

Chapter 5

Policy recommendations

This chapter discusses why it is important to act now to reverse deterioration in performance. Recommendations are formulated as to what can be done. Particular attention is paid to pressing with the reform of institutions, strengthening regulation, containing costs and investing wisely. Under these conditions, EECCA countries will be better positioned to attract additional financial resources for water-related investments.

Overview of the chapter

The WSS sector in EECCA has shown some improvements over the last decade but performance remains generally unsatisfactory, with negative impacts on the population, the environment and the economy as a whole. Countries have progressed at different paces and there are some examples of successes that can provide inspiration for other countries in the region. Most countries have experimented with several solutions, such as different scales of operation or different models of private sector participation contract, before identifying the solution that was most suitable to their context, on a “trial and error” basis. Where improvements in performance have been observed, however, they have usually remained at a limited scale. There is considerable uncertainty as to where additional financing is going to come from in order to finance improvements in performance and much needed capital investment.

A number of actions and policy measures can be undertaken now to initiate, consolidate and scale-up improvements in the water and sanitation sector in EECCA countries. Reversing the current trends of service degradation and investing in more sustainable water and sanitation services is critical. Lack of adequate water and sanitation generates substantial costs for the economy. Such costs are going to increase with climate change, rising energy prices and continuous deterioration of water infrastructure. While the global economic and financial crisis constrains financing of water infrastructure, such investments could form part of a “green growth” strategy designed to boost economic activity while supporting the environment and social welfare.

Why it is opportune to act now

The importance of securing reliable water supplies and reducing pollution is going to increase with pressures from climate change, which is going to result in higher unpredictability in rainfall patterns and an increased frequency in extreme weather events, such as droughts and floods. Some countries in the region are already very water-scarce (such as Armenia, Turkmenistan, Ukraine and Uzbekistan), as well as regions of otherwise “water-rich” countries (such as the South of the Russian Federation and urban areas). Strengthening resilience to climate change will require using water resources more efficiently and, where necessary, building infrastructure for storage or resource diversion. Even though municipal water services may only represent a small share of total water consumption, utilities will be a key stakeholder in discussions as to how improve water resource efficiency.

Improving water-use efficiency will also be necessary in the context of rising energy prices. This will require cutting losses (to reduce pumping costs), increasing the efficiency of water and wastewater treatment processes and reaching a more optimal scale of production.

Preventing further deterioration through asset maintenance and rehabilitation is essential, as costs can only rise in the future. As most water and sanitation assets are long-life buried assets, it is sometimes difficult to evaluate their ability to provide sustainable services. A deterioration in service quality, as seen in EECCA countries in recent years, is usually the first visible sign that assets have not been adequately maintained in the past. This means that lack of appropriate maintenance now can create higher future costs.

Although public investment in WSS has not been forthcoming in a decade of economic growth, acting in times of economic crisis can be opportune and well-timed as water could be a key pillar of a “green growth” economic recovery package. Some countries (such as China or South Korea) have chosen to make the environmental sector (and particularly water and sanitation) a key pillar of their “green growth” economic recovery packages. The water sector can generate “green jobs” via ongoing human-resource intensive activities as well as construction activities. For example, even though staff ratios are high in most water utilities in the EECCA region, existing staff (if adequately trained and incentivised) could be assigned to carrying out critical tasks for improving service efficiency over the long-term, such as installing water meters and other water-efficient devices, detecting and mending leaks or improving customer service. Construction activities may include rehabilitating existing assets or building new, more efficient assets (particularly water and wastewater treatment plants or reservoirs).

In addition, the overall context following the economic crisis could be conducive for attracting other sources of revenues to the water sector, including from the private sector (OECD, 2010c). As private capital’s appetite for risk has gone down and preferences have shifted away from high risk/ high returns investments to investments with lower but steady returns and guaranteed cash flows, a well-managed water sector may become more attractive to private sector investors.

The current crisis is another driver for improving strategic planning for water supply and sanitation, to select realistic targets, and to make the best use of all available sources to achieve these targets. Among other things, such planning requires data which are usually not easily available in the region. Typically, UN data on water related MDGs are focused on access. They may not adequately reflect the situation in EECCA as they neither

account for the quality of supply nor do they take account of the risk that the current source will deteriorate (due to lack of maintenance, for instance).

What can be done?

A number of actions and policy measures can be undertaken now to initiate, consolidate and scale-up improvements in the water and sanitation sector in EECCA countries, as set out below.

Determine the appropriate scale and scope of water systems

Several EECCA countries are still searching for the optimal scale of operations of water supply and sanitation systems, by grouping water and wastewater operators that are too small to operate efficiently. Just as devolution to local authorities is not a panacea, regional operators are not necessarily the optimal option. Economies of scale and scope have to be considered. The appropriate scale for water supply may not be the same as for sanitation. Overcoming the effects of over-fragmentation can take different forms: *e.g.* permanent groupings with transfer of asset ownership to a single new operator, or temporary grouping and no asset transfer. Temporary grouping can also be used for reaching an appropriate scale to let private sector participation contracts. EECCA governments would benefit from exploring alternative options.

Strengthen local capacities to set contractual arrangements

Contractual arrangements can be powerful tools to regulate providers of water supply and sanitation services, be they public or private, to improve performance monitoring and to increase transparency.

EECCA governments would benefit from preparing model contracts at national level which can be used and adapted at the local level. Model contracts typically include tariff-setting clauses that enable moving towards cost-recovery, and clear rules and mechanisms for conflict resolution.¹ They also include mechanisms to relay and resolve customer complaints, thereby relying in part on customers to identify and expose inadequate services (with a regulatory agency or equivalent playing the ultimate arbiter role in the event of dispute or abuse).

Central governments can then provide guidance and support to local authorities in charge of contracting, particularly in countries where the water and sanitation sector remains highly decentralised. The objective should be to strengthen the capacity of local authorities to carry out water service regulation, with a focus both on tariffs and service quality regulation. The

latter may include monitoring of service levels (based on a number of commonly agreed indicators) as well as asset conditions.

Tariff projections should factor performance based incentives, particularly when private sector operators have been contracted. Performance based regulation effectively results in tariffs being based, not on historical cost but on what the revenues should be under certain conditions.

Fix tariff setting procedures and explore alternative tariff structures

Tariffs and tariff setting are areas where regulation can be improved. Tariff setting methodologies should be developed and applied, considering estimates of the overall revenue requirements to cover all costs (including operations and routine maintenance, large maintenance expenditure and capital expenditure), alternative sources of finance (taxes and transfers from international community), and capacity to pay from different user groups.

Different tariff structures can be considered to meet specific objectives (see OECD, 2009g, for a discussion). In particular, tariff structures can be designed so as to allow for tariff increases without negatively impacting the poor. Alternative tariff structures include a uniform minimum tariff, with a surcharge for customers in high cost areas; separate fixed charges to cover the cost of metering, billing and collecting tariffs; or negotiated tariffs for large water users in low cost areas.

Plan and invest wisely

Water-related investment planning in EECCA countries can be more systematically based on sound technical and financial analyses.

Investment plans can be designed strategically so as to avoid “disbenefits” along the way. For example, connecting the population to the sewerage network but without adequate investments in wastewater treatment can generate “disbenefits” in some cases, when there is no appropriate outlet for the untreated sewage and effectively transforms diffuse pollution into end-point pollution.

Preventive maintenance and depreciation allowances are cost effective ways to avoid large investments in the future.

From an economic and financial perspective, there is some benefit in prioritising investment in service levels and regions that generate the highest benefits at least cost. For example, generalising improved sanitation in rural areas could be done at low cost, particularly if emphasis is placed on leveraging household investments through targeted use of public funds.

In EECCA, human resource development and capacity building are sound investments. A common constraint for the provision of sustainable services is the lack of trained water sector engineers and managers. Using less but better trained staff can be an effective way to improve service at a reasonable cost.

Increase overall financing to the sector

There is room to attract more funding from central budgets. First, the water sector may receive increased attention from finance ministers when it has strong linkages with the Medium-term Expenditure Framework planning process. Second, finance ministers may be sensitive to the costs of “non-investment” and the actual impact on the economy of poor water-related services. Therefore, water authorities would gain from assessing such costs, in a reliable and convincing way, in order to trigger a policy response from other parts of governments. To be effective, the results of such assessments would need to be widely publicised at national level, by involving the media and the broader population.

Trends in Official Development Assistance indicate that the donor community is attracted by results-based financing as a way to increase the value for money of their funding allocations. As a consequence, EECCA governments may wish to consider using Results-Based Financing instruments; for example, the construction of wastewater treatment plants could be financed by channelling subsidies *ex post* based on indicators of performance (such as the percentage of wastewater treated to the required standard) rather than *ex ante*.

Repayable financing to the sector can be increased by enhancing transparency based on audited accounts and getting water companies listed on local stock exchanges where they are in place.

Note

1. Specialised appeal mechanisms to resolve contractual disputes avoid having to rely on the Court system which is not specialised and may be over-burdened and therefore slow.



From:
Ten Years of Water Sector Reform in Eastern Europe, Caucasus and Central Asia

Access the complete publication at:
<https://doi.org/10.1787/9789264118430-en>

Please cite this chapter as:

OECD (2011), "Policy recommendations", in *Ten Years of Water Sector Reform in Eastern Europe, Caucasus and Central Asia*, OECD Publishing, Paris.

DOI: <https://doi.org/10.1787/9789264118430-7-en>

This work is published under the responsibility of the Secretary-General of the OECD. The opinions expressed and arguments employed herein do not necessarily reflect the official views of OECD member countries.

This document and any map included herein are without prejudice to the status of or sovereignty over any territory, to the delimitation of international frontiers and boundaries and to the name of any territory, city or area.

You can copy, download or print OECD content for your own use, and you can include excerpts from OECD publications, databases and multimedia products in your own documents, presentations, blogs, websites and teaching materials, provided that suitable acknowledgment of OECD as source and copyright owner is given. All requests for public or commercial use and translation rights should be submitted to rights@oecd.org. Requests for permission to photocopy portions of this material for public or commercial use shall be addressed directly to the Copyright Clearance Center (CCC) at info@copyright.com or the Centre français d'exploitation du droit de copie (CFC) at contact@cfcopies.com.