA funds more effectively.

\^3 However, the provision is given that a water company, having chosen a private partner to operate the services via concession contract, is eligible for further EU grants if the tender for selecting the private partner has been organised according to EU principles (transparency, proportionality, equal treatment and non-discrimination) and if the grant funds do not become profit for the private partner but reduce the burden on the population paying tariffs to the operator.
contract was signed in July 2004. The consultants, in association with a Romanian consulting firm, commenced work in August 2004. The 29.3 person-months of service were expected to be completed by the end of 2004.

The actual completion date was extended to the end of 2006 and took 25.8 person-months of work. This was because the services were carried out intermittently and the ISPA assistance was run in a parallel manner. No major changes in the contract have occurred to date. The operation considered that the consultants’ performance had been excellent. At the end of 2006, only €533,982 had been disbursed indicating a relatively low utilisation.

3. PROJECT RATIONALE

The major rationale of the TC assignment was to ensure, in a systematic manner, adequate monitoring of large complex municipal infrastructure projects, which involved several parties and different borrowers, and therefore required significant coordination for the implementation.

4. ACHIEVEMENT OF OBJECTIVES

The overall achievement of objectives of the TC assignment is considered good. The following are the major tasks that were fulfilled. Most of the tasks were properly performed and the TC objectives have been achieved.

4.1 Satisfying the conditions for the first disbursement

The lead time to the first disbursement of the MELF appears excessively long despite the consultants’ support. The major causes of the delay are identified as (i) uncertainty about the security structure; (ii) some contractors’ poor performance or inadequate capacity to carry out the works; (iii) difficult tariff increases undertaken as a precondition to the first disbursements; (iv) transformation of some water companies into commercial entities; and (v) delays in meeting commercialisation requirements, namely entering into a service provision contract between the water company and the municipality.

Due to the technical difficulties in complying with the conditions, the Bank decided to waive the conditions in several cases. However, most of the conditions are related to transition, which the Bank endeavoured to deliver. Therefore, the OPER team considers that the realisation of certain transition impacts resulted in the slow start of disbursements. The achievement of this objective is satisfactory.

4.2 Loan disbursement monitoring

The consultants updated the physical and financial progress of the Bank’s components in each sub-project. The tasks included: (i) forecasting the level of disbursements; (ii) reporting the status of works and identifying problems, if any; (iii) identifying the necessary actions for efficient completion of works; (iv) identifying the surplus proceeds (loan savings) and proposing the use of proceeds as relevant.

The construction progress varies from a water company to another. The Bank’s components are expected to be completed during 2007. On the other hand, the ISPA components, particularly waste-water treatment plants, still show slow progress and some are only 40-50 per cent completed.

---

As part of the tasks to achieve this objective, the consultants were requested to assist the municipalities and the water companies in preparing and drafting the service contract. The service contract constituted an important element of the Bank’s pursuit for private sector involvement in the sector. As later mentioned, however, some were accomplished while others did not reach signing.
Close monitoring of financial progress enabled some water companies to identify uncommitted surplus funds (loan savings) in the early stage of construction.

**4.3 Capacity-building and training at water utility companies**

As observed by the OPER team, the institutional capacity largely varies from one water company to the next. The consultant regularly kept in touch with the water companies and attended to their specific needs with a great deal of flexibility. A workshop was held in May 2005, where training for financial reporting was conducted by the consultants. All the water companies sent representatives to the training. The OPER team learned that the participants found the training very useful.

**4.4 Continuation of the FOPIP**

The Bank pursued the FOPIP under the TC operation. The financial model developed under MUDP I and II and the MELF was made available to each water company.

5. **OVERALL ASSESSMENT**

The TC operation, aimed to ensure smooth implementations of multi-borrower sector facility, is considered _successful_. Despite a slow start-up of disbursements and some difficulties in tendering and the Romanian construction market, nine water companies have participated in the MELF and a total of €41.5 million was disbursed as of October 2006 (50 per cent of commitment utilisation). The fulfilment of TC objectives is considered _good_. The TC also served to fill the gap when ISPA’s assistance for the FOPIP was unavailable and advanced its achievements. A financial model developed under the FOPIP has had significant positive impact at corporate level for all the water companies. Transition impact of the TC operation is therefore considered _good_ while some risks in the sector still exist. The operation team delivered good implementation practices, which were highly appreciated by the water companies. Bank handling is assessed as _good_. The implementation TC for the large co-financed facility has strong additionality, _verified in all respects_.

6. **TRANSITION IMPACT AND ADDITIONALITY**

Transition impact of the TC operation has mainly been experienced at the corporate level. It comprised changes of business standard in financial management. Financial and operational reporting exercises made the water companies aware of their own financial positions and the obligations of borrowers, such as tariff increases and compliance with financial covenants. It facilitated a shift of financial norms from public finance in a centrally-planned economy to profit-seeking commercial services. At a larger scale, the TC operation helped all the water companies achieve compliance with the covenant of tariff increase, thereby improving the financial position of the water companies, creating significant competitive advantages over the other water companies that did not participate in MELF. The OPER team considers the transition impact of the TC operation _good_ with _medium_ risks.

6.1 Company impact

6.1.1 **Private ownership: corporatisation, commercialisation, PPPs and privatisation**

The water companies are wholly owned by the respective municipalities. Even though the water companies are legally independent entities, often the management and/or board were formed of former local government officials or local council members. The Bank has encouraged the water companies to enter into a service contract with their municipality. This aimed to clarify the scope of businesses and mandate in a transparent manner, to introduce governance and an incentive scheme for increased efficiency in operations and to ensure the appropriate environmental
standards are used as operational indicators. The service contract is still considered as a very first step towards commercialisation. The consultants helped the water companies and the municipalities to draft the service contract. A further stage of transition toward privatisation is characterised as a public-private partnership (PPP), which includes a concession agreement with a private sector operator. This has also been one of the sector agendas promoted by the Bank.

A review of the status of commercialisation reveals that only a few sub-projects have been able to move in the direction that the Bank encouraged. The main reasons for this were initial resistance to entering into a service contract, which seemed unconventional. Under the current regulations only a commercial entity was allowed to enter into a service or concession contract with the local government. Therefore, the water companies needed to transform into a corporate firm with a commercial mandate. The government’s newly introduced framework service agreement required a level of consistency between existing service contracts and service contracts to be signed.

The Bank has been satisfied with the involvement of the operation team and consultants. The interaction and dialogue have delivered significant transition from within the water companies. Although the outcome is marginal, the transition impact achieved at the corporate level is considered satisfactory.

6.1.2 Financial models as a commercialisation tool

The financial model developed under the FOPIP and the TC represents a new reporting technology. This spreadsheet model was designed by the consultants under the FOPIP and has been developed under the TC. It is tailored to each water company to produce (i) on an unaudited or indicative basis, a set of comprehensive financial statements (balance sheet, cash flow statement and profit and loss statement), (ii) compliance status with the financial covenants with respect to MUDP II (if applicable) and the MELF; and (iii) key operational figures such as quantity of supplied water and waste water. The input section requires consumer price index (inflation) information and some project costs.

This model has a number of significant advantages as follows:

- Reducing necessary resources for financial reporting.
- Improving the accuracy of financial data.
- Close and proper monitoring of financial position, particularly financial covenants and key ratios. The model helped the water companies to monitor the financial covenants such as receivables collection (debtor days) and debt service coverage ratio.
- Early warning of covenant breaches.
- Verifying appropriate tariff levels. To date, all the participant water companies have increased tariffs as required and continue monitoring for the next increase in accordance with the loan agreement.
- Accumulating the sector financial performance at the Bank.

All the water companies that the OPER team visited were highly appreciative of the financial model and mentioned the benefits. Several water companies advised that it would be even more beneficial if the model could deal with the ISPA requirements as well.

When the water companies started using the financial model, the output figures showed significant variations among the companies because the familiarity and understanding of financial data and ratios was still low at the project implementation units. Reconciliation and consultation efforts were made by the consultants and the project implementation staff of each water company. Through the consultative process, the water companies have become aware of their own financial positions in comparison with the others.
The consultants were sometimes asked by water companies for guidance on their financial status or advice when they were made aware of potential covenant breaches in the financial model. The model fosters proactive actions on the investment. In the longer term, improved practices should help the water companies improve their creditworthiness and the basis for fair comparison and competition, thus building competitive advantages over the non-MELF participant water companies. The verified impact at corporate level is considered good.

6.1.3 Risks associated with transition

Consistency with the ongoing sector reforms

The TC aimed to facilitate implementation of the investment, particularly by clearing the conditions for the first disbursement. However, the first disbursement to several borrowers was significantly delayed due partly to changes in certain regulations.

Two examples are given as follows:

- The Bank had to waive the pledge on shares of the water companies as the enforceability of the pledge against Romanian Law was called into question. The outcome suggests that (i) regulatory risks are not negligible in the country; and (ii) the creditworthiness of the water company needs to improve further.

- The government introduced a framework service contract. New service contracts need to be carefully examined for the consistency with the framework. Existing service contracts between the water companies and the municipalities need to be reviewed and revised as necessary.

Mixed signals on accessibility to the cohesion fund

It seems to be widely recognised that the EU Cohesion Fund is reluctant to provide grant-financed assistance to municipalities which have involved a private sector operator. This perception is derived firstly from (i) past difficulties in obtaining EU grants for municipalities using private sector operators for utility services and (ii) erratic eligibility of grant funds due to frequent changes in, and ambiguity of, the rules.

It seems that many water companies are unwilling to go beyond commercialisation, and prefer to remain wholly publicly-owned “commercial” companies. Moreover, the ISPA required the beneficiary to maintain ownership of the ISPA-financed assets at least for 5 years after completion. Therefore, any PPP scheme which significantly affects the ownership rights is to be avoided by the water companies.

On the other hand, there is a view that the EU is generally positive about providing grants to private utility companies. The underlying principle is that the water users, not the private sector operator, should benefit from the grant fund. In fact, the EU Cohesion Fund does not preclude the water companies from entering into a concession agreement with a private sector operator.

However, it is very unlikely that the water companies would risk their eligibility for access to grant finance by selecting even a moderate form of PPP. Whilst the Bank has long encouraged private sector initiatives in the sector, more time and effort is necessary for the participant water companies to move on to private sector operations. Overall the OPER team perceives the risks for transition to be medium.

6.2 Impact on industry and the economy as a whole

The TC operation, through the consultants, ensured the increase of water and waste-water tariffs to comply with the loan agreements, therefore improving the financial position of water companies participating in MELF. All the water companies reported substantial tariff increases, some were more than expected. It seems that increasing tariffs is easier when the project is financed by an
international financial institution (IFI) because the relevant authorities as well as the public are more accepting of the IFI’s requirements for cost recovery. The establishment of an independent body to communicate between users and the water companies also helped to gain overall public support. The OPER team considers the transition impact of the TC operation at larger scale satisfactory.

6.3 Company financials and environmental impact

Significant delay has occurred in the ISPA components of the sub-projects, particularly for construction or upgrading of waste-water treatment plants. As some of the sub-project investments are still ongoing, it is premature to examine the ex-ante environmental impact. Compliance with the financial covenants has overall appeared satisfactory to date.

6.4 Country strategy and sector policies

The TC operation has high relevance to the country strategy applicable to the TC. The country strategy stated that “the Bank’s primary focus will be to enable municipalities and utilities to improve their financial and operational performance and to strengthen the institutions and the regulatory framework. Achieving these objectives should enhance companies’ credit worthiness and enable private sector transactions”. In this context, the MELF was mentioned as a specific activity.

6.5 Additionality

The Bank’s additionality to the TC was strong. Lessons from two large facilities in the past suggested that monitoring activities across all the participant water companies was the key to successful operations. The TC was designed to mitigate the weaknesses identified in the previous implementation process and to reinforce the momentum of long-term assistance, such as the FOPIP. Without the TC, the water companies could not have achieved corporate development to the same extent. Similarly, the Bank could not have exercised a comprehensive monitoring of each sub-project. The OPER team has verified the additionality in all respects.

7. BANK HANDLING

The OPER team considers that the TC operation has been dealt with in a coordinated and professional manner. Therefore, the Bank handling is assessed as good. A few remarks are provided as follows:

Ambiguity of terms of reference

The consultants’ assignment embodied two distinct tasks: (i) providing the water companies with guidance on implementing the projects in accordance with the Bank’s guidelines; and (ii) enabling the FOPIP to continue. The latter was overlapped by the ISPA technical assistance for a certain period. Therefore, specific tasks or milestones were not defined in the terms of reference (ToR) with respect to the FOPIP. It was a “large envelope” deal, which provided the consultants with much flexibility on one hand, but no particular specificity on achievements to be delivered on the other. Running similar assignments with overlapping scope of services from the same consultant could have advantages and disadvantages. It could increase effectiveness in services as the consultants and the beneficiary companies become more familiar with each other. On the other hand, however, it might be inefficient to have the same services from different donors. The disbursed amount under the Bank’s contract with the consultant reached only reached two-thirds after three years. Although it is difficult to take stock of ongoing exercises like the FOPIP, the Bank could have been more precise in the ToR and coordinated better with the other agencies.

Project scope and concept
The consultants’ monitoring of implementation should have included the ISPA components as well. The consultants have regularly updated the construction progress, but only with respect to the Bank components. As the project concept was designed and presented to the board as one integrated project jointly financed by the Bank and the ISPA, the Bank’s monitoring should follow the same scope and project concept. The OPER team was advised by some water companies that they are unwilling to discuss the progress of the ISPA components because the ISPA components did not concern the Bank’s financing. The project concept set at appraisal should be maintained throughout the implementation period.

Good implementation practices

The operation team including the sector procurement staff and the environmental specialist worked together to ensure project implementation. From the inception of the TC, the Bank’s environmental staff made sure that the environmental policy and guidelines would be translated into the Romanian language, so that all the water companies’ staff could understand fully. Environmental training was conducted concurrently with the consultants’ workshop. The comprehensive environmental reporting formats were distributed with guidance. Many participant water companies advised the OPER team that the training was beneficial. The sector procurement staff provided the water companies with guidance from time to time, which was also appreciated. The Bank’s operation leader was at the Resident Office, which facilitated communications and the project implementation. The quality of monitoring reports is considered good.

8. KEY ISSUES AND LESSONS LEARNED

8.1 Modern reporting intelligence reduces hidden transaction costs of IFI-financed projects.

Financing from IFIs such as the EBRD, other multilateral development banks and the ISPA sometimes entails hidden transaction costs to the borrowers or beneficiaries. The typical example is data collection and report preparation. In a co-financed project, such reporting exercises can mount up since each IFI has specific requirements. Under the MELF, the Bank and the ISPA required reporting separately and independently. The FOPIP facilitated the borrowers’ financial reporting, thus turned a time-consuming task to a diagnostic process for financial status. Some water companies informed the OPER team that they used the model only for reporting purposes at the beginning, but later realised that it had many other benefits. Transition occurs when reporting exercises go beyond the obligation for the company’s own benefits. Similarly, the standardised formats for environmental monitoring prepared by the Bank’s environmental staff provide the borrowers with the same benefits and the Bank with significant intelligence about the sector.

Standardised monitoring across the borrowers can maximise the benefits of the sector programme through quick, easy and accurate comparison of multiple enterprises in the same industry across different regions. It also creates a large standardised historical database. It is considered as a valuable asset for the Bank in the sector.

**Lesson learned:** Ingenuity of monitoring tools can benefit not only the bank but also the borrowers. Monitoring of lending was the area which required most technology and intelligence in this municipal and environmental infrastructure (MEI) project. Primary benefits of systematic and standardised monitoring technology accrue to the Bank in terms of maintaining the quality of the target portfolio. While good monitoring can also benefit the borrowers through enhanced approach in data collection and analysis. Monitoring exercises in this operation have greatly been enhanced when the borrower recognised the value and benefits of such exercises.

8.2 Good implementation track record in long-term assistance
Managing multi-borrower projects is a daunting task, particularly when the institutional capacity of the borrowers varies largely. At each facility from MUDP I to the MELF, the Bank incorporated lessons learned from the implementation of the previous project into project implementation arrangements, and allocated consultancy services appropriately to the areas in need of improvement. While progressively improving the efficiency and effectiveness of implementation, the Bank constantly maintained its policy dialogue in the sector. Its long-term commitment to the sector has gained trust and cooperation from the government, municipalities and the water companies. The policy-level dialogue, along with the Bank’s good field knowledge and commitment to better implementation contributed to the successful achievement of certain important sector agendas such as upgrading the local government’s guaranteeing ability and tariff reforms.

The water companies, which participated from MUDP I and II through to the MELF, have expressed their appreciation for the Bank’s support to the sector. They stated that the Bank’s guidance was unbiased and based on a long-term perspective. They also consider that the Bank’s guidance mostly proves to be correct over time.

**Lesson learned: Large sequential sector facilities in MEI provide opportunities for successful policy dialogue by constantly improving the implementation process.** Feedback from project implementation is the most useful input for sequential phases of long-term sector programmes. Therefore, lessons effectively incorporated into the MEI project cycle facilitate successful future projects, thereby gaining trust and good understanding of the Bank’s long-term endeavours in the sector. It might eventually lead to fruitful policy dialogue on major sector issues.

### 8.3 Successful tariff increases in large sector facilities

Successful tariff increases at the early stages of the project made a positive difference to the financial standing of each water company and therefore made implementation easier. There are four major elements of success for tariff increases in the MELF: (i) a covenant to increase tariffs, ideally as a condition for the first disbursement, proves to be a powerful way of gaining support for tariff increases from local authorities and the public; (ii) the financial model, which can demonstrate to the water company how the tariffs could impact on the financial results; (iii) the consultants’ assistance and guidance was readily available according to the needs for the water companies; and (iv) raised awareness and support of the public and the government officials prior to or at the beginning of the large construction works.

**Lesson learned: Actions and allocation of resources at the beginning of the project increase the chance of success for a difficult sector agenda.** While requiring tariff increases was a condition of the facility, the Bank allocated resources for this operation up-front to support the water company’s proposal and action to increase tariffs and improve conditions. Gaining public and local government’s support for tariff increases is easier when construction works to improve service remain fresh in people’s memories.