



EAP Task Force

Document 4

Joint Meeting of the EU Water Initiative's EECCA Working Group and the EAP Task Force Environmental Finance and Water Networks

29 March –1 April 2005, Chisinau, Moldova

MEETING SUMMARY

***PRIVATE SECTOR PARTICIPATION IN MUNICIPAL WATER SERVICES IN EUROPE, CAUCASUS AND
CENTRAL ASIA***

EVALUATING OPPORTUNITIES FOR A GREATER ROLE OF THE DOMESTIC PRIVATE SECTOR

MOSCOW, RUSSIAN FEDERATION,

20-21 SEPTEMBER 2004

Participants are invited to take note of the document and to comment on it as appropriate.

ACTION REQUIRED: *For information, discussion, and endorsement.*

Note: The views expressed in this report are those of conference participants, and do not necessarily reflect those of the World Bank, OECD or their Member countries.

INTRODUCTION

This summary text presents a broad overview of the presentations put forward during two days at a conference on “domestic” private sector participation in the water supply and sanitation sector that was held in Moscow on 20-21 September 2004.

The meeting was organized by the OECD, the World Bank and the Russian Federation’s Ministry for Industry and Energy to bring together a spectrum of entities active and interested in municipal water & sanitation services of the ECA region (Eastern & Central Europe and Central Asia¹). About 80 representatives of ECA governments, national water ministries, donors, international financing institutions, non-governmental organizations, water utilities and international as well as domestic private sector companies attended the conference.

The purpose of the conference was to assess the actual and potential (future) role of domestic private sector companies, in order to better understand opportunities that might exist for ECA governments, IFIs and donors in co-operating with these new actors in the water market. The meeting in Moscow continued earlier dialogues on Private Sector Participation (PSP) in this region held in 2002 (Paris) and 2003 (Vienna).

The discussion was based on analysis prepared for the conference, including a survey of potential market entrants, and a detailed description of domestic private operators in the Russian water market. The agenda was structured around the following topics:

Session 1: Key trends in domestic private sector participation in the ECA water sector

Session 2: Lessons learned – factors of success and failure in domestic and international private sector participation

Session 3: Ways to improve the effectiveness of domestic private sector participation:

- Improve regulatory frameworks and policies
- Improve contractual relations in the sector, incl. broader and more effective use of performance based contracts
- Innovative business – business partnerships
- Partnerships with IFIs and donors

All powerpoint presentations from the workshop can be found on the OECD website at <http://www.oecd.org/env/water>.

¹ The “ECA” region consists of the following countries in the Balkans (Albania, Bosnia and Herzegovina, Croatia, Macedonia, Serbia – Montenegro / Kosovo), the Baltic States (Estonia, Latvia, Lithuania), the Caucasus (Armenia, Azerbaijan, Georgia), Central Asia (Kazakhstan, Kyrgyz Republic, Tajikistan, Turkmenistan, Uzbekistan), Central Europe (Czech Republic, Hungary, Poland, Slovakia, Slovenia) and Eastern Europe (Belarus, Bulgaria, Moldova, Romania, Russian Federation, Turkey, Ukraine).

KEY FINDINGS

Private sector participation, both with international and domestic operators, remains at very low levels in the ECA region, and this situation is unlikely to change in the short term as shown in a survey of potential domestic operators. The Russian Federation is an exception where domestic private operators have been taking increasing market share over the last 12 months. They are currently serving about 8 percent of the urban population, possibly increasing to 16% in a few years time. The trend was initiated by a political statement from the President welcoming PSP in the communal and housing sector. Whether this trend is sustainable in the long-term, remains to be seen since most contracts are 11-month leases for the moment and it is hard to foresee how many of them are going to be converted into longer-term contracts.

Experience accumulated so far suggests that domestic and international operators are encountering very similar obstacles and limitations to their activities in the water supply and sanitation sector. Regulatory and legal uncertainty, lack of rules of the game, limited capacity in domestic private operators, and lack of capacity at the municipal and utility level are only some of the issues that were raised by participants.

To overcome these obstacles, participants proposed several approaches that could be used by stakeholders:

- The systematic usage of performance contracts, allocated in the framework of competitive tenders could help to dissipate public mistrust of PSP and to force municipalities and utilities to agree upon objectives and means to achieve them.
- Concession and lease contracts could be preceded by management contracts so as to reveal the true state and extent of the infrastructure and reduce the risk of conflict when concession and lease contracts are being implemented.
- Tariff-setting needs to become more transparent and predictable which involves shielding of the tariff-setting process from excessive political interference.
- Use franchising or other forms of business-to-business co-operation to combine the strengths of domestic operators (local knowledge) with the strengths of international operators (operational know-how).

Opening Plenary - Opening Statements

Mr. Brendan Gillespie, OECD and Mr. Lee Travers, World Bank

The conference Co-Chairs introduced the conference topic and objectives and pointed out that this event is a follow-up to a regular dialogue held by the World Bank and OECD with private sector water operators that began with conferences in Paris - 2002 and in Vienna - 2003.

The situation of municipal water services in the ECA region, now 15 years after the political transformations, continues to deteriorate in many respects. Technical indicators present evidence of declining levels of safety, service quality and efficiency in drinking water supplies. The result is a persistently high level of health impacts in the population of EECCA, who frequently have to cope with various water borne diseases. Financial indicators demonstrate a growing gap between water utility costs and revenues, with a continuing need for subsidization from public budgets. Yet, in many localities, water charges that are billed to consumers are at levels well below generally accepted affordability thresholds.

Trends in the ECA region reinforce the global decline of private investment in infrastructure, observed since a peak in 1997. International financing institutions and donors provide only a small fraction of the sector's required financing. Achieving the millennium development goals on water will require the mobilisation of all available funds including from public budgets, users, and the private sector.

Previous dialogues with the private sector had revealed some of the limitations of PSP, especially from the viewpoint of international firms. The unsatisfactory investment climate and high country-, political- and regulatory risk in many ECA countries were identified as key obstacles. Also, a strategic shift in international operators' strategies in emerging and developing markets towards less risk intensive PSP options (mainly management contracts) was observed. Together with the general preference of private operators for large cities (usually with a population of more than 500 thousand), this suggested that the scope for PSP making a major contribution to achieving the Millennium Development Goals on water and sanitation, was actually less than many had hoped for.

Domestic private sector companies could offer a potentially attractive complement or alternative to international firms in this respect, since they are often better aware and able to handle local risks (political and regulatory in particular), as well as operating with lower costs.

A survey of the Russian water market prepared for this conference shows the potential dynamism of the domestic private sector. Private operators are now present in numerous municipalities of the Russian Federation. They are currently serving about 8 percent of the urban population, possibly increasing to 16% in a few years time. The objective of the workshop is to look into these and other trends and to identify means that policy-makers, IFIs and donors could use to support them while ensuring the best possible outcomes for water users.

SESSION 1: TRENDS IN DOMESTIC PRIVATE SECTOR PARTICIPATION IN THE ECA WATER SECTOR

1-1. Domestic Perspectives on Water Utility Management (Results of an ECA – wide Survey) - Christophe Schmandt, Consultant

The OECD and World Bank, with funding from the Bank-Netherlands Water Partnership, have undertaken a survey within the ECA region to gain “grass-roots” perspectives on factors affecting “domestic” inputs for private sector participation. The survey is a cornerstone of a Market Development Study being prepared on the prospects of domestic PSP in the ECA region; a complementary survey and study has been undertaken targeting international PSP, which culminated in a workshop in Washington, D.C. during May 2004.

With about 80% of the population connected to piped drinking water systems and 40% with access to sanitation systems (many though without treatment plants), much work remains to be done in the ECA region if the Millennium Development Goals are to be attained (reduction by half in the proportion of people without access to safe drinking water and basic sanitation services). Many governments and financing institutions look to the private sector as a key part of their strategies to make advances towards this important goal. Yet, interest of the international private sector appears to be waning and many areas in the ECA region seem to lack qualified domestic companies. The market development studies aim to address these impressions and devise strategies to foster viable private sector participation.

Overall, the attitude of the domestic market towards PSP throughout ECA is somewhat cautious with less than half of the responding companies, mostly operators, having considered involvement in service or management contracts to date; when looking ahead five years, this improves to about 60% percent, due to increased interest by consultants in the marketplace. Only 20% of domestic companies will consider higher levels of responsibility in water utility management, such as leases or concessions. Interest for PSP activities seems to be highest in the EU candidate countries, with enthusiasm waning in the new EU states.

These are the preliminary results of the market survey, based on the initial 65 responses, representing all ECA countries, except two (Turkmenistan and Kyrgyzstan); the final report will present the results of now over 80 respondents. Inputs were solicited both from domestic market “experts” (representatives of water ministries, utility owners, professional associations, non-government organizations, etc.) and “participants” (utilities, operators, consultants, construction companies, etc.) via two separate questionnaires. The draft results are based on responses of 35 “experts” and 30 “participants”.

ECA market respondents identify 8 primary limitations to domestic private sector participation (PSP), with generally more barriers present in the poorer ECA countries (such as the Balkans and Central Asia); yet, more affluent areas are not exempt from these issues:

- Country Setting: unsuitable business environment with excessive “non-project” risk
- Water Sector: developing, unclear regulations with limited water ministry capacities
- Market Structure: entrenched public monopolies without a viable economic basis (unsustainable water tariffs according to political influence and/ or social considerations)

- Domestic Market: private sector faces stiff competition for few opportunities
- Procurement: low level of confidence due to concerns with corruption and transparency
- Execution: inaccurate pre-project information leads to unrealistic performance standards
- Domestic Expertise: companies show confidence in specific areas, but not in overall utility management – and they feel trapped in a vicious cycle (lack opportunities to gain experience in order to qualify for greater levels of responsibility in utility management)
- Domestic Capital: companies are unable and unwilling to provide investment capital. Survey respondents suggested numerous remedies to the barriers limiting domestic participation:
- National Water Ministries: should complete ongoing institutional reforms, especially to create a non-political, commercial basis for tariffs (with targeted attention to social cases) and a legal basis for both public and private water utility managers
- Utility Owners & Water Utilities: should relinquish monopoly control over community water services and shed their biases to private inputs
- IFIs and Donors: should actively promote and demonstrate PSP (to foster market-wide understanding and dispel myths), support necessary institutional - sector reforms complementary to project inputs, target domestic companies in new projects, and act as “honest broker” to oversee procurement and implementation
- NGOs and Professional Associations: should actively promote institutional reform and mobilize customer bases towards a more sustainable and efficient water market, whether through public or private means; assume role of “honest broker” during project execution

The efforts of all types of market participants are necessary, if the potential of domestic companies is to be harnessed for increased inputs in expertise (short and mid-term) and capital (long-term) for the ECA community water markets.

Case Examples of Domestic PSP: corporate strategies, challenges, successes and problems met

1-2. Entering the market for communal service: “Novogor-Prikamye” experience in leasing WSS infrastructure in Perm - Mikhail Nikolsky, Novogor-Prikamye, Russian Federation

Novogor-Prikamye, JSC/ New Urban Infrastructure of Prikamye Ltd. is a private Russian operator owned by a member of the INTERROS Holding group. The company represents one of the “newcomers” to the water market, with a base in municipal activities gained from its parent company. It is a subsidiary created to focus exclusively on the City of Perm. Novogor-Prikamye is operating the water supply & sanitation infrastructure in Perm on a short-term lease contract (11 months starting in 2003), but expects to parlay this into a longer term lease in the near future.

The strategy of the company is to build sufficient experience and attain its first success in the water sector, and only then to expand further into the water market. The overall objective of Novogor-Prikamye in Perm is to achieve OECD level standards of water services as quickly as possible. For this the management and control of production costs is key, since product differentiation is not possible in this commodity market.

In order to achieve this objective, the company introduced a new management structure, using performance indicators/ evaluations for entire divisions (budgets, operational targets) and individual staff members (completion of quantifiable tasks, not working “better”; career progression). Incentives were used (salaries, bonuses) to motivate staff, individually and by division, and overcome “70 years of influence under the Soviet System”. With respect to operational improvements the company managed to improve the financial

position of the water utility, and reduce the number of “emergency breaks & repairs” by preventive maintenance and proactive asset renewal.

A primary focus of the private operator has been collection of information about utility performance, the registration of assets, and the organisational restructuring of the utility. The project and contract preparation were found to be insufficient, as most technical and financial data on the utility status was inaccurate or incomplete.

Novogor-Prikamyne found this approach of “total change” to be difficult to implement in the framework of a short-term lease contract, due to the discrepancy between the contract duration and the more long term objectives that they were pursuing. In the future Novogor would rather aim to implement an approach based on “partial or incremental” change to utility management, allowing for data collection and confirmation, to establish a sound baseline for such projects. Another recommendation is to ensure sufficient contract duration, since quick results cannot be expected in this market, especially when the initial status is uncertain.

1-3. Participation of private companies in reforming the housing and communal services sector: RCI experience - Denis Posdnyakov, Regional Communal Investments (RCI), Russian Federation

Russian Communal Investments was recently formed by Bazovyi Element Holding to focus on municipal services. RCI seeks to create regional subsidiaries and secure operations for housing and utilities in a “sizeable number” of municipalities. The company has financial backing from large investors/ shareholders in the Russian aluminium, car manufacturing, energy production, etc. industries.

RCI has assessed 19 municipal water services markets and is encouraged with the market potential: the current “crisis” presents opportunities. Overall, RCI is attracted by the “low level” of competition to enter the markets, probably because of the large investments required in infrastructure, and is encouraged by the “guaranteed” nature of sales, i.e. the natural monopoly.

Yet, RCI sees a limited window-of-opportunity for market entry. Due to the volatile nature of the Russian market combined with the investment /contract cycle of the water services industry, companies not entering the market now, will be excluded for the next 10 – 15 years. The situation is seen as similar to the rush to privatisation of Russian industries during the 1990s.

RCI concedes that only about 10-20 percent of the Russian marketplace is of interest to their company. An important barrier to entry is that municipalities have very little understanding of how the business works, how to reach sound investment decisions and why it might be interested to engage the private communal services market. Invitations for a tender usually sounds something like: “Municipality NN invites private company to lease the municipal water utility which has XX employees, serves YY people and has annual turnover of ZZ roubles”. And that is all the information provided by the municipality, which thinks that it is more than enough for investment decision making!

Further, the company believes it can benefit from an economy-of-scale through its other community services businesses (even cross-subsidisation of the water sector from profits in its heating and electricity activities over the medium-term) and would otherwise not consider the water services market to be financially attractive.

The key to company success in the Russian marketplace is to provide levels of service acceptable to the customers – this will trigger a greater “willingness to pay”. Therefore, customer affordability is not viewed

as a key issue. Water fees must be decoupled from excessive political influence and overriding social concerns to achieve a cost-recovery tariff. Regarding infrastructure improvements, RCI would welcome a cooperative investment strategy with IFIs, donors and national & municipal governments.

Utility efficiency must be improved to address unaccounted-for-water, low collections, etc. and the associated financial implications. Indeed, there is substantial scope for low cost efficiency gains, which can help to reach the break-even point.

A key burden on utilities and municipalities is the requirement to pay Value Added Tax (VAT) on billed rather than collected revenues. Also, contract lengths must be structured to accommodate the pay-back-period for investments, gauged at 7-10 years.

1-4. IFC Experience with domestic private sector participation – Alzbeta Klein, Principal Investment Officer, International Finance Corporation

The International Finance Corporation is part of the World Bank group and works exclusively with the private sector in emerging markets. The IFC has gained substantial experience in the Russian Federation over the last 15 years, but so far mostly in other sectors.

The IFC is keen to parlay its worldwide water sector experience and its presence in ECA, into a greater involvement in PSP and water utility projects. Based on its track record in challenging environments, the IFC indicates several keys to successful water utility projects:

- Understanding the sector and local context
- Targeting specific private sector efficiencies
- Forging political support
- Creating balanced contracts – with sufficient controls on all partners
- Developing a strong Public-Private-Partnership strategy
- Structuring a sound finance package (currency match, timeframe, etc.)

Thorough and realistic evaluation of each partner's needs and capacities (tenor, pricing, cash flow, grace period, investment horizon, returns, etc.) are necessary to devise a viable finance package, whether through debt, equity or quasi-equity financing. The IFC generally operates with three types of finance mechanisms:

1. Project Finance: focus on project specific needs (the favourite mechanism of the IFC)
2. Corporate Finance: assets financed as equity rather than loan (via the company balance sheet)
3. Partial Credit Guarantee: extend finance terms through a 3rd party

While the IFC has limited involvement in the Russian water sector to-date, it perceives solid opportunities for the future.

SESSION 2: LESSONS LEARNED – FACTORS OF SUCCESS AND FAILURE IN DOMESTIC AND INTERNATIONAL PRIVATE SECTOR PARTICIPATION

2-1. A “Home-Grown” Example: the development of a Public-Private-Partnership in Piaseczno, Poland – Christophe Schmandt, Consultant

This case study was conducted as part of an ongoing Market Development Study on domestic PSP in the ECA region (see presentation 1-1) by the OECD and World Bank. The objective of the case study was to determine if private, domestic companies are able to enter and perform in the market for water utility management. The company Aquarius has operated the urban water supply and sanitation systems in Piaseczno, a suburb of Warsaw, since 1993, starting with a service contract, and upgraded in 2003 to a “lease”.

The example of *Aquarius & Co.* in the Municipality of Piaseczno, Poland demonstrates that domestic private companies are able to enter and perform as operator in the community water services market. Yet, the case study also highlights that further progress is necessary in the ECA region, even in new EU states, to ensure transparency in procurement.

As a result of decentralisation and the transfer of asset ownership to local government, the municipality of Piaseczno faced a decision whether to create a new utility or to outsource water supply and sanitation operations. The municipality chose outsourcing and structured its separate urban and rural service areas into two contracts. Aquarius secured the “urban” contract, with minimal competition, essentially through direct negotiation.

Aquarius benefited from a familiarity with the infrastructure systems and the municipality, as former employees of the Warsaw water utility formed the company. Accordingly, the company founders had prior water and wastewater operational responsibility for Piaseczno. Another key was the progressive setting in Poland, whereby commercial structures were quickly resurrected following the political changes; Aquarius was part of the wave of entrepreneurship that swept through Poland in the early 1990s.

Both the municipality and Aquarius were proactively “solution” oriented during a time of rapid and uncertain change in the water sector. Some key results attained over the past 10 + years include:

- Regular water supply and full regulatory compliance (this served as a key control mechanism)
- 400% increase in billings & collections, despite just a 25% increase population increase
- 200% increase in water tariffs; 300% in wastewater tariffs.

Many of the efficiencies, notably the rise in billings and collections, were gained only recently, once the lease contract came into force, with those responsibilities transferred to the private company. The municipality still bears a high share of the cost of water services, with price subsidies.

The project preparation, contracts and procurement most probably do not meet international “best practices”. Indeed, the municipality proceeded despite minimal resources for project assessment and without benefit of external, “experienced” assistance to find a solution for water services. While the first

steps were rudimentary, contracts between the operator and the municipality have become gradually more sophisticated with ever more responsibility transferred to the private company. This demonstrates a need for “clearing house” type support (for standard bidding documents and contracts, expertise for project preparation, etc.) in the ECA region.

While private sector operators have emerged in Poland, the key remaining challenge for the future is to upgrade procedures to create a fully sustainable and transparent market.

2-2. Experience from Yerevan in Armenia; Gagik Khachatryan, State Water Committee, Armenia

Under the International Development Association (IDA) - World Bank loan programme on municipal development, a performance-based management contract was utilized with an “international”(non-ECA based) company to address water supply in Yerevan, Armenia. The contract commenced in April, 2000 and extends to April 2005.

Implementation of the performance-based contract in Yerevan resulted in significant operational improvements for the city water supply. This project also demonstrates that tariffs can be increased, without a reduction in collections efficiency, if service levels are improved. Yet, the process is not complete and further measures are necessary to achieve full cost recovery.

The Yerevan water supply system serves about 1.1 million inhabitants and was on the verge of technical and financial collapse in the 1990s. When the management contract came into force customers received only sporadic water supply (on average 4-6 hours per day, and in some network sections only up to 2 hours daily), collections totalled about 15% of billings and, therefore, revenues did not cover costs (80% of which were for electricity). An intervention was necessary to address and reverse this situation.

The main objectives of the World Bank/IDA project were to decrease the water losses and to increase service continuity. An international bidding took place in 2000 and was won by an Italian company; which assumed overall management of the Yerevan Water Sewerage CJSC.

Parallel legislative and regulatory reforms, such as writing off 65% of utility debt and implementing tariff increases, enabled project success. The following results were attained:

- Water supply service increased to 15 hours per day
- Energy consumption has been reduced to 30% of the amount at the beginning of the contract
- Reduction in Yerevan city’s customer consumption quantity from 250 to about 150 litres per person per day, plus a further reduction of 200 to 100 litres per person per day for other residents beyond Yerevan city.
- Collection rate increase by 440%, in large part according to installation of individual water-meters, e.g. in 80% of apartments

While tariffs have been increased, that did not result in a drop in the collections rate. On the contrary, with better service and a programme to address customer debt, collections and “willingness to pay” have even increased in some neighbourhoods. However, with a shift to meter-based billing and the resulting lower customer consumption rates, the total quantities of water sold and total billings have been reduced. Therefore, revenues still do not cover costs and government subsidies are still necessary to fill the gap.

Outside the capital city of Yerevan, Germany’s KfW has established a technical assistance project to improve water supply in 11 Armenian towns of the Armavir Region. About 65 percent of Armenia’s population resides in towns — and generally lack the technical and financial resources for self-improvements. The physical resources of the water & wastewater utilities in such towns often require considerable rehabilitation.

2-3. Private Sector Participation in the Water Sector – Challenges and Chances; Kurt von Rabenau, Kreditanstalt für Wiederaufbau - KfW, Germany

The German Development Bank (KfW) is a major development bank with global activities and a strong portfolio in the Balkans and Caucasus. The KfW has decades of experience in the water sector, including about 50 private sector participation projects.

The PSP mechanisms most used by the KfW are management and lease contracts, including with domestic operators. Indeed, management contracts are often an effective tool to commence the commercialisation of a utility. Yet, the primary limitation to PSP is the inability to eventually attain cost coverage due to insufficient revenues. The lack of local management capacities limits utilization of domestic PSP.

Currently, KfW is fostering domestic PSP through a 5-year management contract (including creation and strengthening of a domestic operator) in the rural areas of Choresm, Uzbekistan (7 villages and 50,000 population). The KfW is investing 10 million Euros for water supply infrastructure (as a concessional loan) with an additional 3.5 million Euro for consultancy and capacity building of the domestic operator. The intent is to circumvent many of the difficulties of international PSP in an economically challenged region (prohibitive cost structures, currency exchange, etc.) by “growing” domestic capacities.

Regarding PSP via international entities, the KfW experience indicates the necessary economy-of-scale in project preparation and implementation is only attained with urban areas of greater than 500,000 population. A critical aspect for “sustainable” international PSP is to integrate an exit strategy from the beginning of the project: training of domestic staff to replace the foreign operator upon completion of the contract.

An unsustainable water supply in Imishli, Azerbaijan (50,000 population) was reversed through a PSP project to attain 16 hours per day service and an 80% collections rate (for full coverage of operation costs and part of depreciation). The PSP structure included retention of all assets by the local government, 10 year lease and a 25% (public utility) - 75% (private operator) partnership.

Discussion During Sessions 1 & 2:

The discussions in these sessions focussed essentially on an assessment of the current trend of domestic private sector participation in the Russian Federation, as well as on some of the key factors that are perceived to limit the development of PSP.

While it is true that domestic private operators in Russia have been seizing significant market share (8% of Russian urban population served by PSP, and likely to increase to 16% in the medium term) over a very short time period (little more than a year), some participants were cautious about the sustainability of this trend. Since most contracts are short term leases of usually less than a year, it is currently difficult to assess how many of these contracts will be converted into longer term contracts. Most companies appear to use the short term leases to identify and register the assets, as well as to further evaluate the economic viability of the utility. They also focus on operational improvements which could bring visible improvements in service quality and some economic benefits in the short term. But, of course, it is too risky to make capital investments under such short-term contracts. The next two years are, therefore, going to be crucial in determining whether the momentum for PSP in the Russian market will be sustained.

A first sign that the trend of rapid extension of PSP might be slowing down in the next months is the strategic shift taking place in the industry, away from an approach geared towards fast expansion and seizing of market share, towards a more cautious step-by-step approach, such as pioneered by Novogor Prikamye. Several operators said that they would aim to consolidate their existing operations in order to

explore the problems and opportunities that exist in the water market. The main objective now is the “bankability” of projects, while the initial drive for project development was to rapidly acquire market share.

More generally, private sector participants estimated that only 10-20% of the Russian water market would be of interest to them at this point in time. This is largely due to the fact that the remaining municipalities either are considered too small for profitable operation by the private sector, that infrastructure is too severely deteriorated to be operated profitably, or due to the attitude and lack of capacity of local leaders/utilities.

Participants pointed-out the following obstacles to PSP:

- lack of “rules of the game”, which increases the already high levels of uncertainty;
- lack of capacity in municipalities and utilities (municipalities often lack strategic vision and planning for infrastructure development, as well as basic understanding of the potential benefits to be gained from PSP).;
- resistance of or meddling by municipalities and utilities;
- misinformation, wrong perceptions and suspicion vis-à-vis PSP, including resistance by the general public (customers);
- lack of funds for thorough project and contract preparation;
 - lack of knowledge about real physical status of the infrastructure (which might result in higher than expected investment needs);
 - lack of transparency, including information about financial status of the utilities;
- bias and lack of transparency in procurement;
- lack of domestic company capacity with respect to corporate management and finance.

With respect to the risk of political interference into the tariff setting process, it was suggested that re-centralising this responsibility back from the local to the regional level might provide a solution within the Russian context. This is due to the fact that citizens do appear to be more tolerant towards regional authorities than to their local governments, which would allow the former to decide unpopular tariff increases more easily.

Customer affordability was not perceived to be a major obstacle to PSP in the Russian context, while participants acknowledged the need to address this issue in any PSP contract. The quality of service and infrastructure is the driving factor in the water sector, not affordability; customers are willing to pay “much more” than current rates, but only for a “valuable” service, as suggested by some operators

Some meeting participants questioned the viability (and sincerity) of corporate strategies in the Russian Federation, which are based on the expansion from one utility sector (power – typically profitable) to another (water – with a product often considered as a “social” rather than a “commercial” good). In particular, it was debated whether this was a truly sustainable mechanism, or simply building market share to be leveraged at a later period as in other “aggressive” examples of privatisation.

While there are many questions as to the sustainability of increasing PSP in the Russian Federation, as well as many obstacles that would need to be overcome, participants thought that the trend was to be seen as positive overall. In fact, the development of local capacity, knowledge and experience that is being generated in the process of increased PSP was expected to eventually prove useful.

SESSION 3: THE POSSIBLE WAYS FORWARD

The wider context – Reform of the Housing and Communal Sector

3-1. Role of private operators in developing the market for communal service in Russia: recommendations for policy reform – Presentation RCS's vision and experience; Igor Ischenko, RCS – Russian Communal Systems, Russian Federation

RCS is a private operator active in the Russian Federation. The company is an example of a “newcomer” to the water utility management market. From its traditional base activities in the district heating and power sectors, RCS is undergoing a strategic expansion into the water supply & sanitation and gas distribution sectors. It sees itself as strategic investor and long-term partner to municipalities; RCS is transforming itself into a “comprehensive” communal services management company.

After one year of activities, RCS holds a cautiously optimistic viewpoint towards its future in the water services market. While it reports a generally “negative” experience so far, the company views this in a positive manner, as a necessary “learning experience” to fully understand the water market. RCS is attracted by the natural monopoly aspect of community water services.

Building on its base in municipal services, the company has significant experience with utility operations, in general, and PSP, in particular. At this time, RCS (via its 24 companies and 6,500 employees) is engaged in 52 contracts in 16 regions for water, heating, gas and electricity, including 37 lease agreements, and is serving 4.5 million consumers.

Its goal in the water sector is to achieve a new quality standard for water supply. At the operational level, RCS strives to increase profitability via reducing production costs, in part through reduction of personnel (35% staff reduction at its headquarters so far, with even more cuts necessary – despite the social aspect of employment and the associated community resistance).

The major limitations in the market include:

- unwillingness of regional – municipal governments to enter into PSP type contracts
- the un-commercial approach and status of many utilities
- lack of entities, which are ready to invest

Overall, RCS is wary of the privatisation *process*, because it can result in the sale of assets at symbolic prices - an unsustainable basis to an industry. In addition, PSP enjoys little regulatory support from national & local governments, and municipalities are often not yet “capable” to use PSP effectively. Nevertheless, RCS views PSP as a clear motivator towards infrastructure rehabilitation.

Yet, RCS remains cautiously optimistic. Some changes are occurring in tariff regulations. RCS is working with business institutions to bridge the legislative gap; indeed, low levels of regulation reduce burdens on market activity. With momentum gaining towards longer (5 to 7 years) contract terms, conditions will become more favourable to further development of PSP in the market. Another positive point is that local

authorities see RCS favourably as a business “structure” and partner, based on its reputation in the power sector.

3-2. Measures to support private operators of Water Supply and Sanitation Systems; Alexander Bazhenov, independent expert, Russian Federation

The presenter puts forward an assessment of the different forms of PSP possible in water sector in the Russian Federation with comments on market constraints and suggestions for possible remedies.

Overall, the water and sanitation markets of the Russian Federation are open to PSP inputs, though it faces numerous institutional, transparency and practical constraints in implementation. Private sector inputs are legal in the Russian federation. Like in the energy sector, a joint (public-private) partnership structure is typically used for water utility management contracts. The following options are legally available for PSP structures in water sector:

- Consortium of a municipal enterprise and a private operator
- Privatisation of a municipal enterprise through its incorporation into a joint stock company 100% owned by municipality with subsequent options:
 - Delegation of executive management powers in JSC to an outside private operator (management contract)
 - Sale of share to a private operator
 - Increase of JSC capital allocated to a private operator
- Lease of infrastructure to a private operator
- Procurement of infrastructure developments by a municipality from a private operator in combination with renewable lease of the infrastructure being improved
- Investment agreement = Concession (Law is in Duma for second reading)

The obstacles to and risks of long term lease contracts include the need to register municipal property rights in advance of a long-term contract – with costs drawn from the municipal budget, fair asset valuation before privatization, the impossibility in attracting transparent state subsidies and support if results remain in private property, the absence of legal requirement to make competitive selection of a future operator, etc.

The “RCS model” demonstrates a form of “lease with investment obligations” and is like a procurement contract for “infrastructure improvements” (capital investments and major repairs) let by the municipality to a private company, which simultaneously leases and operates the infrastructure. This model is a strategy to avoid most of the obstacles listed above. Indeed, such an approach requires a competitive tender, and the winner signs both a lease agreement and a procurement contract. Under such arrangements, the winner is protected from the risk (to a private operator working solely in a lease contract) that its capital investments will be recouped through early termination (for example, even if the lease contract is prematurely terminated, the municipality is required to pay fully for investments made under the procurement contract).

Under this scheme the municipality accumulates the rent paid under the lease agreement in a special fund and uses it to pay the private operator for the procured “infrastructure improvements” (capital investments and major repairs). Therefore, the lease payments balance the municipality’s obligations under the procurement contract, with no extra burden on the municipal budget.

Regarding market entry, private operators currently prefer direct negotiations and debt / bankruptcy pressure on the municipality; the process seldom incorporates formal tenders, not to mention real

competition. But the current approach increases political risk of early contract termination. A competitive solution is necessary to resolve transparency issues raised by direct negotiations.

Regrettably, the “RCS model” was not sustained, because of insufficient capital (to cover operations & spur investment) – investment obligations taken by the shareholders would have provided sufficient capital but the commitments were never honoured, in addition to an ensuing conflict-of-interest with many shareholders (some initiated independent businesses often in direct competition with RCS). While the projects prepared by RCS were very attractive (3 main projects had IRR= 22-42% and NPV amounting to USD 65 Million over a 15 year period)

The legal framework presents less of a problem (if any) than the availability of local capital. The roles of the private sector, the government and the IFIs are important to promote wider use of private investments and private initiative in water sector:

On the Private Sector side:

- Raising local capital base to sponsor project development
- Consolidating existing, underdeveloped service companies (engineering and contracting, project management, other services, HR training, etc.) to build necessary competencies
- Developing projects and contracting medium to long-term
- Maintaining current quality and improving productivity in contracted operations
- Helping local companies to gain industry know-how by twinning with international operators

On the Government side:

- Limiting possible “damage” to the sector by qualifying and limiting the number of players
- De-blocking Government subsidies and loans to municipalities from IFIs
 - Developing and providing partial credit guarantees to lower risk for local institutions and to mobilize local capital market into infrastructure projects
 - Government subsidies (ex-Gosstroy Agency and Water Resource Agency) pairings with private investment and qualified private management

On the IFI side:

- Taking proactive steps to demonstrate water sector viability to local capital markets:
 - Pilot loans to local operators to benchmark their credit risk to the local market
 - Capital infusions to local operators to benchmark the value of their operations to the local capital market

3-3. Government Strategy: to attract private investment and initiative into the Water Supply and Sanitation Sector; Liudmila Solovieva, Ministry for Industry and Energy of the Russian Federation

The ministry presented an overview of the market status, according to ongoing legislative reforms in municipal housing and water services. The utility and housing sectors are intertwined in the Russian Federation, according to the centralized legacy of communal services.

The evolution of government policies continues at the national level towards a more sustainable and effective water services market. In particular, the Duma has approved most components of a package of reforms known as “27 + 2” (only two laws, the Law on Investment Agreements in Communal Services Sector and the Law on Local Tax on Real Estate are still pending). This “revolutionary” legislation aims to consolidate the currently “complex” situation and limit the discretionary powers of the municipality.

According to the new institutional structures in the Russian Federation in place since early 2005, it is now the Ministry of Regional Development that is spearheading many of the relevant reforms². They include:

- Establishment of a new urban planning
- Reorganization and “un-bundling” of municipal services (e.g. creating separate entities for , heating, electricity, water, municipal waste, etc.)
- Creation of a 5-7 year development plan, including an industrial and investment plan
- Law on tariffs for utilities (introduction of industry tariffs and connection fees sufficient to finance utility operations and investments, respectively)
- Amendments to tax legislation to allow for depreciation charges

The portion of the laws termed “+ 2” include specific public safeguards for assets. For example, the *Law on Privatisation* will prohibit sale of the communal infrastructure, even in case of bankruptcy.

Regarding changes in legal forms, the legislation is to provide a 1-year evaluation period, to enable the owner (municipality) to decide on the utility transition. Preconditions to private contracts will include requirements for infrastructure investment funds and resolution of utility staff employment issues. Regrettably, the Ministry considers the municipalities still incapable of providing investment capital. However, an important first step to attracting investment capital is to build capacity at the municipal level to formulate and justify investment objectives.

3-4. Experience from the World Bank’s Housing and Communal Services reform projects in the Russian Federation; Peter D. Ellis, World Bank

The World Bank has extensive experience in the Russian Federation, both before and after the political transformation. The state and administration of housing and communal services have a key influence on consumers and water services.

The reforms in housing and communal services must continue, if a sustainable and effective water services market is to be attained. While there is no secret recipe, the key lies in maintaining ongoing activities and pressure within the sector during the long-term process of reform.

The Russian Federation is a highly urban context, with two-thirds of the population living in apartment houses. Since the political changes, Russia has undergone numerous major crises (wages in the early 90s, currency devaluation in the late 90s, privatisation of industry, etc.) with significant impacts on economic conditions. Regrettably, the situation on-the-ground is even worse than indicated by the macro conditions.

The housing stock is dilapidated, poorly maintained and still in use well beyond its economic life. The housing market is not sustainable as insufficient public finances and a lack of incentives for private investment (lack of private property ownership and a viable housing market stifle the potential for basic “homeowner” upkeep and inputs) result in poor maintenance and full depreciation of assets.

A key deficiency is the “grey zone” of responsibility in apartment blocks between the property line (to which the municipality delivers communal services – water, heating, etc.) and the front door of apartments

² Previously, this responsibility was with the Ministry of Industry and Energy, but the Department for Construction, Housing and Communal Services Complex was transferred into the newly created Ministry of Regional Development in early 2005.

(the point at which residents have an interest). No standard mechanism exists for maintenance and upkeep within the apartment block infrastructure itself.

Similar to the water sector, reforms in the housing sector must focus on financial (tariffs, cost recovery), institutional and regulatory factors over the long term. The key areas for reform include:

Over the Short Term:

- raise tariffs, to include rents & maintenance
- recover costs, both operations & depreciation
- full commitment to eliminate or monetize “privileges & exemptions”
- provide social protection to needy cases in the form of a housing allowance

Over the Long Term:

- Institutional strengthening is essential, as money alone will only postpone problems

Yet, the demand for change is minimal; the status quo is favoured for fear of disruption. Therefore, change must be nurtured, such that any price rise is accompanied, even preceded, by service increases. Prevailing market uncertainties also undermine the likelihood of change (e.g. whether maintenance will remain a municipal responsibility?).

While the market is void of examples of comprehensive reform of the HCS sector in any particular municipality, a promising sign is that many regions and municipalities are now expressing willingness to reform by learning from each other.

Effective usage of performance based contracts

3-5. Guidelines for Performance – based Contracting in EECCA – Key Requirements; Anthony Molle, Gide Loyrette Nouel

This presentation from the legal perspective reports on the basic requirements for effective performance-based contracts and is based on the “OECD Guidelines for Performance-based Contracts between Municipalities and Water Utilities in EECCA”, that was made available during the meeting.

The need for sound contracts has been confirmed by the generally uncertain conditions prevalent in many parts of the ECA region, especially in the 1990s during which many international companies discovered their dream projects had turned into liabilities. The necessity to think ahead and define key responsibilities with the proper incentives is essential for project success.

Performance - based contracts should establish project clarity, in particular by stipulating the goals, resources/ financing and the mechanisms to measure goals and resources.

Many elements should be considered in drafting contracts. The first step is to set realistic objectives and priorities, especially regarding capital expenditures (for both operations and asset rehabilitation/expansion). The financial soundness of the project must be ensured, by defining the sources of cash: tariffs possibly including automatic adjustments (per changes in laws, priced index, exchange rates, interest rates, etc.), subsidies (to address social cases or revenue shortfalls) or performance incentives.

Any contract must stipulate the ownership of the assets. The contract duration must be set in accordance with the on-the-ground time needed to realise the project goals, not arbitrarily by the category of contract.

Similarly, general “best-practice” guidelines for risk allocation can be used as a starting point, but must be tailored to the specifics of the individual project – off-the-shelf contracts remain risky.

The overall project setting and backdrop must be understood. It is necessary to determine the applicability and authority of the legal and institutional frameworks.

The essence of a performance - based contract is to ensure whether the intended results have actually been achieved. Therefore, performance indicators are necessary to measure and monitor project execution. The key is to devise a practical system (perhaps in the form of a Management Information System?), which is not excessive (this raises the expense of routinely extracting the results) or overly intricate (this can blur the real priorities of the project).

Incentives (remuneration of contractors, staff salaries & bonuses) and controls (performance penalties are really passed on to the end users) should be carefully considered to ensure that objectives will be attained. Likewise, the enforcement and conflict – resolution (incorporation of a mediation step may avoid more costly settlement in the courts) mechanisms must be carefully planned during project preparation. While a good contract requires an initial expense, it generally pays itself back many times over through smoother project execution and undisputed attainment of project goals.

3-6. EBRD Approach towards PSP in Municipal water Services Sector in Russia and CIS; Eugene Ofrikhter, EBRD

The European Bank for Reconstruction and Development has extensive experience with the water sector of the Russian Federation and the Commonwealth of Independent States; over 50 percent of its portfolio in the housing and communal services sector is in water projects. The EBRD reports on its overall experience in the ECA region.

The EBRD utilizes and will continue to utilize private sector participation models for water utility management, contrary to the current trend in much of ECA of less PSP. The basic reason is that the private sector typically provides greater effectiveness and efficiency than the public sector.

The ECA region needs continued reform to address chronic deficiencies (continued public health incidents, such as a cholera outbreak in 2002, and low levels of services) and limitations (the excessively political - social tariff policy; lack of transparency, weak legal framework, etc.). Domestic financing opportunities remain low due to limited creditworthiness of municipalities/ utilities and the lack of capabilities of the local banking sector. Therefore, the need for external and international inputs, such as by the EBRD, remains as one part of strategy to realize improvements in ECA.

No single contract type or PSP mechanism provides a comprehensive solution; rather each contract must be crafted to meet the needs of each individual project. A primary factor in the preparation of a project is to differentiate clearly the responsibilities of the asset owner vs. the service provider; and to provide the appropriate incentives. Many projects tend to be plagued by unsustainable expectations, such as unrealistic levels of service, or a mismatch of financial needs vs. capacities. A fair and balanced contract with realistic expectations is essential for a successful project.

Any private sector project must be implemented using a competitive, transparent and fair procurement process. This is the best safeguard against contract renegotiation or even cancellation – a key concern of would be investors.

The EBRD typically uses three approaches to PSP financing:

- direct to the asset owner (public sector procurement),
- private operator as selected by the asset owner through competitive bid or

- asset owner with an existing private operator (even if selected through direct negotiation), on the condition that the services are again put out for competitive bid.

The EBRD has found a successful formula in its approach – focus on one contract, before moving on to the next. Yet, the EBRD enjoys a pragmatic approach and believes private companies must be allowed to fail, if they cannot execute their contract. Overall in the ECA region, constant attention is necessary to further reduce political risks and the possibility of contract cancellation in order for inputs to be more acceptable for private operators & credit institutions.

3-7. Recent Experience with a mixed type “concession-service” contract in Surgut, Russia; Alexander Melnik, Surgut Municipality, Russian Federation

The municipality reports on an EBRD financed project for water supply, district heating and institutional development. The finance package totals 87.5 million Euros. Two years of the 10-year term has been completed to date.

The comprehensive project has started well, despite facing challenges inherent to much of the ECA region as a whole (legal framework, non-project risk, unsustainable tariffs, etc.). Some of the primary lessons learned include allowing sufficient time for project & contract preparation (at least 1 year), as well as integrating a sufficiently long transition period (2 years) to allow for sound asset valuation and utility adaptation.

The main project aims are continuity of service, a tariff to cover operational costs plus administrative and infrastructure efficiency. The institutional strengthening is a key component focused on improving credit standing and meeting performance indicators for the utility.

The project has three main components. The first is the preparation of a corporate development plan for the housing utility. This focuses on the creation of a financial management entity (joint stock company), a management information system, asset management (municipality remains owner) and customer relations.

The second component is a concession-service contract for utility operations. The preparation of the contract took over 1 year to prepare and stresses the conversion of the municipality from an administrative to a contractual relationship with the private operator. The legal framework presented some obstacles, with gaps regarding laws on concessions, rules for depreciation, etc. In the end the contract was comprehensive, but “bulky” with 5 basic documents and over 200 pages. It is unclear if simplification of the contract would have decreased its effectiveness.

A key element is the development of an asset management/replacement plan. Performance indicators are important, especially to commit the operator to investments. The debt service on the financing is borne directly by the operator. A two-year transition period is foreseen to enable full inventory taking of the assets.

Third, a tariff scheme was developed for 100% coverage of operations, to start; the tariff policy will be reviewed every 5 years. The water tariffs are set by municipal regulation, but include negotiation with the operators (based on performance criteria). The allowances for “standard” privileges & exemptions provided difficulties in the negotiation process.

Business-business partnerships

3-8. Can Franchising Enhance the Professional Capacity of Domestic Private Operators in the Water Supply and Sanitation Sector?; Meike van Ginneken, World Bank

This presentation focuses on a Bank Netherlands Water Partnership evaluation of the applicability of franchising to the water and sanitation sector. This private-private contract model presents opportunities to improve capacities of water utility operators worldwide as well as in the ECA region.

Franchising is a viable mechanism to improve water utility management “expertise” in the ECA region, most likely through partnerships between established and up-and-coming private operators, and is open to both international and domestic companies. This mechanism focuses solely on providing professional support and is not intended for investments.

This technique enables a local entity to “purchase” water sector expertise from a reputable operator, in order to raise production and management efficiency. Examples of franchising in other sectors were referenced: hotel and restaurant chains, postal service, etc. A key by-product of franchising can be increased trust in the operator by financial markets, leading to indirect opportunities to raise investment capital.

Franchising is one of four basic “professional support” models (the others being twinning, technical assistance and joint ventures). It focuses on the transfer of business know-how and practices to ensure the necessary skills and expertise for running a successful business and is applicable to water utility management. The franchising model is likened to a navigator (franchisor) assisting the driver (franchisee) of an automobile steer around the various roadblocks of the industry to successfully reach its destination (sustainability, efficiency, etc.).

The structure of franchising and the extent of know-how transfer can be limited to specific areas (such as billing and collection) or comprehensive (utility management). In any case, franchising often involves training and capacity building. Yet, this model is not similar to a consultancy; a change of thinking is required on the part of the franchisee to fully develop and take on the necessary professional capacities, while the franchisor retains a greater degree of operational responsibility.

This contractual model for professional support is normally based on a royalty fee. Care must be taken to structure the royalty fee payments for a balance between service, fees and revenues. Four types of payments are typically used, often in combination (up front, time based – e.g. monthly, unit fee – e.g. per man-month, and performance based).

Franchising may be attractive to international operators, as a strategy to gain access to new markets, such as ECA. Operators, who are not yet “comfortable” with the market to take on a lease or concession, may be attracted by the generally lower levels of risk in franchising. However, the companies must address the potential risk of diminishing their brand name, in case of project difficulties. Domestic companies may view franchising as an opportunity to build alliances with established operators and build their own capacities.

Partnerships with IFIs and Donors

International and Domestic Opportunities in ECA's Community Water Markets; Christophe Schmandt, Consultant

This presentation draws together the results of both the “domestic” and “international” surveys on private sector opportunities in the ECA region. The conclusions of the forthcoming Market Development Studies are previewed with a focus on recommendations to foster greater private sector inputs, both international and domestic, for greater expertise and capital in the ECA water markets.

There is a broad consensus from within and beyond the ECA region that concerted efforts and some changes are necessary to improve expertise and increase investments in the water utility markets, especially if the *Millennium Development Goals* are to be met. However, the extent to which the private sector can contribute to meet these enormous needs is not clear, and seems to vary by country, even by region or city – dependent on the willingness of the respective governments and communities.

Domestic and international companies confirm the various market limitations and share many of the same concerns (see presentation 1-1), even from their different vantage points. The hard truth remains that many ECA water markets are simply not economically driven markets – the key factors in setting tariffs remain political and social aspects, rather than the commercial requirements to cover operations and investments. Until this fundamental market flaw is corrected, the majority of the water utility management market will remain unsustainable, regardless of whether operated by a public utility or a private company. Another key concern is that water utility management is locked in monopoly structures, though changes are apparent in many countries.

Yet, the private sector offers some opportunities to improve levels of expertise in water utility management. Indeed, some of the strengths and weakness of the domestic and international players are complementary and offer some opportunities to expand the market scope for private inputs (pairing of domestic and international companies to offset “non-project” risks, prohibitive international cost structures in relation to revenue potential, fill the gaps of dissimilar capacities and experience, provide service in more remote regions, currency exchange, etc.). Both domestic and international companies remain interested and even eager to participate in the market, assuming the non-project risk and economic viability issues are addressed (assistance is sought in these areas from international finance institutions and donors to make the market more attractive in the form of guarantees, more accurate project preparation, transparent procurement, etc.).

The vast majority of both domestic and international companies answer with a resounding “NO” to the prospect of providing investment capital; the water market must first be proven viable on an operational basis.

Discussion During Session 3:

The discussions in this session focused on three main topics: the use of performance contracts and competitive bidding, and the potential for partnerships to foster PSP.

Competitive tenders and performance-based contracts

Domestic company representatives did not question the necessity of a comprehensive approach to prepare and implement contracts, but rather the viability, in particular the costs, of achieving such steps in the ECA region. Another concern that participants expressed related to the lack of available expertise to

develop performance-based contracts. Many wondered if a more succinct, practical and economic mechanism is possible.

Another significant problem is the insufficient level of data and documentation on system assets, financial status, service levels, etc. when a contract is signed. Often it turns-out later that the data used for the contract was flawed and did not present an adequate picture of the utility, therefore putting in question the value of the exercise. The World Bank mentioned that this is a problem that is not specific to the ECA region. In a recent PSP failure in Atlanta (USA) an extensive and state of the art due diligence process did not reveal the true condition of the utility assets. The contract failed due to the discrepancy between the on-the-ground reality vs. the initial contract data and the inability of parties to renegotiate the contract. This experience suggests that ahead of a long term contract, a 3-4 year contract could be used to ensure that a follow-up long term contract uses the right figures and hence is realistic.

Moreover, contracts in Russia are often negotiated rather than tendered and, hence, lack transparency. Participants saw some of the causes for this in: the mentality and low capacity of municipalities who often do not know exactly what they want to achieve, apart from getting rid of responsibility for providing water services. They also find it sometimes difficult to understand the rationale of a tender in a context where there is little competition. Finally, the time needed for the preparation of tender documents (generally at least 6 months), as well as the significant, often unaffordable, costs act as deterrents.

Partnerships to foster PSP

Both international and domestic private sector participants saw an opportunity for co-operation with each other in the Russian water market. International operators thought that they would benefit from domestic operators who are better able to evaluate local risks. Domestic operators thought that they could benefit from the extensive experience in preparing contracts and managing water utilities that international firms have.

One of the possible forms of co-operation is franchising, which may have limitations for application in some markets, due to its exclusive focus on “expertise” without directly addressing “investments”. Furthermore, the discussion revealed that in any form of co-operation the valuation of the international operator’s contribution would seem to be the key obstacle to an agreement though. While international operators perceived that their brand name would be exposed in a partnership with domestic firms, domestic operators were arguing that in the Russian Federation these international brands are unknown and therefore would not provide any competitive advantage. Participants felt that more discussions between international and domestic operators could however lead to overcoming this obstacle.

Many meeting participants noted the difficulties of building momentum towards and affecting structural change for sustainability – whether in the water sector or related sectors. In particular, dramatic institutional & regulatory reforms are generally void of appropriate “incentives” for policy-driven or market-driven improvements. The lack of a model for private property ownership, for example, has ripple effects in the “unwillingness” of entities to accept responsibility for change and improvement.