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Water Supply and Sanitation Sector Reform

Elements for Draft Joint Statement by Participants at the Yerevan Ministerial Conference on...

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Elements for Draft Joint Statement by Participants at the Yerevan Ministerial Conference on ..¹

1. We met in Yerevan, Armenia 17-18th November 2005 to review progress in reforming the water supply and sanitation sector in Eastern Europe, Caucasus and Central Asia (EECCA). It is five years since we met in Almaty, Kazakhstan to discuss these issues. At that time we adopted a set of Guiding Principles to guide our efforts to reform the water supply and sanitation sector, and these provide a reference for our meeting.
2. We are grateful to the government of Armenia for their active support in hosting the Conference and for the hospitality shown to participants.
3. We welcome the active participation of NGOs and the private sector at the conference and the inputs they provided.
4. The information we reviewed suggests that the water supply and sanitation sector of EECCA has not improved appreciably since the Almaty Conference in 2000 and is still not on a sustainable path. The state of water infrastructure in EECCA countries has deteriorated further since then and is still in a critical position, posing serious risks for human health, aquatic ecosystems and economic development. Many EECCA countries have introduced important reforms, but it may be too early to see the results. What has changed since the Almaty meeting is that there are now a number of positive examples and tools to support reform of the water sector in the EECCA region. The main challenges are to establish sound policies and institutions to scale-up these positive examples and to provide training and other support to implement the policies and apply these tools. This will require political commitment, the mobilisation of additional financial resources and capacity building.

Assessing Progress

5. The coverage of urban populations with centralised water services remains at high levels in EECCA. Some indicators have shown positive signs, such as significantly increased levels of metering in virtually all countries, decreasing levels of water consumption, and improved rates of bill collection.
6. However, these positive developments do not suffice to reverse the overall negative trend. Disruptions of water supply, pipe breaks, and unaccounted-for-water have steadily increased in recent years. In many places in the EECCA region people receive water for only a few hours per day. Key financial indicators have not shown significant improvement: tariffs generally do not cover operational costs, much less maintenance and capital costs.
7. There are no signs that the continued deterioration of the EECCA water sector is slowing or that this trend will be reversed in the near future. The consequences for public health, the environment, and economic development in the region are serious. The World Health Organisation (WHO) estimates that in the ECE region more than 13,000 children under the age of 14 die every year from poor water conditions, probably most of them in the EECCA region.
8. On these trends it is unlikely that the water-related Millennium Development Goals (MDGs) will be achieved by 2015². However, official statistics and estimates paint an overly-optimistic picture of progress in this regard. Improvements in the methodologies and data collection are urgently needed, not least to

¹ The countries, institutions and stakeholders participating would be identified

² The water-related MDGs aim to reduce by half the proportion of people without access to safe drinking water and basic sanitation by 2015.

provide a more reliable basis for priority-setting and the elaboration of MDG-focused development strategies.

9. While the overall trend is broadly the same across the EECCA region, the state of water services and their adverse impacts is quite diverse. While some positive achievements have been registered in some capital and large cities, the situation is much worse in small and medium sized cities. In many rural areas, water services have collapsed following the dismantling of the collective farm system in the 1990's. Thirty-six per cent of population in EECCA live in rural areas, underlining the importance of more effective programmes in these areas in order to achieve the water-related MDGs. More generally, the situation in the poorest EECCA countries is much worse than in the more affluent states, especially in terms of water quality and resulting health impacts.

10. A review of the major institutional and legal reforms in EECCA indicates that many countries have undertaken measures to improve the situation in the water supply and sanitation sector, many of them in line with the recommendations in the Almaty Guiding Principles. In particular, central governments have improved the institutional set-up for the water sector, and developed framework legislation to better guide local level actors, mainly in setting tariffs. Continued and strengthened efforts are needed to ensure that these reforms are implemented and improve the provision of water services.

Financing Water Services and the Social Implications of Tariff Reform

11. One of the main reasons for the deterioration of water infrastructure in EECCA countries over the last 20 years has been the chronic under-funding of the sector. Increased financial flows are a necessary but not sufficient condition for improving the provision of water and sanitation services in EECCA countries: appropriate policy and institutional frameworks are also needed to improve the mobilisation and utilisation of financial resources and to ensure the financial sustainability of the sector.

12. Between 50 and 90% of water utility revenue currently is generated by user charges; the rest mostly comes from public budgets. In some countries user charges have been increased quite significantly and billing procedures improved, thereby generating more revenues for utilities. However, in many countries utility revenue still covers only about 60% of operational costs, which is unsustainable. Water consumption has fallen as tariffs have increased, but the level of service provision, with some notable local exceptions, generally has not improved.

13. In these circumstances, most utilities in the region have decreased the levels of service that they provide in order to save on costly inputs such as energy and chemical reagents for water treatment. As a result, they have been unable to carry-out basic maintenance, further accelerating the deterioration of infrastructure. The water sector in many EECCA countries is caught in a vicious circle of financial unsustainability and declining service provision. Action to break out of this vicious circle, and to promote financial sustainability of the sector and improved service provision, is urgently needed.

14. It has been estimated that between USD 15 to 34 per capita per year of additional finance would be needed to properly maintain and renew water infrastructure, and a total of about EUR 7 billion, roughly double the current level of available finance, to achieve the water-related MDGs in EECCA countries.

15. There are no simple solutions for meeting these financial challenges. EECCA countries will have to combine all sources of finance to enhance synergies, avoid crowding out other sources, and maximize leverage on total flows. Finance strategies, developed through a cooperative process involving Finance, Economics, Environment and other Ministries with responsibilities for the water sector can be a useful way of addressing this challenge.

16. User charges will continue to be the major source of finance, particularly for operational and maintenance costs. In many EECCA countries there is scope to further improve billing and raise tariffs within affordability limits. However, appropriate provision should also be made to ensure that poor or vulnerable households have adequate access to at least a basic level of service provision. Generally this will be through a block tariff system or through social protection mechanisms. Political reluctance to raise tariffs should also be addressed, for example by ensuring that decision-makers bear the financial consequences of such decisions.

17. Public budgets will also be essential in most countries, particularly for capital costs. They need to be used more strategically in order to achieve national policy objectives, to leverage other sources of finance, and to reduce risks that might be associated with other forms of finance. At the same time, care must be taken to avoid “crowding out” other sources of finance, inducing subsidy dependency or impeding essential reforms.

18. Domestic resources will be the dominant source of finance, although foreign assistance could play a significant role in the poorer EECCA countries. There is potential for greater flows of Official Development Assistance (ODA) to the water sector in EECCA countries: ODA to EECCA for this purpose is lower than to comparable regions; EECCA countries face major challenges in achieving the water-related MDGs; and the new neighbour policy adopted by the EU could provide opportunities for strengthened cooperation with some EECCA countries. EECCA countries would be better placed to seize these opportunities if they assigned higher priority to water issues in national development strategies and implemented convincing reform strategies.

19. Access to debt financing, both from International Financial Institutions (IFIs) and domestic financial and capital markets, can provide the up-front finance for investments and help spread the repayments over the life-time of the infrastructure. For most EECCA countries, IFI finance is the more realistic option. However, to take out non-concessional loans, EECCA countries will need to be willing and able to provide sovereign guarantees and/or IFIs to make sub-sovereign loans. In the foreseeable future, accessing local capital and financial markets will only be possible for some of the larger, richer countries such as Russia and Ukraine.

The Role of National Authorities in Supporting the Provision of Water Services at the Municipal Level

20. As the Almaty Guiding Principles stress, decentralisation is an essential means for fostering improved delivery of water services in EECCA countries. However, central authorities still have an important role to play in establishing the legal, regulatory, institutional and financial frameworks, and in providing targeted technical and financial support, needed for improved delivery of water services at the local level. Central authorities can also support capacity development at the local level. The recommendations concerning national authorities in the Almaty Guiding Principles are still relevant and we would encourage their strengthened application.

21. Central authorities should devolve responsibilities for the water sector to the lowest practical level while avoiding excessive fragmentation. This should also provide incentives for local governments to cooperate and coordinate their efforts in order to achieve economies of scale in infrastructure provision. In relation to the water sector, central authorities should establish the framework for integrated water resource management at the level of river basins. From a finance perspective, a river basin management approach is essential to ensure that scarce resources are targeted on the most efficient and effective investments, and this requires cooperation among municipalities.

22. Fiscal transfers from central to regional or local authorities will continue to play an important role in most EECCA countries. Such transfers should be carefully designed as this can affect the provision of water services. Generally, such transfers should not form part of a mechanism for regional redistribution of resources. Global, rather than earmarked, grants are generally the preferred approach, provided they are accompanied by clear conditions and performance criteria.

23. Central authorities should decentralise fiscal responsibilities in line with the capacity, integrity and fiscal discipline of regional and local authorities.

The role of Municipalities and relations between Municipalities and Water Utilities

24. There are a number of positive examples where municipalities have adopted plans with clear objectives and identified the means for achieving them (e.g., Surgut, Saint Petersburg and Yerevan). In addition, some municipalities have begun to manage their finances and have become sufficiently creditworthy in order to take on debt to finance the construction or rehabilitation of water infrastructure. However, these cases are very much the exception. Lack of reform at the municipal level is arguably the single biggest obstacle to improved provision of urban water supply and sanitation and reform at this level should be accelerated. A huge effort is needed to roll-out and replicate the positive experiences in municipalities throughout the EECCA region. Central governments, donors and IFIs have important roles to play in this respect.

25. Local authorities in EECCA need to commit, and require support in order, to:

- set consistent, stable objectives for the water supply and sanitation sector as part of city or regional master plans;
- elaborate realistic finance strategies to achieve these objectives;
- translate these strategies into rolling, medium-term investment programmes, rather than the annual programmes that many municipalities currently follow; and
- promote public participation in the development and implementation of these activities.

26. Reforms to separate and clarify the relative roles of local governments and utilities should be accelerated. In many EECCA countries, local authorities remain *de facto* service providers and are too much involved in the management of utilities. Greater use should be made of performance contracts between municipalities and utilities to clarify the relative roles and responsibilities of the two sides, and to create a structure of incentives that rewards good performance by utilities.

27. The management, organisation and capacities of utilities need to be enhanced as part of the reform at the local level. Private sector participation in the operation of utilities can be one way of achieving this goal. Progress in this regard has not been as fast as some had expected at the time of the Almaty conference. Clear and stable operating conditions, and appropriate measures to mitigate risks, need to be in place to attract greater private sector participation. Appropriate regulatory arrangements and public consultation will also be essential. We note with interest the growing and substantial involvement of domestic private operators in the Russian water sector and we look forward to drawing lessons from this experience.

Next Steps

28. The Almaty Guiding Principles continue to provide a useful framework for reform of the water sector in EECCA countries. Efforts to strengthen and deepen the implementation of the Guiding Principles should be strengthened. The evidence we reviewed suggests that a higher priority should be assigned to the water sector from a poverty reduction and economic development perspective; and this should be reflected in national development strategies and public budgets. More consistent and coherent policies would help to

replicate the positive results that have been achieved to date, and to break out of the vicious circle of financial unsustainability and declining quality of service provision. This is particularly true at the local level. It will be essential to engage stakeholders from the non-governmental sector in this process.

29. Greater priority should be given to the challenges in small and medium sized cities and to the rural sector. Developing more effective strategies and programmes for water supply and sanitation for the rural sector will be particularly important in order to achieve the water-related MDGs in the EECCA region. Donors, IFIs and International Organisations should assist EECCA countries in formulating their priorities, and in identifying and implementing the means for achieving them.

30. Specific areas where further efforts would be most useful are:

- improving data and methodologies to provide a reliable basis for a sound planning and decision-making and to enable more MDG-focused development strategies to be developed;
- strengthening capacity of the institutions responsible for developing and implementing sound national and/or regional policies for water supply and sanitation sector;
- cooperation among Economic, Finance, Environment and other Ministries to develop realistic finance strategies to achieve national and/or regional policy goals for the water sector, including at the level of river basins; these strategies should be integrated with related national plans such as those for economic development, poverty reduction and river basin management;
- elaborating mechanisms for establishing and adjusting tariffs with the ultimate goal of achieving full cost recovery, taking account of the need to ensure that poor and vulnerable households have continued access to safe water and basic sanitation;
- promoting the establishment of effective performance contracts between municipalities and utilities;
- promoting effective and fair competition when private participation in the operation of water utilities is under consideration;
- strengthening the strategic and financial planning capacities of municipalities and utilities;
- strengthening capacity for project preparation in accordance with international standards, particularly at the local level; project preparation should, as far as practicable, be related to the implementation of national, regional or local strategies;
- water quality, construction and other standards that affect investment costs should be reviewed and, as appropriate, brought into line with international standards;
- promoting procurement of civil works, equipment and services through competitive tenders to ensure more effective use of available resources.