

SPECIFICATION

PROJECT TITLE: Screening of water pricing policies, cost recovery mechanisms and economic instruments for inclusion in Programme of Measures and in relation to Article 9 of the WFD

Terms of Reference

Effective and efficient implementation of measures in River Basin Management Plans (RBMPs) requires consideration of the potential role played by water pricing policies, cost recovery mechanisms and economic instruments in delivering the EC Water Framework Directive (2000/60/EC) (WFD).

This research will provide an initial screening of candidate water pricing policies, cost recovery mechanisms and economic instruments that might contribute to cost-effective and proportionate implementation of the Directive and in accordance with the requirements of Article 9 of the Directive.

This study will need to cover England, Wales and Scotland.

Background

Collaborative Research Programme

Defra is leading on a collaborative research programme (CRP) for the economic analysis for the WFD. A major work programme has been started through the development of six projects and will run till 2008, eventually providing the tools necessary for the economic analysis for River Basin Management plans. This programme involves many of the major stakeholders in England, Wales, Scotland and Northern Ireland. The Programme has the following six sequential projects:

1. To set out an initial identification and illustration of the issues related to the economic analysis and its role in the decision making for programmes of measures under the Water Framework Directive.
2. To determine how to assess costs and economic impacts for each of the main types of options affecting the major different sectors that will need to be appraised in River Basin Management Plans (RBMPs) in an even handed manner.
3. To scope and characterise the potentially disproportionately costly cases in RBMPs and the main gaps in information to draw up an appropriate process for assessing them and making best use of original and existing work to fill these gaps. This will include exploring alternative assessment methods.
4. Focus group analyses to specify clearly environmental damages of concern in these cases.
5. Development, trial and refinement of guidance on benefits assessment for RBMPs.
6. New studies to provide better assessments and related demand information of the major environmental benefits of RBMPs.

SPECIFICATION

This project is part of project 1 in the CRP.

In addition to Defra, the Welsh Assembly Government, Scottish Executive, Environment Agency, English Nature, DTI, SNIFFER, UKWIR and the Joint Environment Programme are currently offering funding for the programme, or for specific projects. It is anticipated that other organisations, including industry groups and Non-Governmental Organisations will also make financial commitments. Further organisations are contributing to the programme in kind including Country Land and Business Association, UK Major Ports Group and the RSPB. The process of inviting tenders and appointing contractors will be managed by Defra, in consultation with its partners on the Programme Steering Group. Further information regarding the CRP is available at:

<http://defraweb/environment/water/wfd/economics/research.htm>.

River basin Characterisation

This project will build on the work undertaken by the Environment Agency and SEPA to identify the pressures and impacts on the water environment and identifies those water bodies that are unlikely to achieve the environmental objectives set out in the Directive by 2015. The assessment places each water body into one of four risk categories. Further information is available on the Environment Agency's website:

<http://www.environment-agency.gov.uk/business/444217/444663/955573/958199/1001324/?referrer=/business/444217/444663/955573/> and on SEPA's website: <http://www.sepa.org.uk/wfd/character/index.htm>.

Information on the next steps in the characterisation process is available on the Defra website at <http://www.defra.gov.uk/environment/water/wfd/pdf/character-nextsteps.pdf>.

Cost effectiveness Analysis and WFD

An initial screening of candidate measures is required in order to identify the requirements for future analysis prior to including measures in RBMPs. This future analysis will include cross-sectoral cost-effectiveness analysis and disproportionate cost analysis. The methodology for these assessments is being developed through other projects with the CRP.

One of the aims of this project is to identify possible measures that could be included in the first programme of measures and which will be assessed in terms of cost-effectiveness in 2006 (at a national scale). This will include the generic cost assessment exercise that will be a pre-cursor to the later site-specific cost-effectiveness analysis. As pricing policies, cost-recovery mechanisms and economic instruments are largely decided upon at a national level, the assessment of cost-effectiveness needs to be undertaken initially through the national level assessment of costs.

Cost recovery and the WFD

SPECIFICATION

Article 9 of the WFD requires by 2010:

- that water pricing policies provide adequate incentives for users to use water resources efficiently, and thereby contribute to the environmental objectives of this Directive
- an adequate contribution of the different water uses, disaggregated into at least industry, households and agriculture, to the recovery of the costs of water services, based on the economic analysis conducted according to Annex III and taking account of the polluter pays principle.

The text of Article 9 of the WFD is included at Annex A.

Defra and the Welsh Assembly Government have produced Economic Supportive Documents in collaboration with the Economic Advisory Stakeholder Group (EASG) that provide contextual economic and cost recovery background information to the Article 5 Reports for each River Basin District (RBD). The documents consist of ten reports, one for each designated RBDs in England, Wales and Scotland. These reports can be found at

<http://defraweb/environment/water/wfd/economics/index.htm>. The reports identify the current level of recovery of the financial costs of water services. The Economic Supportive Documents were developed using the methodology for assessing cost recovery as set out in the report *Cost Recovery and Incentive Pricing* which can be found at: <http://www.defra.gov.uk/environment/water/wfd/economics/index.htm>. The SEPA article 5 reports can be found at: <http://www.sepa.org.uk/publications/wfd/index.htm>.

Further guidance is available from the Common Implementation Strategy drafting group Eco 1, which will provides information relevant to practical application of the cost recovery work. Copies of these sheets will be available to the contractors.

Further background information is available from the DEFRA website in relation to the implementation of the Water Framework Directive in England and Wales: <http://defraweb/environment/water/wfd/index.htm>.

In Scotland both the Scottish Executive and the Scottish Environment Protection Agency websites provide substantial background to the implementation of the directive in Scotland which is slightly different to that in the rest of the UK as water is a devolved issue. The appropriate web addresses for the two organisations are as follows: <http://www.scotland.gov.uk/Topics/Environment/Water/17316/9088> and <http://www.sepa.org.uk/wfd/index.htm>. It would also be beneficial to look at the SNIFFER (Scotland and Northern Ireland Forum for Environmental Research) website as this body conducts significant research to support implementation of the WFD in the UK.

Links to other WFD projects

This project is being undertaken concurrently with other WFD workstreams, within and outside of the CRP. It is therefore essential that linkages are made with the relevant workstreams for the purposes of information sharing and consistency. For

SPECIFICATION

example, this project will need to review work to date (to the extent that these include water pricing policies, cost recovery mechanisms and economic instruments) such as the work on developing the framework for the catalogue of measures to be considered in the development of the Programme of Measures.

As this project is part of the CRP, it will be necessary to understand the context within the other projects completed, planned and currently in progress as part of the CRP, taking account of any UK regional differences. There will be input from project 2a (which will specify the key attributes for defining effectiveness of measures to be considered in RBMPs) and 2b in terms of which categories of costs need to be considered within the cost estimation framework. The main dependencies are from this project to National cost-effectiveness assessment in 2006 and in 2c and 2d in terms of the design of proformas and guidance on considering cost-effectiveness at an operational level including the potential role of pricing policies, cost-recovery mechanisms and economic instruments.

Objectives and outputs

This project will take place largely through a high level screening of measures against a series of developed criteria and in the context of the results of the risk assessment exercise.

Specific objectives are:

1) Review the risk assessment results

This review of the Environment Agency's risk assessment results will review the main reasons for failure to meet WFD objectives where risk reduction may be achieved via alternative water pricing policies, adjustments to cost-recovery mechanisms or the development of economic instruments. This will need to include an assessment of the status of the Daughter Directives on Priority Substances and Groundwater and possible additional/alternative measures.

2) Development of the criteria for comparing instruments

Building on the work of Project 2a of the CRP in terms of how effectiveness is defined in order to define a list of criteria which can be used to compare pricing policies, cost recovery mechanisms and economic instruments in the first and subsequent Programme of Measures (POMs)¹ and in accordance with the requirements of Article 9.

An up to date view of the requirements of Article 9 will be provided by Defra.

3) Identification of candidate water pricing policies, cost-recovery mechanisms and economic instruments

¹ The programmes of measures need to include measures for the Daughter Directives on Priority Substances and Groundwater. Further information on the Daughter Directives can be found on the Defra website: <http://defraweb/environment/water/wfd/daughter-dirs.htm>

SPECIFICATION

This will identify those measures which may play a role in reducing the risk of failure to meet good ecological status/potential in the three plan periods (2009-2015, 2016-2021 and 2022-2027). Candidate measures need to be identified and status summarised, taking account of the broad classification of users in the Directive (households, industry, agriculture). This will include existing instruments together with those under active consideration and those that have been considered in the past but have not been taken forward. The reasons why instruments were not taken forward should be reported as these may have changed.

This will involve some literature review type activities. The literature review will be based on assembling the key information needed to make a judgement about the potential role of the instruments. This will include a review of the work in progress on related policy measures. For example in relation to affordability and water prices, or in relation to catchment sensitive farming or funding of flood defence activities. The research should not prejudice the longer-term policy development processes associated with these areas, as this would not be in keeping with a screening exercise such as this.

However there will be no design of new instruments as the purpose of this initial screening is to synthesise existing information.

New instruments, possible changes to water pricing policies and cost recovery mechanisms will only be considered in this project as possible suggestions for future analysis.

4) *Screening of instruments*

This screening will be undertaken in relation to the risk assessment results (refer 1 above) to identify a short list of water pricing policies, cost recovery mechanisms and economic instruments for further analysis and inclusion in the generic cost assessment exercise following the work of Project 2b of the CRP. An initial assessment of the feasibility of changes to policies or introduction of new instruments should be included.

5) *Synthesis of results*

The results of the screening will be brought together for summary reporting. Reporting should be concise to facilitate high-level decision-making regarding further analysis by the Programme Steering Group.

6) *Suggestions for further analysis*

In addition to drawing together of the existing work on water pricing policies, cost recovery mechanisms and economic instruments, descriptions any novel instruments not thus far considered should be considered.

Outputs:

The main output will be a short synthesis report (no more than 30 pages) together with short summaries of the information on each of the instruments, in a consistent

SPECIFICATION

format, with more detail on those proposed for further analysis. However, where instruments are discounted at this stage a full rationale for this also needs to be provided in order to provide a justification in terms of complying with article 9. The synthesis report will include suggestions on further work. An annotated bibliography will be required for the literature search elements of the work.

Programme of Work

Tenderers should provide as part of the proposed work plan:

- o A list of key milestones.
- o An initial risk assessment, identifying the key risks to non-delivery and potential mitigation strategies, should also be included in the tenders.

It should be noted that the CRP has a pool of peer reviewers comprising individuals with a range of backgrounds and specialties. A suitable panel will be selected from the pool to review the outputs of this study. The comments received shall be fed back to the contractors for consideration prior to the delivery of an agreed final output.

Skills and experience and evaluation criteria

The skills necessary to undertake this work are varied and the following are considered to be particularly appropriate:

- o Solid understanding of economics in particular regulatory economics, cost allocation, cross subsidy analysis, and pricing
- o Knowledge and experience of those sectors for which control measures would need to be appraised in RBMPs (e.g. agriculture, water industry, other industry)
- o Knowledge of water management, integrated catchment management and the approach being taken for the Water Framework Directive.

Criterion	Weight
Quality of the tender:	10 %
Understanding of the issues:	20 %
Quality of the methodology	20 %
Team composition and expertise:	20 %
Timeliness of outputs	20 %
Cost	10 %

Contract management arrangements

The contract will be managed by the appointed project and Executive member of the Programme Steering Group, advised by a small board of PSG members and other relevant individual and in association with the CRP Programme Manager. One individual within the selected organisation will be required to act as Project Manager and to coordinate inputs from team members including those of consortia. Particular

SPECIFICATION

attention will be paid to the quality of the management arrangements within proposed groups.

Publication

Defra will have the right to publish the report.

Timing and milestones

The currently planned timetable is as follows:

An inception report will be required by end of August 2005. This will detail the approach being taken.

An interim report will be due on early/mid-October 2005.

A draft final report will be due in mid November 2005.

The final report should be completed by early/mid December 2005.

Weekly progress reports outlining details of key activities and resources employed to date will be required for the duration of the contract.

Payment

The tenderer must specify how much each milestone is estimated to cost and how this relates to the day rates quoted. Payment will be made in accordance with the agreed milestones on the Department's acceptance of the deliverables produced.

Any additional work required will be agreed in advance with the contractor and payment will be made on delivery of the agreed milestones. Any additional work required as a result of unanticipated requirements made according to the day rates specified in the tender and will be subject to separate orders to be agreed with the contractors.

SPECIFICATION

ANNEX A: Text of Article 9 of the WFD – Recovery of costs for water services

Recovery of costs for water services

1. Member States shall take account of the principle of recovery of the costs of water services, including environmental and resource costs, having regard to the economic analysis conducted according to Annex III, and in accordance in particular with the polluter pays principle.

Member States shall ensure by 2010

- that water-pricing policies provide adequate incentives for users to use water resources efficiently, and thereby contribute to the environmental objectives of this Directive,

- an adequate contribution of the different water uses, disaggregated into at least industry, households and agriculture, to the recovery of the costs of water services, based on the economic analysis conducted according to Annex III and taking account of the polluter pays principle.

Member States may in so doing have regard to the social, environmental and economic effects of the recovery as well as the geographic and climatic conditions of the region or regions affected.

2. Member States shall report in the river basin management plans on the planned steps towards implementing paragraph 1 which will contribute to achieving the environmental objectives of this Directive and on the contribution made by the various water uses to the recovery of the costs of water services.

3. Nothing in this Article shall prevent the funding of particular preventive or remedial measures in order to achieve the objectives of this Directive.

4. Member States shall not be in breach of this Directive if they decide in accordance with established practices not to apply the provisions of paragraph 1, second sentence, and for that purpose the relevant provisions of paragraph 2, for a given water-use activity, where this does not compromise the purposes and the achievement of the objectives of this Directive. Member States shall report the reasons for not fully applying paragraph 1, second sentence, in the river basin management plans.