



Seventh “Environment for Europe” Ministerial Conference

**Astana, Kazakhstan
21–23 September 2011**

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

Executive Summary

Information document submitted by
the OECD/EAP Task Force Secretariat



EXECUTIVE SUMMARY

A decade ago, countries of Eastern Europe, the Caucasus and Central Asia (EECCA) were facing a dire situation regarding water supply and sanitation. Most inhabitants had to cope with the deterioration of levels and quality of service. This situation triggered policy reaction, at both national and international level. In 2000, the Almaty Guiding Principles were identified, to guide water policy reforms in EECCA. They provide a good basis to monitor what has been achieved over the last decade.

The objectives of this report are to evaluate the performance of the water and sanitation sector (WSS) in countries of Eastern Europe, Caucasus and Central Asia over the last ten years and to identify key factors underlying that performance. In particular, the report reviews the reforms that took place over the last ten years as well as the financing that has been allocated to the sector.

Based on this evaluation, the report draws policy recommendations to help countries stem the overall decline in WSS performance in the region, build on existing successes and tackle new challenges. New challenges include climate change, rising energy costs and public budget cuts in a context of global economic crisis.

The full version of this book is available from OECD Library: www.oecd-ilibrary.org.

The countries of Eastern Europe, the Caucasus and Central Asia (EECCA) inherited a well-developed network of water infrastructure from the Soviet period. However, since then, it has seriously deteriorated due to a lack of operation and maintenance, insufficient finance, weak institutions, as well as external factors, such as economic and demographic changes, and rapidly rising energy prices. As a result, people in the region have faced a steady decline in levels and quality of service, as well as significant threats to human health, ecosystems, and economic development.

In 2000, within the framework of the EAP Task Force, Environment, Economy and Finance Ministers of EECCA countries endorsed the “Almaty Guiding Principles for Reform of Water Supply and Sanitation in New Independent States (NIS)”. The Guiding Principles distilled good international practice and proposed four major areas for action to reverse the deterioration of water services: (i) strategic planning; (ii) institutional reform, including regulatory reform, the improvement of the water sector’s multi-level governance, and possible private sector participation; (iii) financial sustainability; and (iv) efficient and cost-effective use of resources.

Progress in implementing the Almaty Guiding Principles was reviewed at a second meeting of Environment, Economic and Finance Ministers in Yerevan in 2005, and at the 2007 Environment for Europe Ministerial Conference in Belgrade. This report builds on the earlier reviews and aims to assess the performance of the water supply and sanitation sector (WSS) in EECCA since the adoption of the Almaty Guiding Principles in 2000. Progress in achieving the Millennium Development Goals (MDGs) on water supply and sanitation is part of the analysis.

Overall, the results of water sector reforms in EECCA countries have been mixed, with improvements in some sectors and countries, and poorer performance in others. Countries have progressed at different paces and there are some examples of successes that can provide models for others. Where performance has improved, more should be done to scale-up and replicate the successful approach.

In retrospect, opportunities provided by rapid economic growth in many EECCA countries during the 2000s were not sufficiently taken. The current economic and financial situation is more difficult, but it could provide an impetus for reform if EECCA governments are prepared to think and act more strategically. A prerequisite is that governments in the region recognise that improved water services are essential for sustained economic development.

The UNICEF/WHO Joint Monitoring Programme (JMP) for the Millennium Development Goals presents a positive picture of how EECCA countries have improved access to water and sanitation services. However, due to the methodology and baseline used, this is a partial and potentially misleading picture. Reviewing a broader range of indicators provides a different perspective on the situation of the water sector in EECCA.

Data collected by the OECD/EAP Task Force secretariat concur with the JMP view that access to water supply in urban areas has remained high. However, with notable exceptions, service quality and the condition of water infrastructure has continued to decline. Only four countries (Belarus, Kazakhstan, the Kyrgyz Republic and the Russian Federation) have uninterrupted water supply 24 hours a day. Per capita water consumption, the energy required to pump water, the volume of unaccounted for water, and staffing levels in water utilities are high compared to OECD countries. Some evidence suggests that corruption plays a role in the operations of the water sector in some countries which also increases costs. Addressing these issues provides opportunities for relatively low-cost efficiency gains.

Sanitation is the area of greatest concern in EECCA countries. Sewage coverage is low. In many EECCA countries, even where wastewater is collected, it generally is not treated because wastewater treatment plants are not functioning. As a result, most wastewater is discharged directly into water bodies without treatment. Municipal water utilities have become the main polluters of surface waters in many EECCA countries.

Access to water and sanitation services in rural areas is much worse than in large urban areas, with smaller urban areas somewhere in-between. Access to water services in poorer countries is particularly acute. Rural dwellers rely on low-cost groundwater sources, protected streams, and, sometimes, surface water intakes. The most commonly used form of sanitation is pit latrines. Wastewater is not treated, even in the case of simple sewage systems.

Inadequate treatment of wastewater has resulted in the deterioration of water quality and levels of waterborne diseases that are significantly higher than in the EU. These trends are likely to continue in the absence of improved provision of water services and better hygiene. The average mortality rate of children under five is 19 per 1 000 live birth (compared with 13 in Europe and 60 globally). In most EECCA countries, rivers and lakes are highly polluted, in some cases compromising their use in agriculture and industrial production. Up to 90 per cent of nitrogen and phosphorus discharges into the Black and Caspian Seas originate from polluted rivers.

Poor water quality imposes high economic costs in terms of impacts on human health and lost production. These costs have not been sufficiently recognised in decision-making in EECCA countries. Analysis of such costs in other regions suggests that the economic returns for investment in the water sector can be 7 to 1. Failure to adequately value the costs of poor water policy, and the potential benefits of investment, is one of the reasons why water has generally not received a sufficiently high priority in EECCA countries. One consequence has been that the water sector has received a declining share of domestic public funding in most EECCA countries over the last decade. International partners should do more to assist EECCA countries to prepare a convincing case for mainstreaming water and sanitation in national development strategies, prioritizing those actions that can yield the greatest benefits at least cost.

EECCA countries have generally been involved in a never-ending process of reforming water policies and institutions. However, developing a clear strategy involving all relevant stakeholders, and clarifying key roles and responsibilities, as recommended by the Almaty Guiding Principles, have proved difficult. In recent years, the EAP Task Force has concentrated much of its work on supporting National Policy Dialogues on strategic financial plans for the water sector, and other selected issues. This experience illustrates the challenges that must be addressed and the positive results that can be achieved by this approach. Further support should be provided for country-led national policy dialogues on issues of priority to EECCA countries.

A key element in the reform of the water sector has been the decentralisation of responsibilities to local authorities. However, the experience from EECCA countries shows that devolution of legal authority is a necessary but not sufficient condition for successful decentralization in the water sector. Local governments have not been given the authority to raise revenues to finance the water sector: there is gap between their fiscal capacity and their responsibilities for water service provision, and their prerogative to set tariffs faces

strong political resistance. Hence they have not had the financial resources to determine investments or levels of service, and they have remained dependent of fiscal transfers from central governments. Continued political interference has prevented water utilities from operating as autonomous institutions on a commercial basis, whether privately or publicly managed. Establishing autonomous, professional utilities, operating on a commercial basis without political interference, should be a key focus for future reform efforts.

One surprising development has been the important role the private sector has come to play in providing water services in some EECCA countries. The population served by private operators in EECCA countries more than doubled between 2004 and 2008, from 24 million to 50 million. As of 2008, private operators delivered water supply and sanitation services to 20.5% of residents of these countries, higher than the world average of about 10%. However, private sector participation varies widely among EECCA countries: it accounts for 53% of the population in Armenia, 40% in Kazakhstan, and 28% in Russia. In the Kyrgyz Republic, Moldova, Tajikistan, and Uzbekistan, private sector participation is either non-existent or very modest. Lease or management contracts account for 80% of the public-private partnerships in EECCA. With the notable exception of the Russian Federation and, very recently, Georgia, these arrangements did not involve capital investments. To date, results have been mixed, with both good and bad experiences. This underlines the benefits that can result from using the OECD Checklist for Public Action regarding Private Sector Participation in the Water Sector.

Lack of adequate finance continues to be a key factor in the poor performance of the water supply and sanitation sector in EECCA. Tariff levels and collection rates have increased. However, they have not kept pace with rising costs and generally only account for between 50 and 90 per cent of water utility revenue. It is only when tariffs cover operational costs that utilities can become autonomous and operate on a commercial basis, either as public or private institutions. Shortage of funds prevents maintenance, rehabilitation and investment in water infrastructure, and contributes to its further deterioration. In some countries tariff increases have resulted in improvements in service quality; in other countries they have not, and this has generated opposition to further tariff increases. There appears to be scope in many EECCA countries to raise tariffs further, if service quality improves, and in conjunction with targeted support for poorer sections of the population who would be adversely affected by such price increases.

Significant subsidies are used to cover the shortfall between revenues from tariffs and utilities' costs. In OECD countries, subsidies for the water sector are for capital expenditures and are justified by the public goods benefits they provide. In EECCA countries, the central authorities provide support for capital investments, but an important share of the subsidies is for operational and maintenance costs, putting an additional burden on public budgets and reducing incentives for utilities to become financially sustainable. EECCA countries should support the emergence of utilities whose operations can be financed by tariffs so that they can concentrate their support on capital investment and social protection. They should also reduce the uncertainties facing utilities by disbursing finance as indicated in commitments. Integrating strategic financial plans for the water sector into medium-term expenditure frameworks could help in this regard.

Official development assistance (ODA) and loans from International Financial Institutions play a major role in financing WSS in some EECCA countries, and a more limited role in others. For example, 88% of total investment in water supply and sanitation in Armenia in 2009 were supported by IFIs and donors. In general, the Caucasus countries have benefited a lot from international assistance, whereas Central Asian countries have received comparatively less assistance, even though their water sector is in the most critical situation. International assistance has generally been biased toward large investments in big cities, whereas many of the most acute problems have been in smaller cities and rural areas. Donors could do more to reduce the time between commitments and disbursements for the water sector.

A number of EECCA countries have benefited from developing strategic financial plans for the water sector. Such plans make a distinction between the ultimate and repayable sources of finance. The ultimate sources of finance are tariffs, taxes, and transfers (from foreign donors) – “the 3Ts.” These sources are distinguished from those that must be repaid such as loans from IFIs or investments by the private sector. When based on solid analysis and developed by consensus involving all key stakeholders, strategic financial plans can provide a sound basis for better integrating water programmes into public budgets, reforming tariffs, and clarifying the contributions that donors and IFIs can make to implementing national water programmes.

Since 2000 when the Almaty Guiding Principles were adopted, the impact of climate change on water resources management has become much more apparent. It is expected to be significant in EECCA compared to many other regions. Some countries (such as Armenia, Turkmenistan, Ukraine and Uzbekistan), as well as regions in otherwise “water-rich” countries (such as the South of the Russian Federation and urban areas) are already waterscarce.

Strengthening resilience to climate change will require using water resources more efficiently and, where necessary, building environmentfriendly infrastructure for storage or resource diversion. Allocation issues will gain prominence as multiple users compete for increasingly scarce water resources. Water related investments and optimal allocation should be considered in the framework of integrated water resource management strategies developed at the level of river basins. If well-designed, they could form part of a “green growth” strategy.