

Promoting the Use of Performance-Based Contracts between Water Utilities and Municipalities in EECCA

Case Study N 3: Shymkent Water Utility “Water Resources – Marketing” Ltd.



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Ситуационное исследование № 3: Шымкентское ВКХ - ООО «Водные ресурсы – маркетинг»

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FOREWORD

This case study analyses the experience of Kazakhstan with privatising water utilities by focusing on one of the most successful cases in the country. The report presents the results from a review of the private water company that manages the water utility in the city of Shymkent: the “Water Resources – Marketing” Ltd.

The findings and conclusions in this report have been prepared to support the Kazakh government in its efforts to further improve the legal and regulatory framework for managing water infrastructure in line with international good practices. The report provides an objective analysis of important aspects of the company’s rights and obligations (defined mostly by the laws), identifies its strengths and weaknesses under the current regulatory framework and proposes a set of recommendations for improvements. The OECD’s *Guidelines for Performance-Based Contracts* served as a benchmark to assess the Shymkent water company’s operations. The recommendations from this review could be used as a basis for discussion and consensus-building among key stakeholders in Kazakhstan on the future of the water supply and sanitation sector.

The report was prepared in the framework of the Task Force for the Implementation of the Environmental Action Programme for Central and Eastern Europe (EAP Task Force), whose secretariat is located in the OECD’s Environment Directorate. The project was managed by Nelly Petkova, with support provided by consultants Guy Leclerc and Alexandra Rosa (from PriceWaterhouseCoopers) and Valeriy Syundyukov from the Kazakhstan Water Supply and Sewerage Utilities Association. The preparation of this report was financially supported by the EU Tacis.

This report is part of a broader project. Three additional case studies have been undertaken using the same methodology. Lessons from all these case studies will be used to adjust the OECD Guidelines for Performance-Based Contracts and will be disseminated in the EAP Task Force context.

The report is based on available documents and data, as well as on inputs provided by the Kazakh partners on the project. The authors would like to specifically thank Anarbek Orman and Zhanatbek Turdaliev from the Water Resources–Marketing Ltd., Nuriddin Musirovich, Member of the Skymkent Oblast Parliament and Arman Zhetpisbaev, Mayor of the City of Shymkent, who kindly agreed to spend time with the review team and share their views with us. We are also grateful to all other Kazakh experts for their support for and contribution to this analysis.

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The views expressed in this report are those of the authors and do not necessarily reflect those of the OECD or its member countries.

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List of abbreviations

ARNM	Agency for the Regulation of Natural Monopolies
EAP Task Force	Task Force for the Implementation of the Environmental Action Programme for Central and Eastern Europe
EECCA	Eastern Europe, Caucasus and Central Asia
EU	European Union
IBT	Increasing block water tariff
ISO	International Organization for Standardization
O&M	Operation and maintenance (costs)
PPP	Public Private Partnership
PSP	Private sector participation
SCE	State Communal Enterprise (for water supply and sanitation – GKP in Russian)
USD	US Dollar
VAT	Value-added tax
WRM	Water Resources – Marketing Ltd.
WSS	Water supply and sanitation
WWTP	Wastewater treatment plant

EXECUTIVE SUMMARY

Background

Since the disintegration of the Soviet Union, Kazakhstan has undergone significant political and economic changes. Along with macroeconomic stabilisation, the government agenda has focused on accelerating Kazakhstan's transition towards a modern market economy, including privatisation and price liberalisation, followed by devolution of a number of important responsibilities to the lower levels of government.

The early years of the transition were rather difficult and the local governments were stripped of cash. Privatisation of state-owned enterprises was seen as one possible solution, carried out mostly as management buy-outs. In the water sector, in the mid-1990s, the government launched massive privatisation of the water utilities. About 40% of these utilities in the country are now fully privatised.

Shymkent, with about 500 000 inhabitants, is one of the main cities with a private water operator in Kazakhstan, Water Resources – Marketing Ltd. (WRM). WRM became fully operational in 2005. It owns the assets but there is a 22% municipal stake in its equity capital. The company is in charge of the maintenance, rehabilitation and operation of the existing water supply and sanitation assets. Investment in new infrastructure and extension of the system are a responsibility of the municipality.

However, apart from the act of transfer of assets between the company and the city as part of the privatisation deal, there is no specific (performance-based) contract that regulates the company's responsibilities for the provision of public water services. It is the Law on Natural Monopolies that provides the major legal framework for the operations of the private water companies in the country.

Objectives of the review

This report provides an objective analysis of all important aspects of the company's rights and responsibilities (as defined in the laws), identifies its strengths and weaknesses given the current regulatory framework and proposes a set of recommendations for improvements. While this case study analyses a private company and not a typical public-private partnership (PPP) type of contract, the analysis still provides important insights in the regulation of the private sector in managing water services.

As such, the findings and conclusions in this report have been prepared with the aim of supporting the Kazakh government in its efforts to further reform the water supply and sanitation sector in line with international good practices. The OECD's *Guidelines for Performance-Based Contracts* served as a benchmark to assess the Shymkent water company's operations. The recommendations from this review could be used as a basis for discussion and consensus-building among key stakeholders in Kazakhstan on the future design of performance-based contracts, if the government chooses to go in this direction.

Through this analysis, the review also seeks to identify good practices and learn lessons which can then be used to further improve the relevance of the Guidelines with regard to specific Eastern Europe, Caucasus and Central Asia (EECCA) experience. This knowledge was largely missing in the first version of the Guidelines. In this context, the Kazakh experience is particularly useful and provides a number of valuable lessons for other EECCA countries which consider involving the private sector in one or another way in managing water utilities.

The regulatory framework poses significant challenges to the private water service companies...

The water sector reform, launched by the Kazakh government several years ago, opened up the way for private sector participation in the country. Attracting the private sector aimed at improving the efficiency of water services and reducing public costs. To achieve these objectives, the government created a regulator at a national level – the Agency for the Regulation of Natural Monopolies (ARNM) which regulates all utilities (telecom, water, heating, gas or electricity services).

Creating a national authority (mostly in charge of tariff regulation in the water sector) is a major achievement as it ensures a better compliance of the water companies with the law in force. However, at the central level there is institutional vacuum as there is no designated authority specifically responsible for water utilities and the reforms in both the urban and rural water supply and sanitation sector. As a result, there is no clear vision and strategy for the development of the water utilities in the country. There is no clear idea about the financial needs for the sector and the way these will be funded. In addition, the absence of a designated water authority results in a lack of specific service standards for the sector. As such, it is not possible to control the operations of individual private water companies and hold them accountable for their performance. Some government representatives confirm that the privatisation of water utilities has not gone always well and there is a need for other approaches to managing the sector and further reforming it.

Currently, there are talks about the creation of such a body (a unit within the Water Resources Committee under the Ministry of Agriculture) which will guide and oversee the sector and develop relevant laws and regulations. It is expected to be created soon through an amendment to the Water Code. While this may not necessarily represent a major change in the Code, the new authorised body will have the authority to decide on reforms in the sector.

One of the major challenges to the private sector, in general, and WRM, in particular, is related to financing rehabilitation expenditure of the utility. In principle, such expenditure are supposed to be financed either from retained earnings or from commercial credits that the company should contract and pay back from the tariff revenue collected from water users. In both cases, the real issue boils down to tariff setting and implementation.

Access to long-term credit for investment is not easily available in Kazakhstan. Bank credit is usually provided for a period of 6 months – to one or two years and at an interest rate of above 10 to 20%. On the other hand, investments could also be covered through the tariff from its depreciation and profit components. Currently, both these are extremely low and do not cover even operating expenditure let alone rehabilitation costs. This situation shows that cost-recovery is not a major goal for the Kazakh government. It seems that keeping tariffs unrealistically low may have been one of the reasons for the great number of bankruptcies in the sector. However, raising tariffs to cost-recovery levels and protecting the poor and socially vulnerable people are two separate issues and should be dealt with under separate policies.

In this difficult situation, tariffs are the most sustainable long-term source of financing. The recently-introduced medium term tariff (a price-cap type) methodology provides some basis for better investment and tariff planning over a period of 3 to 5 years. However, the current eligibility requirements for a 5-year tariff plan are so demanding that it is only WRM, among all private water companies in the country that has been able to meet these criteria and qualify for such a tariff. The

actual implementation of the tariff has proved to be even more difficult: mostly as a result of the tariff freeze, the rejection by the ARNM of the investment plan used to justify the tariff increase and the burdensome reporting requirements.

Furthermore, WRM has financial obligations towards the municipality due to the historical structure of the company's equity. In the past, 100% of the profits corresponding to the municipality's shares were usually reinvested in the company. Since 2006, a change in the regulation has made it compulsory to allocate back to the municipality 50% of the profits corresponding to its shares. This has led to additional dispersing of resources.

In the absence of a performance-based contract, there are no company-specific performance indicators and service standards. However, the absence of performance indicators does not mean the absence of objectives for the company. These objectives are specified both in the current legislation as well as in the company's strategic documents, such as its multi-year investment programmes. Some of these objectives include: providing adequate amount of water to the population, improving the service quality, reducing unaccounted-for-water, reducing electricity consumption.

The problem with these objectives is that they are only vaguely specified and leave a lot of room for interpretation. For the company to be credible, such objectives need to be translated into specific, measurable and time-bound targets and indicators compared and measured against a clear-cut baseline. Experience from other countries shows that the fewer the indicators, the easier it is to monitor them and the more credible they are. In addition, it is important that each indicator is clearly defined and the methodology for its measurement and verification explicitly specified. It would be even better if such requirements are directly incorporated in the legislation in force as well.

...but there are still some good practices in place...

Notwithstanding the above challenges, it is worth noting that the Government of Kazakhstan has achieved certain progress in regulating the water sector given the existing economic conditions in the country. In this context, some of the major good practices (although needing further improvements) that can be highlighted include, among others, the following:

- The creation of a regulator that provides guidance on tariff formulation and oversees tariff implementation.
- The development of a medium term tariff methodology for justifying tariff increases allows the inclusion of investment expenditure in the tariff and provides a certain level of confidence over the tariff rate at least in the medium - three to five year - period.
- The development of a methodology for monitoring the overall implementation of the investment programme as a basis for the tariff increase. This allows better information disclosure to the authorities.
- The implementation of a tariff control procedure by including a financial penalty in case the costs of the investment programme, agreed upon with the operator as part of the tariff increase justification process, exceed 5%. Such a penalty allows to discipline private operators in their spending plans and encourages them to prepare more realistic and sound investment programmes.
- The requirement concerning the procurement procedures built into the tariff plan with regard to the implementation of the investment programme allows for improved transparency and strengthened rule of the law.
- The compulsory public hearings and consultations required in case of a tariff increase requested by the operator open up an information channel and allow both customers and

politicians to better understand the financial needs and challenges of the operator. This kind of communication, if well implemented, can help create mutual trust among the parties as well as make the tariff increases more acceptable.

- The development of indicators to assess and push the performance of WRM shows the professionalism of the company's management and the understanding of the need for certain objectives and indicators which can more easily communicate company's achievements to clients and politicians. Even if the current indicators need to be further refined and made more robust, it is obvious that there is already a certain level of willingness on the part of the company to move in this direction.

...and yet more efforts are required in the future to make the sector sustainable

Despite all these positive developments in the legal and regulatory framework, the private water service companies in Kazakhstan are experiencing enormous problems in financing their investment and O&M expenditure. The low tariffs and the lack of access to commercial debt financing at acceptable conditions further threaten the integrity of the sector. Reports from different analyses show that many companies continue to exist on the verge of bankruptcy which threatens to cause even further degradation of the sector.

Experience from other countries that have chosen privatisation as an option for the management of the water sector shows that privatisation in such countries was preceded by a long period of reforms, during which a robust regulatory framework was created, public utilities were strengthened and corporatised, tariffs were increased to cost-recovery levels, and a system of subsidies for needy households was introduced to help them cope with higher tariffs. These reforms are a crucial element in ensuring the success and stability of the water privatization process (e.g. in Chile, UK).

If the objective of the Government is to make this socially sensitive sector financially healthier, significant political efforts will be needed to implement necessary reforms. In this context, the major recommendations that can be offered for consideration are provided below. These are split into two major groups: recommendations concerning the national level and recommendations to the company and the local level.

1. Recommendations for the national level

The government should:

- Speed up the adoption of the law on water supply and sanitation and the establishment of a designated water authority. This will provide the opportunity to clarify the organisation of the water utilities sector and set overall goals and targets for the sector (e.g. developing service standards and coverage requirements, affordability guidelines).
- Seek to work with the banking sector to create better conditions for access of water utilities to long-term debt finance at an affordable cost by blending, for example, private and public money. The government could channel public money through commercial banks which can disburse it to the sector on softer and more favourable terms. This will be necessary as long as the commercial banking sector gets sufficiently developed to be able to provide long-term credit on its own.
- Consider social tariffs for poor customers, for example, such tariffs could be set for a minimum volume of water consumed (for instance 40 cubic meters a year per household) required for domestic use (mainly for drinking and public health). It seems that the Increasing block water

tariff (IBT) methodology may be the more appropriate option for Kazakhstan as the Kazakh legislation does not allow setting different tariffs for different social categories of customers.

- Seek to relax the reporting requirements on the investment programme as part of the medium term tariff methodology by introducing two different reporting formats: instead of the heavy quarterly reports currently required, the government can introduce a comprehensive yearly report and an intermediary report provided every six months with a focus on major indicators.
- Require that water companies, both private and public, develop or participate in programmes on training and re-training their staff (performance measurement, drinking water quality control, financial management, commercial/customer relations).
- Seek to improve transparency and information disclosure with regard to procurement and public hearings related to tariff increases.

2. Recommendations for WRM/Shymkent municipality

In the absence of a regulatory body that can impose service standards for the sector in Kazakhstan, the municipality of Shymkent can consider developing a specific contract with WRM. Such a contract can at a minimum specify the requirements for providing water and sewerage services that the company should meet. In addition, the contract can include other performance-based indicators, as considered relevant.

Even if the current legislation does not require the development of specific performance indicators, the image and the reputation of the company can only be further strengthened if such an initiative comes from it. WRM should seek to:

- Translate existing objectives into specific, measurable and time-bound targets. Choose a baseline year against which each indicator will be compared and monitored.
- Define the indicators clearly and specify the methodology for measuring and calculating them and agree these indicators with public authorities.
- WRM and the municipality should work more closely on optimising the design of water investments in the city. Although new investments are not a responsibility of the company, once built, such assets will be transferred to WRM to manage and it will have to bear future maintenance and operational costs. Therefore, WRM needs to be well aware of these costs in order to be able to include them in their future business plans.

Overall, WRM reports show that the services provided by WRM in terms of continuity of water (24 hours) and drinking water quality (the company has its own accredited laboratory) are relatively good. Of the privatised water utilities, Shymkent is regarded as the best-performing privatised utility in the country. It seems that it owes its reputation to the smart management of the company. This is also reflected in the fact that in 2006 WRM obtained an ISO 9001 Certificate for good management practices.

However, WRM, which has been rather successful in its operations over the years and creative in their survival strategy, is more of an exception than a rule in the country. Improvements in the company will only make sense in the context of wider reforms in the sector. Therefore, the Government may wish to clarify the organisation of the water sector and look into other models, including different forms of private sector participation, such as the more traditional PPP arrangements (service, management, lease contracts). Concessions are yet another possibility and these may be more easily implemented as there is already a Law on Concessions in the country.

CHAPTER 1. INTRODUCTION

Since the disintegration of the Soviet Union, Kazakhstan has undergone significant political and economic changes. Along with macroeconomic stabilisation, the government agenda has focused on accelerating Kazakhstan's transition towards a modern market economy. As part of this reform agenda, in the mid-1990s, the government launched massive privatisation of the water utilities in the country and about 40% of these companies are currently privately-owned. However, there are no specific laws on privatisation or model regulations establishing the rules and respective rights and responsibilities of the private water service companies in such context. Many countries avoid privatisation of their water utilities; instead, they use other forms of private sector participation (PSP). In such cases, there are usually performance-based contracts (such as service, management or lease contracts - see definitions in Annex IV) between the private operator and the municipality.

Shymkent, with about 500 000 inhabitants, is one of the main cities with a private water operator in Kazakhstan, the Water Resources–Marketing Ltd. (WRM). However, apart from the act of transfer of assets between the company and the city as part of the privatisation deal, there is no specific contract that regulates the company's rights and responsibilities for the provision of public water services.

1. Objectives of the review

The report provides an objective analysis of all important aspects of the company's rights and responsibilities (as defined in the laws), identifies its strengths and weaknesses given the current regulatory framework and proposes a set of recommendations for improvements. Although this case study analyses a private company and not a public-private partnership (PPP) type of contract, the findings and conclusions in this report have been prepared in order to support the Kazakh government in its efforts to further reform the water supply and sanitation sector in line with international good practices.

The OECD's *Guidelines for Performance-Based Contracts* served as a benchmark to assess the Shymkent water company's operations. The recommendations from this review could be used as a basis for discussion and consensus-building among key stakeholders in Kazakhstan on the future design of performance-based contracts, if the government chooses to go in this direction.

Through this analysis, the review also seeks to identify good practices and learn lessons which can then be used to further improve the relevance of the Guidelines with regard to specific Eastern Europe, Caucasus and Central Asia (EECCA) experience. This knowledge was largely missing in the first version of the Guidelines. In this context, the Kazakh experience is particularly useful and provides a number of valuable lessons for other EECCA countries which consider involving the private sector in one or another way in managing water utilities.

2. Performance review process and methodology

At the end of 2007, WRM agreed to share its experience and have its operations and activities reviewed within the framework of the OECD/EAP Task Force Secretariat work. The EU Tacis provided financial support for the project. The project was implemented under the supervision of the OECD and with the support of a team of consultants from PriceWaterhouseCoopers.

The methodology developed to evaluate the WRM legal framework is based on the good practices identified in the Guidelines. It consists of a detailed questionnaire coupled with direct interviews. The questionnaire was sent to all major stakeholders involved in the process. The review involves three stages: preparatory activities, field mission and drafting mission, and preparation of the final report.

A comprehensive set of background documents concerning and relevant to WRM were examined by the review team prior to and after the review mission (see the Section on References). The review mission took place 10-14 March 2008 when the team visited Kazakhstan. During that time the team engaged in extensive discussions with staff of the operator in Shymkent and with the relevant authorities in Shymkent (Shymkent Oblast Parliament and Shymkent Municipality) and Astana (Ministry of Agriculture Water Resources Committee, Agency for the Regulation of Natural Monopolies, Ministry of Economy and Budgetary Planning, Kazakhstan Water Supply and Sewerage Utilities Association).

The results and recommendations presented in the report were discussed at a meeting with the participation of major stakeholders in July 2008 in Shymkent. In addition, the major lessons learnt from this review will be presented at other international fora and will be disseminated through other meetings and mechanisms.

This report provides an opportunity and is a basis for discussion within the Kazakh government to further consider necessary reforms in the sector with a particular focus on the possible introduction of other forms of private sector participation in the country.

Box 1. Major good practices identified in the Guidelines for Performance-Based Contracts

1. Project scope

(i) Definition of contractual objectives and responsibilities

The contract should define as precisely as possible the objectives to be achieved; establish the rights, obligations and responsibilities of each contractual party as well as joint responsibilities; identify a clear, reliable and efficient mechanism allowing the parties to quickly and efficiently respond to any new circumstances that may arise in the course of contract implementation.

(ii) Service area

The service area should be clearly identified early in the process and preferably before Due Diligence is conducted. The extent of the service area has a direct impact on the costs and revenues of the operator. A proper evaluation of the costs and revenues should be carried out in order to establish adequate contractual objectives and consequent performance indicators.

2. Legal and institutional framework

(i) Legal framework

Before entering into a performance-based contract, the applicable legal framework, including all relevant laws and regulations should be carefully studied and assessed. Based on this analysis (as part of the Due Diligence process), the best contractual model should be selected. If changes in the law are needed, these should be made before the contract is finalised. The selected type of contract should be tailored to the needs of the utility while making the best possible use of the legal framework.

(ii) Institutional framework

The institutional set-up should provide for proper regulation and monitoring of the contract implementation. The regulatory authority should be given a sufficient level of independence in order to ensure that all the parties' interests are well balanced and protected.

3. Performance indicators

(i) Initial evaluation

Before selecting the performance indicators, the parties to the contract should conduct detailed evaluation of the technical and financial conditions of the water utility in order to fully assess its pre-contractual performance. Such an evaluation will allow the parties to agree on realistic performance indicators given the existing state of the utility.

(ii) Selection of performance indicators

The contract should clearly specify all performance indicators that will be monitored during contract implementation and the mechanisms for their adjustment. If the operator's remuneration is based on the achievement of selected indicators, these should also be clearly identified. Performance indicators could be linked to the financial performance of the utility (e.g. operating ratio, collection efficiency), efficiency of operations (unaccounted-for-water, pipe breaks), operating performance (average hours of service, population served). The performance indicators should be few, simple, realistic and easy to measure to be able to properly monitor their achievement.

4. Tariffs and financial obligations of the contracting authority

(i) Tariffs setting and adjustment

A sound tariff policy should balance considerations related to the utility's financial viability, its social objectives and economic efficiency. The contract should allow for tariffs to be adjusted over time (tariff revision mechanisms) both in relation to inflation and improvement of services as well as in response to force majeure events or changes in the legal regime. Cross-subsiding should be avoided and replaced, if necessary, by transparent subsidy schemes targeted at well-identified poor households.

(ii) Financial obligations of the contracting authority

When public authorities are fully (e.g. service or management contracts) or partially (e.g. lease contracts) responsible for financing the investment programmes of the water utility, these obligations should be clearly defined in the contract, both in terms of amounts and timeframe of investments. In order to avoid conflicts during the implementation phase, the contract should draw a clear distinction between maintenance works, replacement works and emergency situations.

5. Financial penalties, bonuses and incentives

(i) Financial penalties

In the context of EECCA water utilities, which often face significant financial difficulties, penalties should be used with utmost prudence. In order to avoid putting at risk the general financial health of the utility, and consequently its operational capacity, penalties should be used only when utilities are operated by private contractors. Imposing a penalty would directly affect the ability of the utility to meet the performance levels specified in the contract.

(ii) Bonuses and incentives

If properly designed, bonuses and incentives could contribute significantly to the achievement of the level of services provided by a contractor. When the utility is run by a publicly-owned contractor, bonuses should be provided directly to individuals and not to the utility because no individual will benefit directly from higher performance levels of the utility. When the utility is run by a private operator, incentives should reflect the productivity gains of the utility.

6. Monitoring

Setting an effective system to monitor contract implementation is crucial for evaluating if parties meet their obligations and achieve specified targets. Monitoring provisions should focus on the contractor's success to meet the targets rather than on how it meets these targets. In countries where governments face limited monitoring and regulatory capacity, the monitoring function should be outsourced to an auditing company. The government should then reconfigure its task as monitoring the auditor.

7. Contract enforcement / Contract resolution mechanisms

Performance-based contracts should include formal dispute resolution procedures (e.g. judicial, quasi-judicial, administrative, arbitral). Arbitration should be the preferred dispute resolution mechanism in contracts that include a foreign private entity. The main advantages of arbitration include confidentiality (as it relates to commercial secrets); expertise (arbitrators are selected on the basis of their technical expertise); neutrality (arbitrators are chosen from among individuals unrelated to the parties in the dispute); integrity (arbitrators are chosen from among individuals of high moral repute).

8. Risks

Any long-term contractual relationships involve risks such as: operation and maintenance risks, revenue risks, regulatory risks, political risks. The allocation of key risks should be carefully considered when designing performance-based contracts. Risks should be fairly allocated among parties. The risks should be allocated to the party that is best suited to assume them both in terms of technical expertise and the possibility to mitigate the risk at least cost.

9. Costs

In considering implementing performance-based contracts, the public authorities should be aware of all costs, both direct and indirect, that such contracts may entail to the public sector. Apart from traditional "costs", (overheads or expenditures inherent to the project), there are costs incurred due to indirect "losses" (e.g. costs of hiring consultants to prepare the contract, un-monitorable performance targets). Usually, the contract does not include provisions related to indirect costs. However, during the negotiation stage, the parties should always consider all actual and potential costs inherently and indirectly associated with performance contracting.

CHAPTER 2. THE CONTEXT

This chapter briefly introduces the current developments in the water supply and sanitation sector in Kazakhstan. It looks at the legal and regulatory framework for managing water utilities in the country. In addition, it describes the main premises of the operations of the water company in Shymkent.

1. Current status and development of the water supply and sanitation sector

Kazakhstan is relatively poor in water resources compared to other countries of the European and Siberian parts of the EECCA but it is wealthier than the Central Asian states. The fresh water deficit is one of the most significant environmental problems making sustainable development of Kazakhstan difficult.

Moreover, the spread of water resources is very unequal across the country. The southern part of Kazakhstan, where the city of Shymkent is located, is the richest in water resources, whereas the northern, western and central parts of the country have very poor water sources. Although the general water conditions are good in the region of Shymkent, the natural high variation of water availability during the year makes the situation more complicated and often results in serious droughts during summer periods. This situation is further aggravated as a result of years of poor management of the water resources.

Water quality is also a problem in Kazakhstan due to the natural configuration of the water flows in the country: the water basins of the Caspian Sea, the Aral Sea, the lakes Balkhash and Tengiz have no connections with the ocean. This leads to an accumulation of pollutants in the water basins.

During the Soviet Union period, most of the cities had extensive water supply and sanitation facilities: 90% of the population had access to centralised water supply in the cities. However, the water facilities are now in poor conditions due to years of underinvestment and the lack of maintenance. Currently, the main issue in the sector is the lack of financing for rehabilitation and extension of the system. A survey of UNDP on access of the population to drinking water roughly assessed the needs for drinking water and sanitation at KZT 780 billion (EUR 4.45 billion (in 2008 prices) for the period 2008 to 2015.

Before the political changes of the 1990s, all water utilities were owned and subsidised by the state. After the independence, the responsibility for maintaining the water infrastructure was assigned to the regional and local level. State support for capital investments was cut back. A government decree prohibited the subsidisation of operation and maintenance (O&M) costs of communal service enterprises from the state or local budgets. Involving the private sector in managing the water utilities seemed the only way to save the system from collapse.

Most of the private sector participation arrangements actually involve privatisation. The first wave of privatisation started in the mid-1990s but it was rather chaotic and without clear rules and regulations. Most of the privatisation in Kazakhstan was carried out in the form of management buy-outs or alternatively, assets were bought by local businessmen. Water utilities were sold at very low prices and yet, there were usually few buyers due to the poor financial position of the utilities at that time. Not long after that, some of the privatised water utilities became insolvent and went bankrupt. Insolvency proceedings are usually initiated by the tax authorities when the company cannot pay its

taxes. Many of the private water companies underwent a second bankruptcy because water tariffs could not cover even their operating expenses. As a result, the competences for managing such water utilities were transferred back to regional or local governments (akimats).

About 40% of the water utilities are now fully privatised. There are no public-private partnerships (PPPs) for water services in Kazakhstan. The water services of 36 cities, including Astana and Almaty, are considered to be strategic by the government and no privatisation or PPPs are allowed in these cases. Shymkent is one of the major cities with a private water operator.

2. Regulatory context

The regulatory context for water utilities is not sufficiently comprehensive in Kazakhstan. There are no specific laws regulating the rights, obligations and responsibilities of private water companies and only two main laws regulate the sector: the Water Code and the Law on Natural Monopolies, both enacted in 2003.

The Water Code mainly controls water resources management. It deals with water use rights and different forms of ownership. The only requirement related to the water supply and sanitation services is the obligation to install meters for surface water abstraction. An extract of the Code related to the rights of ownership is presented in Annex III - Box 1.

The Law on Natural Monopolies applies not only to the sector of water utilities but also to other public services, such as telecom, heating, gas or electricity services. There is a range of legal acts, norms, and regulations which precise the law. It contains a number of general provisions related to tariff setting, customer rights and obligations and procurement oversight for natural monopolies. There are two major requirements in the law: the private operator should continue the initial activity of the company which has been privatised (any potential other activities should not exceed 5% of the income); and the income has to cover at least the operational costs. An extract of this Law is presented in Annex III - Box 2.

In addition to the Law, the Agency for the Regulation of Natural Monopolies (ARNM) issues decrees and instructions that give more detail to the general provisions of the law and which can be tailored to the needs of the water supply and sanitation sector. Some of these include: Rules for tariff setting and tariff structure (most recently amended on 7 March 2006) which regulates the costs that can be included in the tariff requested by natural monopoly entities, including for water supply, water transmission and wastewater collection and treatment. These also set the limit on the profit level that can be obtained by the natural monopoly, including for water utilities.

Another instruction, issued by ARNM on 27 January 2007, further details the calculation of the profit rate that can be achieved by water utilities and utilities in the energy sector. Yet another ARNM instruction (of 12 June 2006) specifies the rules for setting the marginal rates of tariffs and the rules for reporting on the implementation of the investment programme on which the tariff rate is based. These decrees and instructions are key for the operations of water utilities as they determine the levels of the tariffs that can be charged by the utilities as well as the level of profit that the private companies can expect to obtain.¹

A draft law “On Water Supply and Sanitation” was initiated in 2004. This draft law was supposed to regulate the contractual relations between clients and water service companies. This reform however was abandoned mostly because the government thought it was more efficient to rather focus on the creation of an authorised body for the regulation of water service companies (see section 3 below on

¹ Other laws, relevant to water utilities, include among others: the law on self-governance, bankruptcy law, law on licensing, the Environmental Code, the Soviet time technical and service (SNIP) construction standards.

institutional context). In addition, the Law on Natural Monopolies is being revised and is expected to come into force soon. The main changes in the law concern issues of competitiveness; however, given, the overall non-competitive nature of the water sector, the revised law might be of little importance in this context.

3. Institutional context

Before the 1990s, the water utility sector was regulated by the Ministry of Housing and Municipal Utilities of Kazakhstan. At that time, there used to be a specific division and government head responsible for water utilities. This ministry was dissolved in 1991 and a number of responsibilities for the sector were decentralised to the regional authorities. Water companies are now under the control of the “Akimats”, which are local government entities at “oblast” (Kazakh province), “rayon” (Kazakh district) or municipality level.

The Akimats regulate the water consumption standards for users without meters; they appoint the director of the public water service companies; approve the investments plans and tariff increase requests before their submission to the Agency for the Regulation of Natural Monopolies; and have a decisive say on the provision of subsidies through the Drinking Water Programme.

At a national level, there are now four main institutions with responsibilities for the water infrastructure sector:

- ⇒ **The Agency for the Regulation of Natural Monopolies** which reports directly to the Prime Minister and which is in charge of tariff regulation and monitoring water utilities’ operating expenditure;
- ⇒ **The Water Resources Committee of the Ministry of Agriculture** which regulates the water abstraction (sets limits for surface water extraction) and issues the associated water abstraction licences;
- ⇒ **The Sanitary and Epidemiologic Agency of the Ministry of Health** which sets drinking water quality standards and monitors utilities’ compliance with these standards;
- ⇒ **The Ministry of Environmental Protection** which issues permits for wastewater discharges in the environment. The permit specifies the maximum permissible concentrations for various pollutants discharged into surface waters. Monitoring is carried out by environmental inspectors at a regional level and Kazhydromet (the Hydro-Meteorological Service in the country).

However, at the central government level there is no authorised body specifically responsible for water utilities and the reforms in the water supply and sanitation sector. As a result, there is no clear vision and strategy for the development of the water utilities sector in the country. There is no clear idea about the financial needs for the sector and the way these will be funded. In addition, there is no government body that sets service standards for the sector.

Some government representatives confirm that the privatisation of water utilities did not go well and some of them are being taken back by the state. It is becoming clear that full privatisation is not a panacea and that there is a need for other approaches to managing the sector. Other forms of private sector participation are being considered.

In addition, a project for the creation of an authorised body for the water sector had to be discussed in the Government by October 2008, and should have been completed by the end of 2008. This project will be an amendment to the existing Water Code. Once the amended Water Code is approved (including the approval of the authorised body) by the parliament, the government should decide

where to locate this body. The decision will be made through a Government Decree. It seems likely that this authorised body will be in the jurisdiction of the Water Resources Committee. This amendment will not represent a deep reform of the Water Code. However, the new authorised body will have the authority on the water supply and sanitation sector and could decide on reforms in the sector.

4. History and current status of the company

Privatisation of the Shymkent water utility took place through several stages:

- In 1993, the Shymkent water utility went through an important financial crisis related, among others, to the inefficient use of water and high electricity costs. At that time, the utility was completely broke and could not cover any of its costs. The utility would produce about 500 000 m³ of water/year of which 70% was lost in leakages. In order to improve the financial standing of the utility, the municipality of Shymkent decided to split it into several subsidiary enterprises. It was expected that this split would allow to reduce the level of corporate taxes and social contributions the utility was paying. As a result, the water utility was divided into 8 small public enterprises, of which 4 companies for water abstraction, 1 for repairs, 1 for water supply and 1 for customer management. All these enterprises were part of the State Communal Enterprise (SCE or GKP in Russian) for Water Supply and Sanitation. Each of the small enterprises had a contract with the SCE as well as contracts with each other.
- In 1997, the changes in the regulatory context made possible the sale of the individual public companies to private owners. These small companies were sold in an auction at a very cheap price and bought by staff of the company. The assets were sold together with the companies. That part of the SCE which was not financially viable was declared bankrupt but the municipality remained the owner of 22% of the shares (it owns mostly the garage and transportation workshop). A new company for selling and marketing the services was created: the Water Resources Marketing company, which is the name of the current water operator.
- On 1 October 1999, the individual companies were all reunified into a Limited Liability Company. This new company owns the licence² for water abstraction and is registered as a natural monopoly company.
- In 2004, the Limited Liability Company and the SCE were transferred to WRM (under the “Act of transfer”). The municipality transferred its share to the WRM as well (22%).

WRM finally became fully operational in its new activities covering all water supply and sanitation services in 2005. Since then, it has been a private company, which owns the assets, and with a 22% municipal participation in the equity capital. This company is in charge of the maintenance, rehabilitation and operation of the existing assets. Investments in new assets and extension of the system are a responsibility of the municipality which transfers the operation of the new assets to WRM.

The main technical characteristics of WRM are presented in Box 2 below. According to the Management of the company, the main technical challenges nowadays are the high leakage rate between the water intake and the supply (especially on the main pipes) and the high power consumption. To overcome these problems, WRM has developed an investment programme which estimates the investments needs at KZT 17 billion for the 10 coming years. This is a significant amount which cannot be covered through the tariff so WRM is currently negotiating a loan with the EBRD to make investments. The loan amount would be KZT 1 billion (~ USD 8 million) for 10 years

² “Licence to Mineral Rights in the Republic of Kazakhstan” issued by the Government of the Republic of Kazakhstan.

at a 7,5% annual interest rate (3% margin + 4% Libor³), including a 3-year grace period. This loan will have to be agreed by the ARNM.

However, the Water Code does not allow any contribution of the state budget to a private company loan. This is also true for the municipal budget, therefore the municipality cannot get involved in the loan (for instance via its 22% shares in the capital). Therefore, the guarantees will probably have to be provided by the company itself through the revenue from the tariff.

Overall, as stated in a company's report, the services provided by the company in terms of continuity of water (24 hours) and drinking water quality (the company has its own accredited laboratory) are relatively good. Of the privatised water utilities, Shymkent is regarded as the best-performing privatised utility in the country. It seems that it owes its reputation to the smart management of the company. This is also reflected in the fact that in 2006 WRM obtained an ISO 9001 Certificate for good management practices.

³ LIBOR – London Interbank Offered Rate – is a key rate in international bank lending, LIBOR is the rate at which major banks in London are willing to lend Eurodollars to each other. It is used to determine the interest rate charged to creditworthy borrowers for fixed-term borrowings, such as three-months, six-months and so on.

"Box 2." Main technical indicators of WRM Ltd. (March 2008)

Shymkent general data

Population: 500 000 inhabitants
Number of private houses: 50 000

WRM general data

Number of employees: 800
WRM supplies water to 1 GKP (State Communal Enterprise) and to 3 LLPs (Limited Liabilities Partnerships) which have altogether 40 000 connections
Total people served (directly and indirectly) by WRM: 800 000

Water supply services

Water tariff (VAT excluded): 28,48 KZT/m³
Water tariff (VAT included): 32,18 KZT/m³
Number of connections: 120 000
Water abstraction: 543 000 m³/year
Water sold: 150 000 m³/year
Unaccounted for water (global losses): 40%, of which:
- 70% are illegal connections (28 %)
- 29% are leakages (12 %)
Current average water consumption: 110 L/person/day
Water consumption (before the installation of meters): 500 L/person/day (reduction by 76%)
Average household consumption: 9m³/month
Number of underground pumps: 110
Private houses connection rate: 95%
Apartment blocks connection rate: 100%
Water treatment: electrolysis and chlorination (6 chlorination units)
Water network: 1 700 km

Sanitation services

Waste water treatment tariff (VAT excluded): 10,22 KZT/m³
Waste water treatment tariff (VAT included): 11,55 KZT/m³
Private houses connection rate: 65%
Apartment blocks connection rate: 100%
Waste water treatment: primary and secondary treatment installations / secondary treatment no longer efficient. This plant is currently under rehabilitation
Sewage network: 472 km

CHAPTER 3. ANALYSIS OF THE CONTRACTUAL IMPLEMENTATION

This chapter presents the core analysis of the review. Although there is no specific contract between the municipality and the water operator, the analysis covers all major issues that need to be considered when the private sector is involved in managing water supply and sanitation infrastructure. These include, among others, requirements originating from laws and regulations that govern the water sector, in general, and WRM Ltd. activities in particular, as well as performance indicators, tariffs and financial obligations, and financing of investment needs.

The analysis is divided into 11 main issues, assessed against international good practices, such as those contained in the OECD's Guidelines for Performance-Based Contracts and followed by respective recommendations as well as the identification of good practices.

1. Contractual relations between the private operator and the municipality

As the Shymkent water utility is privatised, there is no specific (performance-based) contract between WRM Ltd. and the state or the municipality. At the same time, there are several different contracts which regulate the relations between the company and the municipality. These include: Contract for Integrating the Shymkent Water Utility into Water Resources Marketing Ltd. (14 May 2004) and an Act for Transferring the Shymkent Water Utility Property to WRM Ltd. (17 May 2004). The latter is a basic contract of two pages which allows the transfer of all rights and obligations of the Shymkent water utility to WRM Ltd. All costs related to the transfer of assets were a responsibility of the private company. The contract also specifies the existence of municipality's shares in the company's capital (for more information, see Chapter 3, Section 4). In addition, there is a Contract for Integrating 7 Individual Companies into WRM Ltd. None of these contracts however contains any performance indicators (service, water quality or financial indicators).

The Law on Natural Monopolies which regulates most of the company's activities can be considered as a contractual framework for WRM operations. Because WRM is a private company, it is difficult to have a tripartite contract between WRM, the municipality and the ARNM. The major way to improve the relations between these three entities is to improve the regulatory context for water service companies in Kazakhstan. Therefore, most of the discussion below focuses on suggestions for possible improvements of the regulatory framework in the country.

It is also worth mentioning that the Director of the company, a highly respected man in the city, has been mayor of Shymkent for several terms. This gives the company an insider's knowledge in the workings of the municipality and creates possibilities for finding practical solutions to problems even if the relations between the two sides are not formally regulated through a contract. In addition, mutual trust and understanding, openness, and excellent communications are as important to the success of an arrangement as the fulfilment of the formal contract terms and conditions.

However, it should be noted that countries that have chosen to privatise their water utilities (such as the UK and Chile) have developed very strong regulatory and licensing regimes. For example, in the UK, the regulatory acts as well as the individual licences contain clearly-established service standards that are legally-binding for the water companies. The so-called Guaranteed Standards Scheme for the

water utilities in the UK lays down the minimum guaranteed standards of service that water companies have to deliver (e.g. these cover among others, such issues as coverage, minimum pressure, interruption of water supply, flooding from sewers, dealing with customer complaints). Water companies have to pay compensation to customers if they fail to meet these standards. In addition, if the water companies fail to meet their statutory and licence obligations, the regulatory body has at its disposal various tools to enforce the standards, including financial penalties.

In the absence of a regulatory body that can impose service standards for the sector in Kazakhstan, the municipality of Shymkent can consider developing a specific contract with WRM. Such a contract can at a minimum specify the requirements for providing water and sewerage services that the company should meet. These standards can be set on an annual basis. In addition, the contract can include other relevant performance-based indicators, as discussed further.

Recommendations

Given the above discussion, the major recommendation to the municipality of Shymkent is to:

- Consider developing a contract for the WRM with specific service standards as well as other relevant performance-based indicators. This will introduce more clarity in the relations between the two sides and will make the company more transparent and accountable to its clients and stakeholders.

2. Legal and institutional issues

Presentation and analysis

As already mentioned in section 2, the institutional and regulatory environment for water sector utilities is not sufficiently developed in Kazakhstan. This situation raises three main questions related mostly to the lack of consistency in the current legal, regulatory and institutional framework.

The first issue is related to the responsibility of WRM for rehabilitation and maintenance works. These have to be carried out with company's own resources – either from retained earnings or from commercial credits that the company should take and pay back from the tariff revenue collected from users. By law, private operators in Kazakhstan have no access to state subsidies either for investments or for operating expenses. On the other hand, there was a high level decision to freeze tariffs for some time as a way to contain inflation in the country and only recently the company has obtained the right to increase the tariff rate (as of April 2008). However, the current rate is still very low; calculations made by the company show that the rate needs to be at least 3 times higher in order to ensure normal operations.

Furthermore, access to long-term credit is not available. Bank credit is usually provided for a period of 6 months – to 1-2 year(s) and at an interest rate of above 10 to 20%. This situation is currently further aggravated by the financial crisis in the world banking sector. Even the Kazakh Development Bank is a typical commercial bank, and does not provide specific arrangements for utility companies. All this does not allow the company to carry out the implementation of its investment plans as envisaged, which results in a further deterioration of assets.

On the other hand, while WRM is responsible for the rehabilitation works on the existing facilities (*Law on Natural Monopolies, Article 6*), the municipal Akimat remains in charge of investments in the extension and development of the system. The city of Shymkent is growing and new customers need to be connected to the system. The design and the procurement of these new investments are carried out by the municipality. Thus, the separation of these responsibilities leads to the lack of optimisation and efficiency of the overall water investments in the city. The procurement process could be

improved if all investments needed are at least coordinated by the municipality. The technical aspects of the rehabilitation and new investment works could also be optimised if considered globally rather than separately.

The second issue is related to the investments needed and the process of approval of the investment programme of the company. There are significant needs for water and sanitation investments in Shymkent. Indeed, the population increase and the city enlargement are part of the development of Shymkent. New networks and intakes developed as a result of the city growth are currently financed by the municipal budget, after which their management is transferred to WRM. The water sector investments planned for 2008 in the municipal budget amount to USD 3.5 million.

The responsibility for investments is split between WRM (rehabilitation works) and the municipality (new investments). For WRM, investments are supposed to come from profit and depreciation but as set now their rates are both very low and the tariff cannot cover the normal operations of the water utility, including rehabilitation. This also shows that cost-recovery is not a goal for the government.

As for the approval of the investment programme, there are two stages in this process: first, at a local level, the municipal Akimat approves the scope of investments proposed by WRM and then the ARNM approves the financing of the investments. Logically, this division of responsibilities can lead to an uncomfortable situation for WRM if the approved scope of works and the financing of works are not consistent.

The third issue, as mentioned above, is more strategic and is related to the lack of a competent designated body responsible for the water sector at a national level. This situation leads to the absence of clear standards for water utilities, as opposed to the other utility sectors. Moreover, the existence of the Water Resources Committee under the Ministry of Agriculture can lead to a conflict of interests between the natural resource conservation policies and the use of water for drinking water supply..

As already mentioned, this new authorised body is expected to be established by the end of 2008. As recommended in a World Bank⁴ report of 2004, the main responsibilities of such a body can include, among others, setting service standards, developing affordability guidelines, designing and managing public expenditure programmes to support water utilities.

Recommendations

All issues identified above point to the need for a global harmonisation of the water sector organisation at a national level. This can be ensured by establishing a dedicated body that is being discussed in the government and the parliament. From this perspective, the following major recommendations could be offered for consideration:

- On a national level, the government should speed up the establishment of a dedicated regulatory unit. This will provide the opportunity to set overall goals and standards for the sector and clarify and make consistent the responsibilities for financing of works as well for investments approval.
- The government should seek to work with the banking sector to create better conditions for access of water utilities to long-term debt financing at an affordable cost by blending, for example, private and public money. The government could channel public money through commercial banks which can disburse it to the sector on softer and more favourable terms. This will be necessary as long as the commercial banking sector gets sufficiently developed to be able to provide long-term credit on its own.

⁴ World Bank, 2004.

- On a local level, WRM and the municipality should work more closely to optimise the design of water investments in the city. Although new investments are not a responsibility of the company, it is important for the two sides to work together as the company will then need to manage the new assets and the future maintenance and operating costs will be borne by WRM. Therefore, WRM needs to be well aware of all plans and their respective costs in order to be able to include them in its future business plans.

3. Performance indicators

Presentation and analysis

In the absence of a performance-based contract, there are no company-specific performance indicators. However, the absence of performance indicators does not mean the absence of objectives for the company. Apart from the general requirements established by the laws, two major documents set objectives for the WRM operations.

The “*WRM 2005-2007 Multi-Year Investment Programme for the Water Supply and Sanitation Sector of the City of Shymkent*” approved by the ARNM contains six objectives for the company’s operations: These are:

1. Keep operational, rehabilitate, and renovate fixed assets used in the production and sale of the water supply and sanitation services;
2. Provide adequate amount of water to the population;
3. Improve the service quality;
4. Reduce unaccounted-for-water;
5. Improve resource-saving (in the river basin);
6. Reduce electricity consumption.

In addition, the “*Integration contract of the individual companies within the Limited Liability Company*” (1 October 1999) also sets objectives for the company’s operations. These objectives are:

1. Set up an economic division;
2. Develop a new staffing policy allowing to accommodate all the changes in connection with the integration;
3. Set up a new accounting service and staff it with skilled personnel;
4. Hire the employees transferred from the integrated partnerships as per the new staffing policy;
5. The production and technical service shall develop a rationale for drastic improvement of the condition of the environment in connection with the use of natural resources by Water Resources-Marketing Ltd.
6. The immediate objectives of the partnership created are:
 - a) Lower the costs of production of services and goods, improve the service quality;
 - b) Improve the state of environment in connection with the use of natural resources by the re-organised company.

Apart from these objectives, the company monitors the ratio [water produced / water sold] as part of the internal technical performance. WRM also keeps records of all consumers’ complaints as part of monitoring the level of client satisfaction.

The objectives, as specified above, are extremely important and they show the professionalism of the company’s management. However, it would be better if some of these objectives are translated into specific, measurable and time-bound targets. As defined now, they sound more like general recommendations which need to be defined in more concrete terms. For example, what is an adequate amount of water, or what does the improvement of resource-saving imply? Each of these objectives can be turned into specific indicators compared against some baseline. Such transparency will make

the company more credible both to politicians and the population in the city. In order to help with the design of indicators, some specific examples are provided below. These examples are not exhaustive and should be adapted to the company's organisation and reality.

- The objective "Improve the service quality" could be equated to a performance indicator on the continuity of service. A relevant performance indicator for monitoring the continuity of service is the percentage of customers with constant supply (weighted hours of supply / total hours for all customers). However, there are different methodologies to measure the hours of supply and the indicator should therefore be accurately defined before announcing it. For instance, if the indicator is based on pressure logger measurements, the number and location of pressure loggers involved in the calculation should be well defined as variation in the methodology could make the results vary a lot.
- The objective "Improve the service quality" could also be equated to a performance indicator on the water quality. This indicator is usually defined on the basis of the sanitary regulation requirements. It is recommended that water quality should be analysed at consistent check points in order to provide a fair picture of the water delivered, and therefore of the quality of service delivered. Indeed, analysis of the water in the tanks could only lead to different biased results as compared to the results from the analysis of delivered water (this may happen when water pipes are in poor conditions which leads to the deterioration of the water quality when it gets to the customer).
- The objective "Reduce electricity consumption". The associated performance indicator could be the ratio [electricity consumption / m³ water sold]. However, the basis for "m³ water sold" should be precisely defined. For instance, to avoid any risk of interpretation, the "water sold" could be specified as the amount of water invoiced or the amount of water delivered. In this specific case, it is recommended to use the amount of water delivered because the amount of water invoiced would lead to biased results through the collection rate.

Other examples of typical performance indicators for monitoring water service companies operations are:

- pressure in the pipes (ground floor, 3rd floor, 6th floor in apartment blocks) (improve the service quality);
- leakage rate (reduce unaccounted-for-water);
- number of bursts (reduce unaccounted-for-water);
- number of customer complaints (improve the service quality);
- percentage of invoices paid (financial efficiency).

All these examples show that the accuracy of the definitions in the calculation methods supporting such indicators is crucial in order to avoid misunderstanding while using the performance indicator. Experience from other countries shows that fewer the indicators, the easier it is to monitor them and the more credible they are.

Recommendations

The development of performance indicators to assess and push the performance of WRM is a good practice to recommend. Even if the current legislation does not require such indicators from the water utilities, the image and the reputation of the company can only be further strengthened if this initiative comes from it. It is commendable that the company has developed certain indicators for its operations. It is a good practice that could be recommended even in the case of privatisation.

The main recommendations related to performance indicators are:

At a company level:

- Translate existing objectives into specific, measurable and time-bound targets.
- Keep indicators few and simple.
- Choose a baseline year against which each indicator will be compared and monitored.
- Define the indicators clearly and specify the methodology for measuring and calculating them. Agree these indicators with public authorities. Hence, the need for dialogue and a dedicated body which can guide this work.

At a national level:

- Develop regulations (possibly also through the specific authorised body to be established) and set requirements for the implementation of performance indicators by water service companies, either private or public.

4. Tariffs setting and tariff revision

Presentation and analysis

Two main decrees issued by the Agency for the Regulation of Natural Monopolies specify the tariff setting and tariff revision rules: *Rules for setting of tariffs (prices, charge rates) and preparing tariff estimates for services (goods, works) provided by natural monopolies subject to regulation (N 2256, 29 April 2003)*; and *Rules for the special procedure for determining the costs which can be included in setting the tariffs (prices, charge rates) for services (goods, works) provided by natural monopolies subject to regulation (N 2438, 12 August 2003)*.

The main specific requirements defined in these documents are related to the tariff calculation. Tariffs for the natural monopolies in Kazakhstan can be set according to two different methodologies:

- *Yearly tariff methodology (a cost-plus system)*: a standard methodology where the tariff is approved yearly and does not include any investment expenditure. This basic tariff is composed of operational costs and profit. All costs are clearly identified but costs related to physical water losses or commercial losses from the non-payment of water bills by customers are not explicitly calculated. Instead, a standard loss factor of 3% is provided. In addition, the profit that a company may gain is fixed and if it turns out to be higher, then ARNM requires that the company implement a reduced tariff.
- *Medium term (also called long term) tariff methodology (a price-cap type)*: the tariff is approved for a period of 3 to 5 years. This methodology allows to include some investment expenditure in the tariff, on top of operational costs and profit. This methodology requires the preparation of an investment plan which takes into account the expenditure included in the tariff. This plan is submitted to the relevant authority: the Agency for the Regulation of Natural Monopolies in case of private companies or the Oblast Akimat in case of public companies. The ARNM is required to closely monitor the implementation of the investment plan and associated expenditure. In the case of medium term tariff methodology, the water companies are allowed to submit an updated investment plan and request a tariff revision when necessary (e.g. changes in inflation or exchange rate).

The major eligibility criteria for the approval of a 5-year plan are:

- fixed assets must be owned by the company;
- financial results for the 2 years preceding the application must be positive;
- the collection rate of revenue from tariffs must be at least 97%;

- the utility should not have any loans taken without the ARNM approval;
- the utility should not be subject to any compensatory tariffs imposed in previous years by the ARNM;
- water demand for the 2 years preceding the application should be stable as should be the projected demand;
- the utility should keep separate accounts for primary water supply and wastewater activities on the one hand and other secondary activities, on the other.

Since 2004, WRM has been applying for the second option: a first investment plan was prepared for the period 2004-2007, a second investment plan has been agreed for the five year period 2008-2012. Shymkent is the only city in the country which succeeded to meet all eligibility criteria and complete the process for a 5 year investment plan procedure. The yearly tariff plan was approved by the local ARNM as it has a better knowledge of the local needs and conditions and the operations of the company.

However, the investment plan approved by ARNM does not correspond to the investment plan initially submitted by WRM: a KZT 2.5 billion (EUR 14.3 million (in 2008 prices) investment programme was proposed but a KZT 1.7 billion (EUR 9.7 million) programme was approved. This situation shows that the main objective of the government is to keep investments under control and thus the tariff paid by customers.

The structure of the tariff increase was approved as follows: increase by 25% for the first year⁵, 7% for year 2 and year 3, 4% for year 4 and year 5. This corresponds to an increase by 10% per year on average. Such an increase allows for an efficient and early implementation of the investment plan but requires that the population pays significantly during the first year. In addition, the future inflation is taken into account in the tariff plan on a forecast basis (based on the consumer price index) and not based on the real inflation rate. Although the new tariff plan was approved in December 2007, its implementation has been postponed by a government decision due to the current high inflation situation in the country.

The fact that Shymkent has been the only city in the country to successfully complete a five year tariff plan highlights the complexity of the procedure allowing for the inclusion of investments in the tariff. Moreover, the fact that the initial budget required by WRM was rejected by the authorities, combined with the fact that the initial starting date of the tariff plan was recently postponed, show that it is altogether difficult to obtain and implement a 5 year tariff programme.

There is a single tariff for all consumer categories in Kazakhstan. Nevertheless, there is a social contribution from the city Akimat that provides housing allowances for the poorest families. This allowance is provided to the families for which the total invoices for housing maintenance, municipal services and communication services exceed 20 % of their total income. The Department of Employment and Social Programmes of the Shymkent City Administration (Akimat) is in charge of this allowance allocation.

Income-based or tariff-based measures for the poor

Different countries use different approaches to support socially vulnerable customers. The most common are income-based measures (i.e. direct subsidies) and tariff-based measures (e.g. increasing block water tariffs (IBT)). Both have their advantages and disadvantages. An increasing block water tariff is a price structure in which water is priced at a low initial rate (usually below the cost price of the service) up to a specified volume of use (block), then at a higher or several increasingly higher

⁵ Water supply: 40.67 KZT/m³ VAT excluded / Sewage: 17.33 KZT/m³ VAT excluded.

rates for additional blocks used. This is a form of cross-subsidisation where the subsidy is provided by large customers (in the higher blocks) to small customers (who are in the first block). The main advantage of this option is that there is no need to identify socially vulnerable customers. To have an effective IBT there is a need to have a critical mass of large customers. This may lead to very high rates for such customers which in turn may look for other water sources. This situation may exacerbate the collection rate. In addition, IBT requires meter-based billing, i.e. there is a need to have a widespread installation of meters. The cost of installing, maintaining and reading meters can in some cases be large compared to the average annual water bill of households and may therefore not always be justified.

In contrast, the main advantage of income-based measures, that is a direct subsidy to poor households to support their basic needs, is that unlike tariff-based measures, they do not distort the price signal. The tariff can be effectively raised to cost-recovery levels for all consumers, while ensuring protection of the poor through targeted subsidies. Hence, the social objective to help poor customers on the one hand and to make the water utility financially viable, on the other, can be dealt with in a transparent and objective manner. Experience from other countries shows the importance of having a social programme in place to support poor customers. This solution has been implemented in poor districts in some countries of South America (such as Chile). The main disadvantage of this method is the additional administrative costs required to identify the poor customers and to calculate the subsidy level per person.

Recommendations

The introduction of a medium-term tariff is a significant step forward in improving the tariff structure and the tariff methodology. However, the eligibility criteria are rather difficult to meet and require revisiting them. Given the discussion above, several major recommendations could be offered for consideration:

- Simplify the procedure for the approval of the investment plans and reduce the level of ambition of some of the requirements;
- At a national level, include the real inflation rate rather than an estimated level of inflation in the tariff. In addition, the tariff revision could include nominal rates to take into account the investment plan costs (in excess of current investment depreciation) with an annual inflation indexation formula which could include some of the main costs such as: labour costs, energy and chemical costs.
- Consider social tariffs for poor customers, for example, such tariffs could be set for a minimum volume of water consumed (for instance 40 cubic meters a year per household) required for domestic use (mainly for drinking and public health). It seems that the IBT methodology may be the more appropriate option for Kazakhstan as the Kazakh legislation does not allow to set different tariffs for different social categories of customers.

5. Financial penalties and incentives

Presentation and analysis

Financial penalties and bonuses are an important element of performance-based contracts between a private company and a public entity. As there are no specific and legally-binding performance indicators in the case of WRM, there are obviously no associated financial penalties and incentives⁶.

⁶ The scope of this paragraph is penalties/incentives between the company and the regulator and not penalties/incentives for the internal management of the company.

However, under the *medium/long term tariff structure* chosen by WRM, some financial penalties can apply if the company invests 5% below what is agreed in the plan. In that case, the approved tariff would be revised according to the corrected investment plan, and the company should reimburse the difference between the tariff applied and the new tariff calculated. The estimation of the penalties is based on the compulsory “*annual report on tariff budget execution and investment*”.

This rule has to be applied with caution because in some cases it could go against the principle of cost efficiency with regard to the implementation of the investment plan. Therefore, two different cases can be considered. The first one is when the private company has not reached the targets set in the investment plan (for example, fewer kilometres of the network rehabilitated, fewer kilometres of new networks built, less repairs or upgrading works in the water treatment plants) (all calculated in constant prices), it is then logical to have the tariff revised. On the other hand, if the company succeeds to implement the investment plan at a cost lower than expected, and then faces the risk to have its water tariff renegotiated, generating a modification of the business plan and a loss of the expected profit, this rule would not favour the development of a cost monitoring policy. Therefore, it is advisable that the operator should be given some incentives if he has efficiently implemented the investment programme and if the targets have been reached by spending less money.

However, imposition of financial penalties when costs exceed the investment plan by 5% is a good practice to keep as a price control procedure.

In addition, experience from other countries shows that where there are strict service standards for the sector and water companies fail to meet them, they may be required to pay various financial penalties, including compensation to customers. However, this requires that the government regulates this issue at a national level.

Recommendations

The precise costing of investments is particularly important as it is a significant part of the justification of the tariff rate requested. This requires skills both on the part of the company as well as the regulator who should be in a position to check the precision of the calculations and the realism of the prices proposed by the company. Monitoring the implementation of the investment plan is equally important. As a matter of principle:

- The regulator should be first and foremost concerned with the implementation of the investments by the operator. Financial penalties should be applied on the achievement rate of the investment plan as agreed between the two sides rather than on the amount of money spent.
- To be effective, the regulator should improve the methodology for monitoring the investment plan implementation (see next section).

6. Monitoring of the investment plan implementation

Presentation and analysis

Rules for monitoring of the investment plan implementation are set in the *Government Decree on Monitoring of the Effectiveness of Investment Programmes and (or) Projects Implemented by Natural Monopoly Enterprises (N 18-OD, 24 January 2005)*. The rules are the same for all natural monopoly enterprises in all sectors.

The requirements are the same for both public and private companies as long as they fall in the category of natural monopolies. However, the frequency of reporting is different when the enterprise follows a *yearly tariff methodology* (reporting every quarter) or a *medium term tariff methodology* (reporting every six months). WRM falls in the latter case.

The investment programme monitoring procedure includes the following steps:

- 1) Data collection on the progress of investment programme implementation presented in a matrix format and provided in an annex to the regulation;
- 2) Analysis of the achievement of the actual amounts of delivered services and actual costs;
- 3) Comparison of the achieved financial outcomes with indicators established in the investment programme;
- 4) Assessment of the impact of the investment programme implementation on the change of tariff budget estimate and level of price;
- 5) Preparation of a statement on the results of monitoring.

The Chief Executive Officer of the company and the accountant are responsible for the accuracy and authenticity of submitted data.

The matrix for data reporting is defined in the regulation in a fixed format which includes 5 matrices with around 10 to 15 indicators to report on. However, some of the data required in the matrix may not always fit the company's specificities (public or private companies, water services or energy companies, etc.). A certain degree of flexibility in the data may be useful.

Moreover, the reporting frequency is quite heavy (every 3 months for WRM), and the workload to prepare the full matrix is significant, particularly given the tightness of the reporting deadlines. This can lead to a very heavy burden for the company, and potentially to the lack of accuracy of the data themselves. International experience and good practices show that it is better to have a lighter reporting format for intermediary reporting which requires information containing the most important indicators, in order to allow the company to focus on the quality of the data.

The high frequency and the important quantity of information that needs to be reported on also raise the question of the capacity of the regulating body to analyse all this information on time. Less reporting frequency can improve the efficiency of work of the regulating body and would allow a better control and reactivity.

However, it is not clear to what extent the regulator is in a position to control the environmental and health aspects related to the implementation of the plan. While this type of monitoring is a responsibility of the inspectors of the Ministries of Environment and Health, it is not clear how all these institutions coordinate their findings and to what extent (if at all) such indicators are crucial in assessing the level of implementation of the investment plans.

Recommendations

It is commendable that the regulator has developed and put in place a methodology for monitoring the overall implementation of the investment programme. To make the process more efficient, it is recommended that:

- The reporting matrix should be adjusted to allow for a distinction in the operations and management arrangements of different utilities. The matrix should be company specific and agreed upon at the beginning of each contract.
- The reporting requirements could be relaxed by introducing two different reporting formats: under a medium term tariff methodology, there could be a yearly report based on the full matrix, and an intermediary report every six months based on a lighter format.

7. Conflict resolution mechanisms

Presentation and analysis

In a totally private divestiture arrangement, conflicts and resolution mechanism issues are of a considerably different nature compared to a contractual relationship between a municipality and a water service provider. Since there are no contractual commitments, the performance of the operator can be assessed only if the sector is highly regulated. Insufficient regulation in this field can give way to political interference. Conflicts may arise on a regular basis, when for instance, the tariffs approved by the ARNM are not considered to be sufficient to cover the operational costs. When conflicts occur, they are solved by the General Prosecutor's office, in accordance with the *Law on Natural Monopolies*.

In Shymkent, a conflict occurred in relation to the yearly distribution of the increase of the tariff. WRM had requested the application of the higher increase as agreed in the newly negotiated long term tariff plan. However, the Prime Minister Cabinet imposed a freeze on the tariff increase in 2008. The conflict was solved through negotiations between the parties which led to an addendum signed between the ARNM and WRM which agreed on an intermediate starting date for the application of the tariff increase (April 2008). In addition, in case of disagreement between the Mayor of Shymkent and WRM on the investments scope, the law requires the parties to negotiate but without providing clear rules for resolving conflicts.

Moreover, there are no termination procedures in the current regulation. If in the long term, the operator is not performing well, the absence of termination mechanisms does not provide incentives to the private company to improve its operations and does not allow the regulator to find a way to replace it by another company. It is obvious that in the case of full privatisation it is difficult or almost impossible to terminate the entitlement of the private operator over the ownership of the assets if he is not performing well. However, given that the water sector is such a socially sensitive sector, it is important that the regulator strengthen and incorporate environmental and health criteria in the requirements imposed on the private company.

Recommendations

Conflict resolution in Kazakhstan can be solved in court as specified in the law, or through alternative direct negotiations, as shown in the WRM example. There is, however, a lack of regulation between the two extreme cases mentioned here. This can lead both to a very great number of cases which are arbitrated by the court, or alternatively, to a lack of transparency while negotiating under a direct procedure. There is undoubtedly a lot of room to develop additional procedures and rules to avoid biased decisions and to improve the governance. In this context, the following recommendations are offered:

- A regulatory framework specifically for conflict resolution mechanisms could be developed. The creation of a "Code of Conflict Resolution of Regulated Activities" could be suggested. Such a Code could include potentially all possible cases where the operating activities of the operator should be terminated. This will require a thorough analysis of all existing laws. Termination of operating activities should be done after sufficient notice on the part of the regulator allowing the possibility for the operator to react.
- Alternatively, expert panels (see the Chilean example in Box 3 below) or a licencing system (the UK example - Box 3) could be set up to regulate conflict situations.

Box 3. Chilean and UK examples

A: Dealing with conflicts: the example of the Chilean water sector

A key institutional feature of the Chilean model is the expert panel, created for each operator for each rate setting process to resolve conflicts that might arise with the regulator. Each panel has three members (usually engineers or economists), one named by the operator, another by the regulator, and the third picked by the regulator from a list of candidates previously agreed on with the operator.

As a first step, both the regulator and the operator each carry out a study taking a position on tariff adjustments. Then they exchange their studies and begin a discussion period. If the regulator and the operator do not reach an agreement on the new rates, discrepancies are submitted to the expert panel along with all supporting material. The panel must decide on a value or position for each parameter or aspect on which a discrepancy exists. On each point, the panel must choose the position of one party or the other; it may not set intermediate values. But because of the many discrepancies normally submitted to the panel, the panel's decisions, taken together, have usually translated into an intermediate value between the parties' overall positions.

The panel must reach a decision, by a simple majority, in 30 days. Its decision is final and cannot be appealed in court, a feature that has proved to be crucial in keeping the process at a technical level and ensuring prompt results. Of all the arbitration mechanisms used in regulated sectors in Chile, this one has been the strongest and most effective.

Beyond tariffs, other issues also often lead to conflicts, such as compliance with quality standards and investment plans. Conflicts relating to such issues are normally dealt with by ordinary courts, making judicial independence a critical factor in the regulatory process.

B: The UK licencing system

The Water Services Regulation Authority (Ofwat) is the economic regulator of the water and sewerage industry in England and Wales. Water companies operate under licences, granted by the Secretary of State for Environment, Food and Rural Affairs and by the Welsh Assembly Government, to provide water and sewerage services in England and Wales. Licences include 19 licence conditions detailed in Annex V. Ofwat has the responsibility to:

- protect the interests of consumers, wherever appropriate by promoting effective competition;
- secure that the functions of each company are properly carried out and that they are able to finance their functions, in particular by securing a reasonable rate of return on their capital; and to
- **secure that companies comply with water supply licences and properly carry out their functions.**

In case a company does not comply with the licence conditions, Ofwat has the power to enforce the licence in the following ways:

- **Impose financial penalties** of up to 10% of turnover where a company contravenes its licence or fails to meet required standards in performing its duties;
- **Secure compliance by means of an Enforcement Order** when a company is in breach of the terms of its licence, or is in breach of a duty.
- **Change a company's licence with its agreement.** If the company does not agree, Ofwat can refer the proposed change to the Competition Commission on public interest grounds.

Sources: March 2005, *Public Policy for the Private Sector*, Note 286, The World Bank Group; www.ofwat.gov.uk

8. Major risks and mechanisms for risks mitigation

Presentation and analysis

In a divestiture model where assets belong to a private company the nature of the risks to be managed are different from usual contractual commitments between a municipality and a private entity. Since there is no contract, risks mainly arise from the legal and regulatory context. In this kind of arrangement, the main risks are those which may not be properly mitigated and may lead to the collapse of the water company.

The **regulatory risks** can occur in the case of WRM not because there is no regulator (it is the Agency for the Regulation of the National Monopolies) or because there is no legal framework (there is the Law on Natural Monopolies), but because there is not a specific body for water service suppliers, where a significant part of these activities are performed by private companies. Apart from the Water Code, there is no specific law for the regulation of water supply and sanitation operations. This means that in case of a conflict between WRM and the Agency, the dispute can be only settled in court which can take time and seriously impact the financial situation of the water company.

WRM can face **political risks**. This has been recently the case when the Kazakh government unilaterally decided to postpone the tariff increase which had been approved by the ARNM. This decision was taken for internal political reasons due to the domestic high inflation rate without consideration for existing agreements. Such situations also raise questions as to the autonomy of the regulator to take independent decisions.

The systemic policy of installation of flow meters by WRM has led to a decrease of water consumption. There is therefore a fall of the water demand which creates a **revenue risk** for the operator. Generally, in order to secure stable revenue streams for the water utility, the decrease of water consumption is mitigated by an increase of the water price. In case of a decrease of the water quantity sold, there is a proportional increase of operating costs by cubic meter due to the repartition of the fixed costs to a smaller volume of water. The approval of the tariff in the framework of the medium term methodology that is an approval for a five year period taking into account the inflation rate on a forecast basis, substantially increases this risk.

Another types of risk facing WRM are the **force majeure risk** and the **insurance risk**. Natural risks like floods or earthquakes can destroy water treatment plants or severely damage the network. Since these are generally considered as “Act of God”, the material consequences are not covered by insurance companies. Without a contract between the two sides, the risks resulting from force majeure, cannot be regulated. It seems that there is no specific mechanism through which WRM could claim compensation for the financial consequences of this risk.

Recommendations

The risks faced by WRM go far beyond the situation of the water utility in Shymkent but concerns more generally the situation of the water sector in Kazakhstan.

In general, the water supply and sanitation sector in the country needs to be significantly reformed. If a dedicated body to oversee the sector is established, this body, as discussed earlier, can focus on developing the legal basis of the sector. Among others, it should clarify issues related to regulatory and political risks, revenue or force majeure risks. This new entity could govern the water and sanitation sector and become the national water regulator. More specifically, it should:

- Clarify the organisation of the water sector with the involvement of municipal companies, private entities and possible future PPP arrangements.

- Simplify the procedures in case of dispute between the regulator and water service providers.
- Take into consideration all the risks facing both private and public operators, such as: revenue risks in case of a water demand drop or force majeure risks which can have severe impacts for the water service providers and their capacity to survive.

9. Personnel management

Presentation and analysis

The water services sector is nowadays in a very poor situation compared to what it used to be before the political changes. Salaries in the water sector services are amongst the lowest in the country even for skilled employees. This is also the case for the WMR staff, although it is a private company.

As a consequence, educated people are not willing to work in the water sector and the water companies have difficulties to recruit and keep skilled employees and good technicians. Moreover, there are no requirements in the law for personnel management and personnel training programmes. The level of water service employees is therefore poor which does not help to reach a high quality of service and maintenance.

In this context, authorities at a national level, and specifically when a new dedicated body is organised, can think of developing a training programme which will be provided to water utilities staff, both at a management level and for technicians and maintenance operators. Such programmes can include courses on: commercial / customer relations, financial management, managerial courses, drinking water quality control, technical safety at work. There are a number of training institutions in the country and/or universities that can be approached to work on this issue.

The recently-opened Eurasia Water Center can be one option to attract both national and international experts. The programme(s) can be developed jointly and/or with the Association of Water Utilities. These programmes can be designed to be financially self-sustainable where participants will be charged a course fee. There are a number of international organisations that provide such courses as well and these could be solicited in this process. The experience of other countries in providing such courses can be consulted as well.

Recommendations

No issues specific to WRM were raised during the interviews with regard to this question. Nevertheless, the national government should:

- Require that water companies, both private and public, have or participate in programmes for training and re-training their staff.
- Think of developing and providing specific programmes targeted at staff working in water utilities. Training should be provided to maintenance operators, technicians, but also managers of such services as well as administrative staff. The programmes should be designed to be self-sustainable.

10. Transparency

Presentation and analysis

The main transparency issue is related to procurement undertaken by the company. All investments made by WRM are subject to procurement procedures under various laws and regulations, including:

- The *Law on Natural Monopolies* that requires companies to follow procurement procedures for the investments included in the approved tariff: “*Procurement of services (goods, works), whose cost is included into established tariffs (prices, charge rates) or their threshold rates and tariff budget estimates for regulated services (goods, works) provided by a natural monopoly entity shall be carried out in a form of a tender*”.
- *The Rules of State Procurement for Natural Monopolies* that regulate investments made by WRM which are not included in the tariff, but financed by other means (mainly as a result of depreciation payments or profits).

However, the WRM review shows that a third category of investments is not regulated by the existing procurement procedures. It refers to the case where customers finance some of the works. Over the last couple of years, WRM has undertaken major works and plan more for the coming years. The reconstruction of the secondary network has been completed for about 50 000 private houses and there is a plan to replace pipes for 10 000 houses / year until 2011. The reconstruction of the secondary network was financed 50% by WRM and 50% by the customers themselves, with a possible social help from WRM through bank loans guarantees.

While making customers pay for such works is a major challenge in many countries, WRM has been particularly successful in convincing them to do so. This can be partially explained by the company’s management being able to well formulate their arguments but also because there are a number of customers in the city who are solvent and are in a position to pay their water tariffs regularly which is also seen in the very high collection rate in Shymkent.

In addition, WRM has convinced those customers who cannot pay for this work to take commercial credits where WRM provided guarantees on the credits. Given the high reputation of the WRM General Director, it seems that this scheme worked well. As such, customers paid for the installation of the new pipes which are made of polypropylene. No procurement was organised for these rehabilitation works as the financing of these investments was not included in the approved the tariff.

Thus, the current procurement procedures do not allow for full transparency in this process. Such a situation is not acceptable for a public utility service, even when the company is a private company such as WRM.

It should also be pointed out that the company prepares and publishes annual reports on its activities. The annual report provides information to both authorities and customers and increases the level of transparency of the company’s technical and financial operations. This contributes positively to the image of WRM in the city as well as in the country.

Recommendations

The requirement to follow specific procurement procedures for investments included in the tariff plan or investments financed 100% by the company can be considered a good practice. However, there are no such requirements for investments which would be partly financed by customers. Therefore, there is a need to strengthen the legislation related to procurement in order to cover procurement procedures for investments financed by third parties as well, including by customers. However, compulsory procurement procedures for all the investments would lead to an excessive amount of procedures and to a potential lack of reactivity for the water service companies. In this context, it is recommended to:

- Include thresholds in the regulatory framework and to define various levels of procurement procedures according to the thresholds set.

11. Public information

Presentation and analysis

Providing public information on tariff levels is part of the requirements of the *Law on Natural Monopolies*. Indeed, the companies falling under this law have to go through public hearings for the approval of tariff increases.

Before public hearings, WRM is required to prepare a report in a special format, which includes the information on tariff increase to be presented during the public hearings (e.g. “*Report by the WRM - First Deputy General Director on public hearings while considering tariffs for water supply and related sewerage services for the 2008-2012 medium-term period*”).

The local ARNM is in charge of the organisation of public hearings. They are organised in the following way:

- The local ARNM provides information to the public through mass media. Anyone interested can attend the hearings.
- A feedback on the attendance of the hearing is prepared in writing (minutes of the meetings) and the meetings are filmed and shown in TV programmes (videos of the audiences).
- A meeting of the Committee of the Experts Council is organised after the hearing to discuss the conclusions from the meeting.

The decision on tariff increase is taken on the basis of the tariff justification report prepared by the water service company, the minutes of the public hearing, and the minutes of the expert meeting. This decision is taken by the local ARNM.

The process described shows that the discussions and conclusions are well documented in writing and videos. However, there seems to be no track of people who attended the public hearings which may raise concerns with regard to the appropriate representation of interested stakeholders at these hearings.

Recommendations

Compulsory public hearings in case of a tariff increase, strong documentation and feedback on the meetings and experts’ discussion can be considered as good practices for public consultations and information disclosure.

However, although anyone is theoretically informed about and free to attend the hearings, it should be ensured that the participation during public hearings is representative and transparent. This is why it is recommended, as one possible solution to improve the process that the regulator should:

- Require that a list of the representatives of the major institutions and groups involved in the hearing be provided as evidence in order to ensure that all sides’ interests have been taken into account.

CHAPTER 4. CONCLUSIONS

1. Major findings

The major finding of this study is that the regulatory context of the water sector in Kazakhstan is not sufficiently comprehensive and suffers from the lack of a designated body that can set service standards and oversee the reforms in the water sector. This results in the lack of clear rules and division of responsibilities between different stakeholders. In the case of the Shymkent water utility this is reflected in the poor separation of the responsibility for rehabilitation works (WRM) and extension works (Municipal Akimat) leading to the lack of optimisation of investments in the city.

Another major issue is that WRM has benefited from the *long term tariff methodology* (a price-cap type), which allows the water service company to include investments financing in the tariff. This methodology includes the monitoring of the approved investment plan. Some observations on this issue include:

- WRM is subjected to performance targets (mainly through the yearly investment programme) but there is a lack of real performance indicators, which weakens the monitoring of the targets achievement;
- There are however requirements for the monitoring of the implementation of the investment plan. The reporting requirements are exhaustive (5 tables of around 10-15 indicators each) and numerous reports (quarterly reporting for WRM), which leads to a heavy workload for the WRM reporting department and potentially creates a respective burden for the authorities to analyse the information provided by the company;
- The tables and indicators are identical for any natural monopoly company which implies that some of the indicators are not particularly relevant to water companies;
- The financial penalties envisaged in the methodology are based on the monitoring of the amount spent for investments as per the investment plan which does not truthfully reflect the real level of implementation of the investment plan.

With regard to tariff and financing issues the main findings are:

- Shymkent is the only city which succeeded to complete the procedure to include part of the investments in the tariff (*long term tariff methodology*). This shows the level of difficulty to undertake successfully this procedure;
- The tariff increase plan includes a very strong increase on the first year (25%): this is not sustainable for customers;
- The start of the tariff increase plan was postponed by a year upon Government's decision: this is not sustainable for WRM;

- The inflation rate included in the tariff is based on a forecast inflation rate: although tariff revisions are possible, this represents a major financial risk for WRM;
- There is a single tariff for all customers and for any quantity of water consumed, which leads to a lack of tariff optimisation;
- No public financing or subsidies are allowed to support private water companies in the country. Moreover, there are no long term loans at affordable conditions available for the water service companies. The combination of these conditions leads to difficulties with financing a multi-annual investment programme.

2. Recommendations

Key recommendations

Detailed recommendations for the national level and for WRM are presented below. The five key recommendations (mostly at a national level) are:

1. Efficient and sound private water services are not possible without a strong and consistent regulatory context. This framework is the first step to implement in order to improve the operations of the private and potentially public-private water service companies in the future.
2. Tariff formulae should include a minimum number of criteria (real inflation, volume of water sold) to keep the financial risks for the companies under control.
3. Financing of water service investment needs is always a difficult issue for water service companies to ensure. The government should facilitate access to long-term debt financing to water companies (soft loans, public shares).
4. Efficiency should be a criterion at the heart of the operation performance (in terms of monitoring, financial penalties).
5. Transparency is a crucial requirement to make future tariff increases acceptable (as part of the procurement procedures, public hearings).

Detailed recommendation for the national level

- The government should speed up the establishment of a dedicated body for water supply and sanitation. This will provide the opportunity to set overall goals and standards for the sector and clarify and make consistent the responsibilities for financing of works as well for investments approval.
- The organisation of the water sector with the involvement of municipal companies, private entities and possible future PPP arrangements should be further clarified.
- The government should seek to work with the banking sector to create better conditions for access of water utilities to long-term debt finance at an affordable cost by blending, for example, private and public money. The government could channel public money through commercial banks which can disburse it to the sector on softer and more favourable terms.
- The regulation, through the specific authorised body to be established, should require water companies, either private or public, to implement performance indicators.

- The real inflation rate, rather than a forecast rate, should be included in the tariff formulae. In addition, the tariff revision could include nominal rates to take into account the investment plan costs (in excess of current investment depreciation) with an annual inflation indexation formula which could be based on a revision formula including such main costs as: labour costs, energy and chemical costs.
- Social tariffs for poor customers should be considered. For example, such tariffs could be set for a minimum volume of water consumed (for instance 40 cubic meters a year per household) required for domestic use (mainly for drinking and public health). The IBT methodology is a possible option to implement as the Kazakh regulation does not allow setting different tariffs for different social categories of customers.
- Due to the fact that water infrastructure is a sensitive sector with social implications, the public sector should find a way to contribute to it – either directly to the water companies (in particular, for heavy investments) or by raising the tariff to cost-recovery levels and supporting poor customers.
- The regulator should be first and foremost concerned with the implementation of the investments. Financial penalties should be applied on the achievement rate of the investment plan as agreed between the two sides rather than on the amount of money spent.
- The reporting matrix should be adjusted to allow for a distinction in different utilities' operations and management arrangements. The matrix should be company specific and agreed upon at the beginning of each contract.
- The reporting requirements could be relaxed by introducing two different reporting formats: under a medium term tariff methodology, there could be a yearly report based on the full matrix, and an intermediary report every six months based on a less demanding format.
- A regulatory framework specifically for conflict resolution mechanisms could be developed (e.g. creation of a “Code of Conflict Resolution of Regulated Activities” or establishment of specific expert panels).
- Water companies, both private and public, should be required to develop or participate in programmes for training and re-training their staff.

Detailed recommendation for WRM / local level

- WRM and the municipality should work more closely to optimise the design of water investments in the city. Although new investments are not a responsibility of the company, it is important for the two sides to work together as the company will then need to manage the new assets and the future maintenance and operational costs will be borne by WRM. Therefore, WRM needs to be well aware of these costs in order to be able to include them in their future business plans.
- Even if the current legislation does not require the use of performance indicators from the water utilities, the image and the reputation of the company can only be further strengthened if this initiative comes from it.
- Performance indicators should be few and simple, they should be measurable and time-bound targets. The methodology for measuring and calculating them should be clarified from the outset and agreed upon with the authorities.
- In the lack of specific service standards for the sector, the municipality should consider developing a contract for the WRM containing such specific standards as well as other relevant performance-based indicators. This will introduce more clarity in the relations

between the two sides and will make the company more transparent and accountable to its clients and stakeholders.

3. Challenges for the future

The above findings and related recommendations point to the main challenges in the sector for the future.

At a national level, the challenge is to successfully implement the water sector policy reform. This reform should lay the basis for a sound and efficient private (or public-private) water sector and particularly, the creation of a designated water body. The reform process has already been launched but it will take some time to implement it.

At the WRM level, the major challenge is related to ensuring adequate investment financing. This is particularly difficult given the state of the banking sector in the country and the lack of access to affordable debt financing instruments. Tomorrow's financial sustainability of WRM depends on its ability to finance the investments needs of today.

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ANNEXES

Annex I: Socio-economic indicators for Kazakhstan

	2000	2001	2002	2003	2004	2005	2006	2007
GDP (USD mln)	18,275	22,135	24,599	30,860	43,152	57,124	81,003	103,840
GDP (% change, real terms)	9.8	13.5	9.8	9.3	9.6	9.7	10.7	8.5
GDP per capita based on PPP (current international dollars)	4,811	5,597	6,247	6,934	7,735	8,732	9,962	11,086
Population, total (million)	14.9	14.9	14.9	14.9	15.0	15.1	15.3	15.4
Population, urban (% of total)	56.3	56.5	56.7	56.9	57.1	57.3	57.6	57.8
Consumer price inflation (average, %)	13.3	8.4	5.9	6.4	6.9	7.6	8.6	10.8
Unemployment (annual average, % of labour force)	12.8	10.4	9.3	8.8	8.4	8.1	7.8	..
Current account balance (USD million)	546	-1,194	-1,024	-273	335	-1,056	-1,795	-6851
Current account (% of GDP)	3.0	-5.4	-4.2	-0.9	0.8	-1.8	-2.2	-6.6
Trade balance (USD million)	2,168	983	1,987	3,679	6,785	10,322	14,642	13,015
Gross capital formation (% of GDP)	18.1	26.9	27.3	25.7	26.3	27.0	24.9	..
External debt (% of GDP)	69.3	68.4	74.1	74.3	75.8	76.0	91.3	..
External debt (% exports of goods and services)	122.7	148.8	157.8	153.4	145.8	142.5	153.5	..
Foreign direct investment, net inflows (% of GDP)	7.0	12.8	10.5	6.8	9.6	3.5	3.1	5.3
Aid (% of GNI)	1.0	0.7	0.8	1.0	0.7	0.4	0.3	..

Source: EBRD, *Transition report 2007*; IMF, *World Economic Outlook Database*, April 2008; World Bank, *World Development Indicators Database*, 2007.



Source: IMF, *World Economic Outlook Database*.

Annex II: Kazakhstan water sector indicators

	2000
Total water consumption	35 km³/yr
% consumption by households	2%
% consumption by industry	17%
% consumption by agriculture	82%
Access to improved water supply	
Total	86%
Rural areas	73%
Urban areas	97%
Access to improved sanitation	
Total	72%
Rural areas	52%
Urban areas	87%

Source : http://www.unicef.org/french/infobycountry/kazakhstan_statistics.html ;
<https://www.cia.gov/library/publications/the-world-factbook/geos/kz.html>

Annex III: Extracts from major laws

Box 1. Extract from the Water Code (N 481-II of 9 July 2003, amended on 09.01.2007)

Chapter 4. Right of Ownership and Other Rights to Water Facilities

Article 24. Right of Ownership to Water Facilities

1. Water facilities may be state- or privately owned.
2. Relations involving use, possession, or disposal of privately-owned water facilities shall be governed by the civil legislation of the Republic of Kazakhstan, except if otherwise provided by this Code.

Article 25. Special Strategic Water Facilities

1. Special strategic water facilities shall be state-owned and may not be leased or transferred into trust management and shall not be subject to privatisation.
2. The list of special strategic water facilities shall be determined by the President of the Republic of Kazakhstan.

Article 26. Republic-Owned Water Facilities

The republic-owned water facilities shall be attached to the state-owned water entities.

The list of republic-owned water facilities shall be determined by the Government of the Republic of Kazakhstan as advised by the authorised body for water fund use and protection, as well as by the authorised body for exploration and use of mineral resources.

The republic-owned water facilities may be leased, transferred into trust management and privatised in compliance with the legislation of the Republic of Kazakhstan.

Article 27. Publicly-Owned Water Facilities

Publicly-owned water utilities shall be attached to the state-owned utilities and under the legislation of the Republic of Kazakhstan may be leased or transferred into trust management or free use, except for the special strategic water facilities.

Article 28. Right of Ownership to Drinking Water Supply Systems

1. Drinking water supply system may be owned by the republic, be publicly-owned, or be owned by a natural person or legal entity.
2. The drinking water supply systems owned by the republic shall be operated by state-owned entities. The publicly-owned drinking water supply systems shall be operated by state-owned or other entities.
3. Some drinking water supply systems may be a part of housing condominiums.

Article 29. Water Facilities Designed to Service Agricultural Water Users

1. Water facilities designed to service agricultural water users may be state- or privately owned.
2. The state-owned water facilities designed to service agricultural water users may be leased, transferred into trust management or free use or sold or transferred without charge to the water users or their associations maintaining those facilities in accordance with a procedure and subject to conditions prescribed by the legislation of the Republic of Kazakhstan.

Article 30. Temporary State Management of Water Facilities

1. In the event of threat to the interests of national security, human life or health and for the purposes of ensuring stable operation of specific water facilities of great strategic importance for the economy of the republic or region, the Government of the Republic of Kazakhstan, as advised by the authorised state property management body, may introduce temporary state management of those facilities.
2. The procedure for introducing temporary state management of the water facilities specified in paragraph 1 hereof shall be determined by the Government of the Republic of Kazakhstan.

Article 31. State Registration of Rights to Water Facilities and Transactions therein

1. Rights to the water facilities and transactions in them shall be subject to mandatory state registration in compliance with the legislation of the Republic of Kazakhstan on the state registration of rights to immovable property and transactions in it.
2. The state registration of rights to the water facilities shall be carried out provided there is a facility fiche the format of which shall be prescribed by the authorised body for water fund use and protection.

Article 32. Responsibility of the Water Facility Owners

1. Water facility owner shall be responsible for its safe technical condition in compliance with the laws of the Republic of

Kazakhstan.

2. Supervision over the owners ensuring the safety of the water facilities shall be carried out by the authorised bodies for water fund use and protection, emergencies, and industrial safety.

Article 80. Requirements with Respect to the Operations of Water Facilities

1. Water facilities shall be considered as natural monopoly entities and their operations shall be regulated by this Code, by the legislation of the Republic of Kazakhstan, the foundation charter of the company and the agreements between parties.

2. Water facilities shall be liable to:

- 1) ensure the appropriate technical state of water supply systems and facilities;
- 2) to ensure water supply to consumers within the established time period as per agreement;
- 3) set water meters at the field delivery points in accordance with the agreement with water consumers;
- 4) take actions aimed at preventing pollution, contamination and exhaustion of water bodies and hazardous impact of water;
- 5) possess a passport of water supply facilities.

Box 2. Extract from the Law on Natural Monopolies (2003)

Article 10. Rights of Consumers of Services (Goods, Works) Provided by Natural Monopolists

Consumer of services (goods, works) of a natural monopoly entity shall have the following rights:

- 1) to purchase regulated services (goods, works) of a natural monopoly entity within the procedure and tariffs (prices, charge rates) established by the designated body, demand installation of metering devices, or purchase and install them independently;
- 2) apply to the designated body with requests on introduction of changes and amendments, adoption of new and termination of current decisions;
- 3) appeal to court on acts (non-acts) of the designated body as well as decisions thereof;
- 4) appeal to the designated body and (or) court on actions of a natural monopoly entity non consistent with the legislation of the Republic of Kazakhstan;
- 4-1) take part in public hearings;**
- 4-2) take part in bids on procurement of services (goods, works) of natural monopoly entities;
- 5) other rights stipulated by the law of the Republic of Kazakhstan.

Article 15. State Regulation of the Operations of Natural Monopoly Entities

1. State regulation of the natural monopoly entities shall be carried out through:

- 1) approval of tariffs (prices, charge rates);**
- 2) approval of tariff budget estimate;**
- 3) approval of temporary over-depreciation rate;
- 4) approval of a special procedure for development of costs;
- 5) approval of procedure for separate accounting of revenues, costs and assets used for each type of regulated services (goods, works) and in general on other activities;
- 6) coordination of accounting policy;
- 7) establishing of temporary countervailing tariff.

Article 15-1. Procedure of the Development of Tariffs (Prices, Charge Rates) or their Threshold Levels on Services (Goods, Works) Rendered by Natural Monopoly Entities

1. Tariffs (prices, charge rates) or threshold rates thereof on regulated services (goods, works) of natural monopoly entities established by the designated body shall not be less than the cost required for the provision of regulated services (production of goods, works) and shall take into account the possibility of obtaining profit, ensuring effective operation of the natural monopoly entity.

2. Upon approval of tariffs (prices, charge rates) or threshold rates thereof, the designated body shall apply a special procedure for developing of costs while considering the following factors:

- 1) regulation of costs included into the tariff (price, charge rate or a threshold thereof);
- 2) restriction of expenditure items of natural monopoly entities within the limits of technical and technological standards for the consumption of raw materials, fuel, energy as well as regulatory technical losses;
- 5) Coordination of applied methods for the computation of assets depreciation;
- 6) Coordination of assets revaluation and redeployment of depreciation costs included into the tariff budget estimate of natural monopoly entities. A special procedure for the development of costs shall be approved by the designated body.

Article 17. Procedure for Consideration of Draft Tariffs (Prices, Charge Rates) or their Threshold Rates and Tariff Budget Estimates

1. In cases where an application to change the tariff (price, charge rate or a threshold rate thereof) applied on regulated services (goods, works) of a natural monopoly entity is received for examination, the designated body shall conduct an expert assessment of draft tariffs (prices, charge rates) or their threshold rates and tariff budget estimates. Independent experts, state bodies, consumers and public associations, natural monopoly entities that have submitted a draft shall take part in examination proceedings.

2. The designated body shall be obliged to publish in mass media information on the date and place of public hearings in the following cases:

- 1). When establishing tariffs (prices, charge rates) and their threshold rates on regulated services (goods, works) of a natural monopoly entity under a general procedure not later than fifteen days prior to the hearing;
 - 2). When establishing tariffs (prices, charge rates) and their threshold rates on regulated services (goods, works) provided by a natural monopoly entity in accordance with Clause 5 Article 18 of this Law not later than seven days prior.
- Requirements of part one of these Clauses shall not be applicable to the natural monopoly entities with small capacities in

a course of establishing tariffs (prices, charge rates) on regulated services (goods, works). [...]

Article 18-4. State Control over Procurement Procedures of Natural Monopoly Entities

1. Procurement of services (goods, works), cost of which is included into established tariffs (prices, charge rates) or their threshold rates and tariff budget estimates on regulated services (goods, works) of a natural monopoly entity shall be carried out in a form of a tender except for the cases stipulated in Clauses 4 and 5 of this Article.

2. A bid shall be conducted by a natural monopoly entity based on compliance with the following principles:

- 1) transparency and publicity of bidding procedures;
- 2) ensuring of equal opportunities for all tender participants;
- 3) fair competition among potential suppliers.

2-1. A natural monopoly entity shall purchase strategic goods directly from manufacturers of strategic goods, except for the following cases: existing deficit of electric power on the appropriate commodity market due to the lack of access to a centralised trade market of electric power and capacity; non-eligibility of a natural monopoly entity to participate in wholesale electric power market operations; purchase of gas from organisations involved into import thereof due to gas deficit.

3. Procurement procedure shall be defined by the designated body.

This requirement shall not be applied in cases where procurement is carried out in compliance with the Republic of Kazakhstan law on state procurement by the state bodies, state institutions, as well as state entities, legal entities, where fifty and above percentage of shares (equity stakes) or controlling stake is owned by the Government and affiliated legal entities.

3-1. Natural monopoly entities shall have the right to act as a single bid arranger for its affiliated parties.

4. In cases established by the legislation of the Republic of Kazakhstan, a natural monopoly entity can proceed with procurement from one of the sources, classified tenders, tenders with two-stage procedures, quotations.

5. Natural monopoly entities shall have the right to conduct procurement of goods (works, services) without announcing a tender in cases where the annual volume of procurement in value terms does not exceed the threshold size established by the designated body. [...]

Annex IV: Definitions of the main public-private partnership type of contracts

Service Contracts

Service contracts include supply and civil works contracts, technical assistance contracts, plus subcontracting or contracting out aspects of the water supply service. These contracts involve a water utility contracting with a private contractor for the provision of specific services such as design, construction, tunnelling, information technology, tariff collection, operations and maintenance. In its simplest form, the private contractor provides agreed services to the public authority under the public authority's general control and supervision.

Service contracts are a potentially beneficial form of private sector participation (PSP) where there is strong political or community opposition to the wider involvement of the private sector and if there is opposition to water tariff increases which are generally required for many of the other forms of PSP (e.g., lease contract).

Management Contracts

A management contract is a more comprehensive form of service contract, under which the public authority appoints a private contractor to manage all or part of its operations. Under such contracts, the bulk of the commercial risk and all the capital and investment risks remain with the government. These contracts are useful if the core objective is to increase a utility's technical efficiency for performance of specific tasks. If management contracts include clauses which link the contract payments to utility performance, they come closer to the lease and concession arrangements.

Like service contracts, management contracts can lead to improvements in the service for those customers who are connected to the network but they provide little potential for improved access by those potential customers who are not connected to the network.

Management contracts are a potentially beneficial form of PSP when there is strong political or public reluctance to water tariff rises or there is concern about handing over more control to the private sector.

Management contracts may also be the preferred approach if potential private sector investors consider that the risks associated with a higher level of private involvement are currently too high. If this course is followed, the government can seek to address some of the risk factors over the duration of the contract. For example, the government may implement changes in tariff and regulatory structures to facilitate a greater preparedness for private sector risk taking in the future.

Lease Contracts

Under a lease contract, a water utility leases the full operation and maintenance of its facilities within an agreed geographic area to a private operator for a period of time, say, ten years. The contract grants the operator the right to invoice and collect charges from customers within that area. The public utility would own the assets and remain responsible for major extensions and upgrades. The operator would be consulted on all major works, especially when the continuity of service is involved, and may participate in tender evaluation or submit its own tender.

Under a best practice lease contract, the private operator would take the full commercial risk on all operations within its lease area, with its remuneration directly linked to the charges it collects from customers. From these charges, it would pay the public utility a rental fee intended to cover the public utility's capital costs in extending or upgrading the facilities.

Under a lease contract, the operator is usually required to finance the renewal of plant and equipment. At the termination of the contract, the government would compensate the operator for the works it had financed that had not yet been fully depreciated. The management of such works (preparation, procurement, and supervision) would be the operator's full responsibility. Best practice lease contracts have built-in incentives that encourage the private operators to:

- Update customer files and implement efficient collection procedures to improve the collection ratio from customers (including government agencies);
- Implement an aggressive commercial policy aimed at servicing more customers to increase the revenue base;
- Reduce operating costs to maximise profits;
- Carry out regular maintenance to increase the reliability of plant and equipment and postpone their renewal; and,
- Make decisions, not only on day-to-day management issues, but also on improvement of the facilities for which the operator is responsible.

Source: OECD, *Guidelines for Performance-Based Contracts between Municipalities and Water Utilities in Eastern Europe, Caucasus and Central Asia, 2006.*

Annex V: Description of the UK licence conditions

1. **License Condition A** – Conditions of the instrument of appointment.
2. **License Condition B** – Sets out the formula for calculating price limits. This is performed every 5 years. Water companies must submit expenditure requirements, which are assessed and tariffs set accordingly. Water Companies have the right to appeal against tariffs through the competition commission.
3. **License Condition C** – Infrastructure charges – the rate of increase in charges (expenditure requirements) is limited to new connections.
4. **License Condition D** – Charges schemes – requirements for water companies to publish their charges for water and sewerage.
5. **License Condition E** – Discrimination in charging – prohibits undue discrimination of charges to any class of customer or potential customer.
6. **License Condition F** – Details the accounts and financial information that a water company must adopt. This provides benchmarking between water companies. Every year each water company board must provide a certificate stating that it has sufficient financial and management resources to fulfil its functions for the following year.
7. **License Condition G** – Code of Practice for Customers, and relation with the Consumer Council for Water. Requires that each company publish codes of conduct (reviewed every 3 years) for:
 - a. Services provided and charges;
 - b. Billing arrangements and complaint handling;
 - c. Matters relating to water meters;
 - d. What to do in emergencies.
8. **License condition H** – Code of Practice and Procedure on Debt Recovery – prevention of water companies to disconnect domestic customers for non-payment, must publish guides for customers with difficulty paying their bills.
9. **License condition I** – Code of Practice on Leakage – this condition deals with charging of customers for leakage repair on the customer side connecting/service pipes. It describes how the customer can receive assistance from the appointed water company on leakage repair.
10. **License condition J** – Levels of service – appointed water companies are required to maintain an efficient and economic system for water supply. Each company must provide an annual report setting out its performance against 8 service indicators (these figures are reported in June Tax Returns).
11. **License condition K** – Ring-fencing and disposal of land – appointed water companies must ensure that they have access to sufficient assets to be able to perform their duties and operate as an independent company. Companies must also ensure that they submit certificates and valuation reports for protected land disposals to third parties. Protected land is land issued to the private water company at privatisation. Proceeds from sale must be distributed 50:50 between customers and shareholders.
12. **License condition L** – Underground asset management plans – each company must submit plans to demonstrate that it maintains and develops underground assets (water and sewer

pipes) necessary to fulfil its legal obligations. Plans must be continually reviewed and updated at each price review (every 5 years).

13. **License condition M** – Provision of information – appointed water companies must provide information to enable Ofwat to carry out its functions as a regulator.
14. **License condition N** – Fees – the regulator is given the power to levy license fees from the appointed water company to cover: running costs; costs incurred for undertaking the price review; to facilitate the Consumer Council for Water; the costs of competition commission referrals.
15. **License condition O** – Circumstance in which a replacement appointment may be made – allows the Secretary of State to terminate the appointment of a company by giving a minimum of 25-year notice.
16. **License condition P** – The role of the appointee’s owners – this condition applies to appointed water companies that are part of multi-utility organisations or part of a large group. It requires the regulated companies to: obtain legally enforceable undertakings from their owners requiring them to provide information for regulatory purposes; avoid any actions that would place the regulated company in breach of the conditions of its appointment; and maintain a number of independent non-executive directors on its board.
17. **License condition Q** – Drought compensation – all appointed water companies have this condition, which commits them to pay compensation to customers whose water supply is interrupted under drought orders.
18. **License condition R** – Provision of combined and wholesale water suppliers – this condition requires appointed water companies to put in place arrangements that will enable their water supply systems to be used by licensed water suppliers.
19. **License condition S** – Customer transfer protocol – this condition requires appointed water companies to put in place arrangements that will enable eligible customers to transfer to another supplier.

Annex VI: List of people interviewed during the review mission

Water Resources – Marketing Ltd.

Anarbek Orman, General Director
Zhanatbek Turdaliev, Economic and Financial Manager
Leila Bashirova, Chief Accountant

Shymkent Oblast Parliament

Nuriddin Musirovich, Member of the Skymkent Oblast Parliament

Shymkent Municipality

Arman Zhetpisbaev, Mayor of the City of Shymkent

Ministry of Agriculture, Committee on Water Resources

Anatoliy Ryabtsev, Chairman of the Committee on Water Resources

Agency for Regulation of Natural Monopolies

Azamat Maitiev, Deputy Director
Anna Martynenko, Chief Expert

Ministry of Economy and Budgetary Planning

Almagul Mazhrenova, Head of the Department of Agriculture, Water, Forests and Fisheries
Economy

Kazakhstan Water Supply and Sewerage Utilities Association

Valeriy Syundyukov, President