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**COMMUNICATION FROM THE COMMISSION
TO THE COUNCIL AND THE EUROPEAN PARLIAMENT**

Establishment of an EU Water Fund

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1. BACKGROUND

Water plays a vital role for sustaining life and human development on this planet. More people die every year world-wide from unsafe water than from war. In Africa close to 40% of the population are without access to safe water supply and even more lack adequate sanitation.

Water is critical for human health, sustainable rural development and food security (agricultural production accounts for 70% of water use), environmental protection (water pollution and bad management of the resources undermines economic development opportunities), gender issues and land resources management. It is thus a central issue for poverty reduction, sustainable development and the achievement of the Millennium Development Goals (MDG's).

With the recent reform of **EU water policy** and the new Water Framework Directive the EU has one of the most advanced water policies in the world and can provide significant experience and expertise.

In May 2002 a **Council resolution** was adopted endorsing the "**Communication on water management in developing countries**", which stressed the need to integrate sustainable water management in national and regional development strategies and to support partner countries in developing sustainable solutions.

The **EU Water Initiative** which was launched at the World Summit for Sustainable Development (WSSD), is a catalyst and a foundation on which future action can be built to meet the water and sanitation MDG's. This can be achieved through the promotion of good governance, sustainable water resources management (which includes a sound management of water for agricultural production), research and knowledge transfer, enhanced co-ordination and stronger partnerships. A new **EU-African strategic partnership on water affairs and sanitation** was signed by President Prodi, Prime Minister Rasmussen and African Heads of State in Johannesburg.

To meet MDGs and WSSD targets requires the mobilisation of substantial funds from public and private, local and international sources and the establishment of new innovative financing mechanisms. This is a conclusion of the financial analysis of the EU Water initiative and was also outlined in the **World Panel on Financing Water Infrastructure (Camdessus Report)**. The Report stresses in particular the importance of this issue and the urgency to take measures to deal with it, and states: "...the flow of funds has to roughly double, with the increase to come from all sources".

The **Kyoto 3rd World Water Forum** (16-23 March 2003) has further demonstrated the need to address this critical challenge. However, it resulted in disappointing conclusions because of the lack of trust between the different actors (public, private and NGOs), and the lack of clarity on their respective roles. Furthermore, the Forum did not take any major decision regarding the availability of financial resources for investments in the water sector.

2. WHY A FUND

As indicated in the **Camdessus report**, mobilisation of a significant level of resources is the key factor to the realisation of the MDG's in the area of water and sanitation. The present level of funding has proven inadequate for meeting the investment needs to comply with these goals and new innovative funding mechanisms are urgently required to attract more private investments.

Establishing a specific Water Fund could constitute a substantial contribution to the solution of the problems as it would facilitate the leveraging of resources from a large range of sources. As a first priority, the Fund would be oriented to achieving the targets on water supply and sanitation, within the framework of integrated water resources management. and would include co-financing with other EU sources of finance.

This mobilisation of adequate levels of resources should also include

- optimal **co-financing** with various sources of funding (local/international, private/public) taking into account their respective strengths and weaknesses.
- use of **financial engineering** techniques, including introduction of new instruments guaranteeing and leveraging the mobilisation of funds from a wide range of sources, taking into account the principles of transparency, accountability, and appropriateness for the specific socio-economic contexts.

To mobilise the necessary resources the possibility of using the conditional reserve of €1 billion foreseen within the Cotonou Agreement could be explored, while respecting the legal bases which apply to the EDF. Due consideration would have to be given to the necessary procedural steps and to the legal provisions which might have to be modified in order to allow the reserve to be mobilised for this purpose.

Co-financing would be offered to authorities in ACP countries, acting jointly with EIB, other EU public financial institutions involving as appropriate private/public operators from these countries or from the EU. In this context, in particular for grass roots projects, EU civil society organisations can play an important role. Access to the co-financing of the Fund could be extended to other International Financial Institutions (IFIs), in particular the African Development Bank (AfDB) and the World Bank Group (including International Financial Co-operation and Multilateral Investment Guarantee Agency).

3. THE ROLE OF THE FUND

There are various existing initiatives to finance country-specific and multi-country advice and related activities for the development of Public Private Partnerships. The proposed **EU Water Fund** should not compete with these existing initiatives, and should not be directed to finance those private sector developments which provide a reasonable return on investment. The Fund would primarily provide concessional funding, which, by nature, has a higher leverage than lending and would be additional to other EU and international financial instruments.

The main role of the fund is to be a **catalyst** (promoting initiatives, providing information, being a clearing-house, building research and management capacity in ACP countries) on the one hand and an instrument which can provide the missing link in financing sustainable projects and activities on the other hand. There exists many plans and proposals in the area of clean water and sanitation, but, as indicated in the Camdessus-report, the majority cannot be realised because of the inflexibility of existing instruments. The proposed EU-Fund should be able to give a very flexible answer to a variety of situations.

The Fund should be directed towards **achievement of the WSSD and MDG targets** and should concentrate its activities in countries, which have a sound national water policy or which are strongly committed to develop it, based on good governance principles, and where there is prioritisation of spending towards social sectors, and definition of the relevant indicators as part of the Poverty Reduction Strategy process (PRSP). Countries which do not satisfy these criteria should be assisted to develop national policy and associated indicators as part of capacity building projects.

On this context, the activities of the fund shall capitalise on knowledge generated within European and International Water research and scientific co-operation. Research plays a key role in providing knowledge-based approaches for innovative policy formulation and implementation instruments covering various aspects from institutional reform, socio-economic analysis, integrated water planning and management, and appropriate technology transfer.

The Fund could cover a wide variety of actions but focus mainly on:

- Co-financing of investments with local authorities and financing institutions

Many large water projects have long pay back periods and high risk, making them unattractive for commercial or even IFI financing. The Fund would provide grants complementary to local funding and funding by international sources to finance the initial investment. The two basic domestic sources of finance are namely:

- Consumers: user charges (fixed in relation to the population's ability to pay and sensitive to the needs of the poor) should at least cover operating costs and essential maintenance. Establishing a system of tariff cross-subsidisation may be part of the solution,
- Taxpayers: should contribute in accordance with the public finance and debt situation of the beneficiary authorities (sovereign and sub-sovereign).

Efficient management of the Fund will require appropriate “financial engineering”, ensuring both maximal leverage of the grant funding and optimal satisfaction of the needs of (poor) consumers.

The Fund would primarily co-finance investments in the area of water supply and sanitation. Such projects should be realised in the context of an integrated management of water resources at the level of the river basin. The Fund could also finance projects in transboundary river basin development.

- Enhancing the 9th EDF "Investment Facility" managed by the EIB

The “Investment Facility” (I.F) is the appropriate vehicle for assisting projects involving private commercial (public/private) operators or other forms of private intervention. Financial instruments facilitating the intervention of EU operators, such as guarantees, risk insurance, soft loans etc., should be provided. Being accessible to EIB as well as to other public finance institutions of the EU, the I.F. should encourage co-financing and complementarity between these various sources of finance and with the Fund.

- Co-Financing and capacity building for Community based projects

In addition to sectoral and larger scale projects, resources should be set aside for community based actions, implemented by local authorities and/or grass roots organisations, e.g. in co-operation with EU NGOs. In poor communities the partnership approach requires strong support from civil society, thus the need for capacity building at this level too.

- All forms of technical assistance and mechanisms for longer-term capacity building, in support of the development of activities which contribute to the institutional, environmental, social and financial sustainability of the sector and improving the information systems, such as:

- (1) Water policy development leading to sector reform

TA could be provided in support of Governments efforts to adopt integrated water resources management policies and implement water strategies, which, while protecting and conserving the ecological integrity of their water resources, are also coherent with their poverty reduction strategies.

- (2) Strengthening and reform of Water utility management

TA could be provided for improving the management capacity of water-related institutions at government and municipal level. This includes management training and institution building of the regulatory authorities.

- (3) Management of transboundary water courses

Technical assistance should be provided to develop river basin management plans in large transboundary water courses and the necessary international agreements, in addition to building local/regional capacity of ACP institutions through investment into water related research and management capacity.

4. MANAGEMENT OF THE FUND

The operation of such a Fund to be put in place should reflect the principle – that the decisions on financing should be taken on the merits of the project proposals received, not on the basis of pre-determined national envelopes. In view of the origin of the money (EDF) it has to be clear from the start that the money can only be spent in ACP-countries.

Preparation of the project design and technical implementation of the investment projects should be the responsibility of the international, national or local authority and the co-financing (EU) institutions. The “management structure” of the fund should reflect this principle and therefore be lean and flexible. At the same time, it should respond to sound principles of transparency and accountability. It should focus on strategic choices of projects to be financed as well as general supervision of the use of the funds. The management of the fund should be able to operate closely with the financial institutions but with a firm view on how the grant element can be used to create a maximum leverage of the amount of other types of finance that can be mobilised.

In order to maintain a focus on the problems of Africa and ensure a privileged relationship with African institutions, a close link should be established between the management of the EU Water Fund and i.a. AfDB, AU, NEPAD, the African Ministerial Council on Water, the African Water Facility and African experts in general. Similar links will be established with institutions in the Caribbean and Pacific regions.

Once the decision of principle is taken and the source of financing within the EDF is clarified and secured, an appropriate method of implementation should be found within the applicable financial rules in order to achieve the above objectives. Several options are available, as laid down notably in Articles 14 and 15 of the EDF financial regulation and in the relevant provisions of the EDF legal bases.

The creation of an Executive Agency, as mentioned in the above Articles of the EDF financial regulation, might be an appropriate way to manage the new Fund. However, its use in the EDF would have to be very carefully considered, in accordance with Article 15 of the EDF financial regulation, and Council Regulation n° 58/2003 of 19 December 2002 laying down the conditions to be met for using executive agencies.

5. REGULATORY FRAMEWORK

For the financing of the EU Water Fund, it is envisaged to use the “conditional” € 1 billion foreseen in Article 2.2 of the Internal Agreement on the Financing and Administration of Community Aid under the Financial Protocol to the Cotonou Agreement of December 2000.

To take this proposal forward, commitment and support at the highest political level from both the EU and ACP sides will be required, in particular to address the following points:

At present the use of the reserve is conditional on a mid-term review of the global performance and implementation. It is foreseen that the release of the conditional €1 billion will be decided by the Council after an assessment of the degree of realization of commitments and disbursements in 2004 according to the Financial Protocol of the Cotonou Agreement.

The Internal Agreement for the 9th EDF (Article 2.2) specifies that this will be done on the basis of a proposal by the Commission. The Commission intends to make this proposal in due time so that the release of the funds can take place early in 2004.

In respect of the principles of ownership and partnership of the Cotonou Agreement, the possible use of the conditional €1 billion should be the subject of an exchange of views with the ACP Group. The Joint Council Meeting of May 2003 constitutes an excellent opportunity for such an exchange since the follow up to Johannesburg and Monterrey will be a point of discussion in the agenda. Following this exchange of views a joint ACP-EC decision by the Council of Ministers on the use of the conditional billion will be necessary.

In accordance with the Financial Protocol, if the conditional billion is released, it will be distributed proportionally amongst the three envelopes (the long-term development envelope, the regional cooperation envelope and the Investment Facility). The situation is simple under the regional cooperation envelope where the Community is entitled to notify to the ACP-party funds for intra-ACP cooperation. As regards the Investment Facility, there are no major constraints as long as the proposals comply with the conditions for loans from this facility. However the resources from the long-term envelope are supposed to be used for topping up National Indicative Programmes.

In order to use funds on the basis of the merits of the activities proposed and the ownership and commitment by involved stakeholders, and not on a pre-determined distribution, it should be agreed with ACP partners that a more flexible approach is needed and should be endorsed by the Joint EU/ACP Council.

6. CONCLUSIONS

Mobilization of a significant level of resources is a key factor for the realization of the MDG and WSSD targets, and flexibility in the response is required to meet the challenge in an effective manner. This flexibility must be achieved in order to ensure that the proposed Fund constitutes an effective mechanism to use the conditional billion for a priority objective in an innovative manner.

The establishment of an EU Water Fund will contribute to the achievement of the Millennium Development Goals of halving by 2015 the number of persons without access to safe water and sanitation.

The Commission therefore proposes to:

- Endorse the recommendations presented in this Communication.
- Consider the release of the conditional €1 billion , so as to enable a decision in early 2004.

- Prepare in collaboration between EU and ACP partners, the decision by the Joint ACP Council on the use of the conditional €1 billion from the EDF for the financing of an EU Water Fund ,on the basis of the approach outlined in this Communication.
- Examine the most appropriate implementation method for a possible Water Fund financed by the EDF, for example that of a possible Executive Agency, based on a cost benefit analysis of the different options.

ANNEX
LEGISLATIVE FINANCIAL STATEMENT

Policy area(s): Development and relations with ACP States
Activit(y/ies): Development co-operation policy and sectoral strategies

TITLE OF ACTION:

**COMMUNICATION FROM THE COMMISSION TO THE COUNCIL AND THE EUROPEAN
PARLIAMENT ON THE ESTABLISHMENT OF AN EU WATER FUND**

1. BUDGET LINE(S) + HEADING(S)

Not applicable as it is proposed to be financed by the European Development Fund.

This Communication has no net consequences on human and administrative resources at this stage.

2. OVERALL FIGURES

Not applicable. See above.

4. LEGAL BASIS

Articles 14 and 15 of the EDF 9 Financial Regulation.

5. DESCRIPTION AND GROUNDS

5.1.1. Objectives pursued

Set up an EU Water Fund for ACP countries, using the conditional one billion Euro foreseen in the Cotonou Agreement, and serving to co-finance as a priority with other sources of EU funding.

This Fund will contribute to the achievement of the millennium development goals for water sanitation.

5.3. Methods of implementation

Implementation options, including the setting-up of an Executive Agency, will be studied.