

GUIDING PRINCIPLES FOR REFORM OF THE URBAN WATER SUPPLY AND SANITATION SECTOR IN THE NIS

INTRODUCTION

Several recent studies have documented that the water supply and sanitation services in the New Independent States of the former Soviet Union (NIS) are in critical condition and deteriorating.¹ There are frequent interruptions in service, yet water consumption is excessively high by international standards with considerable wastage. Water quality is deteriorating, and in some NIS resulting in adverse impacts on human health, productivity and important ecosystems.

Although investments are required, these problems will not be solved only by increasing the supply of financial resources from public budgets: such an approach would not be sustainable and would reinforce the inefficiency of existing arrangements. In any case, the financial resources required to address the scale of the present problem simply do not exist. In some countries only 30-40% of the resources needed to operate and maintain the existing networks are available, and external financial resources could only help to address a small fraction of the total needs.

Important initiatives to reform vodokanals (water utilities) have been launched at the local level in some countries which are yielding valuable experience, and they should be continued. However, it is questionable whether these initiatives can be widely replicated unless new policies are implemented establishing a sounder, more sustainable basis for sector reform. Some local initiatives have involved support from donors and/or International Financial Institutions (IFIs); but, overall, the results achieved from these projects have been mixed, with the results of some projects disappointing compared with the effort invested. This generates frustration for both local and foreign partners.

Experience gained since 1991 clearly indicates that a new framework is needed to guide the reform of the urban water supply and sanitation sector. Such a framework is essential to stop the continued deterioration and eventual collapse of water and sanitation services, with the serious consequences for the health of the population and their environments which this would entail. The objective of the reform should be to address these problems and to ensure that good quality water and sanitation services are delivered reliably, sustainably and at least cost to the population. Some of the key reforms needed to achieve this objective include:

- Decentralising responsibility for water service provision from national authorities to the local level.

1 . UK Department for International Development (2000), "Obstacles and Opportunities to Commercialising Urban Water, Services in the New Independent States"; Danish Ministry of Energy and Environment (2000) "Environmental Finance Strategies for Georgia, Moldova and Novgorod"; World Bank (2000) "Water Supply and Sanitation Sector Review and Strategy for Azerbaijan". Some of the main findings of these studies are summarized in the Background Document on this issue prepared for the Almaty Ministerial Consultation CCNM/ENV/EAP/MIN(2000)5.

- Reforming vodokanals so that they have the autonomy, capacity and means to provide water and sanitation services efficiently and effectively, based on a realistic assessment of needs and subject to strict supervision by public authorities.
- Engaging the public directly in the reform process.
- Establishing the sector on a financially sustainable basis so that funds are available to cover operation and maintenance costs and to make necessary investments, while addressing the needs of poor and vulnerable households.
- Creating incentives to substantially increase efficiency in the use of water by consumers and in the operation of vodokanals.

The Guiding Principles set out below are intended to present a “vision” of the types of reform which are needed. They suggest how the roles and responsibilities of different stakeholders should be changed in order to ensure that safe water and high quality sanitation is provided reliably and cost-effectively. They should be seen as an inter-related group of recommendations where new rights (e.g. for vodokanals) are balanced by new responsibilities. The Guiding Principles address the urban water sector; they would need to be adapted to apply to rural water supply. More generally, urban and rural water reform should form part of integrated river basin management systems.

The Guiding Principles are not strict “rules”; rather they propose a direction for reform. They reflect “best practices” which have been successfully applied in other parts of the world, including in Central and Eastern Europe. They have been developed through a participatory process involving major stakeholders. NIS governments, donors, IFIs, NGOs, the private sector and other stakeholders are invited to take the Guiding Principles into account when reforming the urban water supply and sanitation sectors.

The Guiding Principles clearly need to be elaborated further and adapted to the particular circumstances in each NIS. This process of adaptation will need to be integrated into the broader process of reform, and to take account of the important differences in the financial capacities and structures of the urban water supply and sanitation sector of the various NIS. However, the NIS also share many common features which could underpin a process of co-operation and experience sharing, implemented through the EAP Task Force.

The Guiding Principles are set out immediately below:

I. KEY ELEMENTS OF URBAN WATER SECTOR REFORM

1. Establishing Strategic Objectives

1. The main strategic objective of urban water sector reform should be to ensure that good quality water and sanitation services are delivered reliably, sustainably and at least cost to the population. This objective should be translated into national action programmes which contain realistic, quantitative, time-bound targets covering performance and quality objectives.
2. The national authorities should facilitate participatory processes involving governmental and non-governmental stakeholders to establish targets, and to develop a strategy for achieving them, which prioritises actions to minimise adverse impacts on human health, productivity and important ecological systems. Urban water sector reform strategies should ultimately be integrated into river basin management schemes.
3. Finance strategies should be developed in which the feasibility of targets are assessed against a realistic appraisal of the likely sources and levels of finance; the measures required to ensure that the levels of finance provided from different sources (including vodokanals) are sufficient to achieve agreed targets should be clearly identified.
4. Socio-economic and willingness-to-pay studies should be carried out to assess the demand for, and affordability of, improved utility services at the level of households; the studies should include an assessment of the needs of poor and vulnerable households.

2. Reforming Institutions and Clarifying Their Roles

5. **The Role of the National Authorities** should be to set the framework for managing urban water supply and sanitation by:

Decentralization:

- decentralising responsibility for water supply and sanitation services to the municipal level, avoiding excessive fragmentation.
- establishing the legal, regulatory and institutional framework for sound and sustainable municipal finance, including effective planning, supervision and fiscal control systems for municipalities.
- clarifying the legal status of vodokanals, their relations with local governments and property rights for infrastructure.
- establishing a framework for treating the inherited debts of vodokanals.

Regulatory Oversight:

- depending on the particular circumstances in a country, consider establishing an independent, national regulatory agency to ensure that vodokanals do not exploit a monopoly position and/or to protect them from undue political interference. In such cases, the objectives of the regulation should be clearly identified and appropriate means for achieving them provided.

- regulating issues that have national or inter-municipal dimension, such as standards for environmental quality, wastewater discharge and drinking water; and establishing the legal framework to facilitate water and sanitation management initiatives undertaken jointly by groups of municipalities.
- establishing the legal and regulatory framework for stakeholder involvement, including private sector participation and consumer protection.
- establishing a framework for managing the competitive uses of water at the national and regional levels, including principles and rules for the management of different water resources, and policies for integrating municipal water and sanitation systems into coherent programs for water resources management within river basins.
- ensuring that an adequate system for monitoring water quality is in place and that the results are available to the public.

Strategy Formulation and Technical Assistance

- defining strategic policies and development objectives, including investment strategies and the means for financing them; such policies and investment strategies should strike an appropriate balance between water supply and sanitation objectives.
- providing assistance to utilities and local governments in areas such as capacity building, finance, and international assistance co-ordination.
- promoting demonstration projects to reform selected vodokanals; disseminating results; publishing performance indicators for vodokanals.
- facilitating market creation and promoting competition in the supply of goods and services to vodokanals.

6. **The Roles of Local Government² and Vodokanals** should be clarified. Local governments should establish vodokanals as autonomous, commercially-run utilities, with responsibility for billing and collecting payments. They also need to build capacity to exercise effective regulatory oversight over utilities. This would involve:

Transparent Transfer of Responsibilities to Vodokanals:

- Over time, the responsibility for setting and adjusting tariffs should be vested with vodokanals, subject to the supervision of local government or an independent regulatory agency. The public should also be involved in the process.
- The right of vodokanals to use assets over long periods of time should be established unambiguously. When ownership of assets is to be retained in the public sector, the assets should be transferred to the lowest level of government; this should not be lower than that of the service provider.
- Local and national governments should develop a plan for dealing with vodokanals' debt and removing obstacles to their raising capital for investment; options for payables include reorganisation and debt relief from the national authorities or liquidation; options for receivables may involve a once-only subsidy.

2. "Local government" is used to mean the appropriate level of sub-national government, whether at the regional or municipal level.

Regulatory Oversight:

- Local government should hold vodokanals accountable for their performance, e.g. using performance contracts which clearly define performance and quality targets to be achieved by the vodokanal and the support to be provided by local government. The contracts should include appropriate incentives and sanctions to encourage efficient service provision by vodokanals, as well as a requirement to issue regular reports to the public on progress in achieving performance targets.
- Local governments should subject vodokanals to hard budget constraints and not provide support, in any form, in addition to that agreed in performance contracts.
- In the transition period (and subsequently), vodokanals should be required to prepare proposals, supported by detailed justification, for tariff rates and structure, taking into account the recommendations on tariffs described above.

Strategy Formulation and Private Sector Participation

- When developing a strategy for water sector reform, local governments and vodokanals should consider inviting private operators to participate in providing water and sanitation services. The arrangement selected should be consistent with the government's reform strategy and capacity.³
- When contracting a private utility operator, interested governments should retain the assistance of experienced legal, technical and financial advisors with substantial international experience. Decisions to invite private sector participation should be based on competitive bidding procedures. The process should be open and transparent, with adequate provision for public participation.
- Vodokanals should develop and implement a program of comprehensive investment planning, covering operation, maintenance, rehabilitation and eventually capital investments, based on realistic estimates of future revenues.

7. **The Public** should be directly engaged in the reform process. Reform of the urban water sector will change the role of the public from essentially passive consumers of state-provided services, to purchasers of those services. This will require greater involvement of the public in decisions concerning the level and type of service provision, and the associated financial implications. Government and vodokanals should provide for effective public decision-making in sector reform and ensure that poor and vulnerable groups have adequate access to water services:

- National authorities should establish a legislative basis for public participation in key decisions concerning water supply and sanitation services.
- Local government and vodokanals should actively provide consumers with full information and opportunities to participate in key decisions concerning water supply and sanitation, especially through public meetings and participation in decision-making bodies.

3. The options and issues associated with private sector participation in the urban water sector are analysed in the background document on this subject prepared for the Almaty Conference CCNM/ENV/EAP/MIN(2000)7.

- Performance contracts between local governments and vodokanals should be developed through a participatory process and ensure that the interests of all stakeholders, particularly the poorest and most vulnerable, are protected.
- Government, and not vodokanals, should have the ultimate responsibility for ensuring that poor and vulnerable households have adequate access to water and sanitation services; transparent, targeted and efficient subsidies which take account of tariffs for all utilities and address integrated household needs should be used to provide support to such households.

3. Establishing a Framework for Financial Sustainability

8. The following measures are important to create conditions for financial sustainability of vodokanals:

- Improve coverage and efficiency of billing and payment collection so as to maximise revenues; introduce and enforce sanctions for non-payment, including cut-offs as the last resort.
- Phase out as quickly as possible non-cash forms of payment, where such practices exist.
- Settle outstanding payments by public organisations to the vodokanal; make these organisations responsible for ongoing payments for water services; if financial support is needed, it should be through transparent government subsidies.
- Replace the current “basic cost-plus” tariff formula with one that provides incentives for cost reductions and allows for an acceptable level of profits.
- Reduce large differentials in tariffs between household, industrial, and other users; this will likely encourage more rational water use by those who are currently cross-subsidized, and reduce resistance to pay their water bill by those who currently pay very high tariffs.
- Establish a procedure for periodic tariff revision and adjustment, which is transparent, involves the participation of stakeholders, and is indexed to inflation.
- Develop a program for gradual tariff increases to cover operation, maintenance, rehabilitation and ultimately investment costs; such increases should take full account of affordability constraints and be part of a strategy for service improvement which has been developed through a participatory process.
- Introduce accounting systems that conform with international standards; national authorities should determine tax liability on this basis.

4. Promoting Efficiency and Cost-Effective Use of Resources

9. Governments should establish an operational framework for vodokanals which promotes the efficient use of water and other resources; this framework should encourage vodokanals to develop new approaches for promoting the efficiency improvements in networks and plants which are urgently needed.

10. National standards which are stricter and more costly than those established internationally should be reviewed and modified so as to reduce compliance costs to a realistic level.

11. A new management culture needs to be introduced to water sector institutions based on clear responsibilities, incentives for initiative and good performance, and accountability; this should be supported by appropriate management and salary structures, performance-related pay and computerised information systems.
12. Human resources management policies should promote appropriate staff training and, in consultation with the work force, the achievement of efficient staff levels. Areas where capacity building is urgently required include: business management, economics, law, consumer awareness, needs assessment techniques and processes for facilitating dialogue and co-operation between vodokanals and the public. The revision of engineering curricula of universities also requires urgent attention.
13. A metering strategy should be designed and implemented to reduce consumption, wastage and operational costs and to improve revenue collection; the efficiency and transparency of metering apartment blocks should be improved as a step toward the ultimate goal of metering individual users; investments in meters should be commensurate with benefits.
14. Vodokanals should develop public outreach programmes which encourage the more efficient use of water by consumers as an integral part of efforts to improve the quality and reliability of water services.
15. Limited investment resources should be concentrated on projects:
- To reduce operating costs through high pay - back investments e.g. demand management, leak reduction and energy savings.
 - To improve the safety and reliability of water supply services, particularly to address public health concerns.
 - To maintain and rehabilitate essential elements of wastewater collection and treatment infrastructure, particularly to address public health concerns.

II. SEQUENCING REFORMS

16. Strategies to reform the water supply and sanitation sector should sequence actions and prioritise those on which other steps depend. Such strategies need to be integrated with, and take full account of, the broader process of economic, political and social reform. Since some actions will require legislative or other time-consuming processes, they should be initiated as soon as possible, or accelerated if already in progress. Priority actions should include:
- Launching participatory, multi-stakeholder processes to support the development and implementation of the strategies.
 - Decentralising authority to the local level.
 - Creating autonomous vodokanals and, as required, an independent regulatory agency.
 - Establishing performance contracts between local governments and vodokanals, initially with a focus on improving service levels through affordable, low-cost measures.
 - Strengthening the financial stability of vodokanals by reforming tariff levels, collection systems and debt.